

cha1

Student: _____

1. In 2007, _____ was the most significant real asset of U.S. households in terms of total value.
 - A. consumer durables
 - B. automobiles
 - C. real estate
 - D. mutual fund shares
 - E. bank loans

2. In 2007, _____ was the least significant financial asset of U.S. households in terms of total value.
 - A. real estate
 - B. mutual fund shares
 - C. debt securities
 - D. life insurance reserves
 - E. pension reserves

3. In 2007, _____ was the most significant asset of U.S. households in terms of total value.
 - A. real estate
 - B. mutual fund shares
 - C. debt securities
 - D. life insurance reserves
 - E. pension reserves

4. In 2007, _____ was the most significant liability of U.S. households in terms of total value.
 - A. credit cards
 - B. mortgages
 - C. bank loans
 - D. student loans
 - E. other debt

5. The largest component of domestic net worth in 2007 was _____.
 - A. non-residential real estate
 - B. residential real estate
 - C. inventories
 - D. consumer durables
 - E. equipment and software

6. In 2007, _____ was the most significant real asset of U.S. nonfinancial businesses in terms of total value.
 - A. equipment and software
 - B. inventory
 - C. real estate
 - D. trade credit
 - E. marketable securities

7. In 2007, _____ was the least significant real asset of U.S. nonfinancial businesses in terms of total value.
- A. equipment and software
 - B. inventory
 - C. real estate
 - D. trade credit
 - E. marketable securities
8. In 2007, _____ was the least significant liability of U.S. nonfinancial businesses in terms of total value.
- A. bonds and mortgages
 - B. bank loans
 - C. inventories
 - D. trade debt
 - E. marketable securities
9. In terms of total value, the most significant liability of U.S. nonfinancial businesses in 2007 was _____.
- A. bank loans
 - B. bonds and mortgages
 - C. trade debt
 - D. other loans
 - E. marketable securities.
10. In 2007, _____ was the most significant financial asset of U.S. nonfinancial businesses in terms of total value.
- A. cash
 - B. trade credit
 - C. trade debt
 - D. inventory
 - E. marketable securities
11. The material wealth of a society is equal to the sum of _____.
- A. all financial assets
 - B. all real assets
 - C. all financial and real assets
 - D. all physical assets
 - E. none of the above
12. _____ of an investment bank.
- A. Citigroup is an example
 - B. Merrill Lynch is an example
 - C. Goldman is an example
 - D. B and C are each examples
 - E. Each of the above is an example

13. _____ are financial assets.

- A. Bonds
- B. Machines
- C. Stocks
- D. A and C
- E. A, B and C

14. An example of a derivative security is _____.

- A. a common share of General Motors
- B. a call option on Mobil stock
- C. a commodity futures contract
- D. B and C
- E. A and B

15. _____ was the first to introduce mortgage pass-through securities.

- A. Chase Manhattan
- B. Citicorp
- C. FNMA
- D. GNMA
- E. None of the above

16. A bond issue is broken up so that some investors will receive only interest payments while others will receive only principal payments, which is an example of _____.

- A. bundling
- B. credit enhancement
- C. unbundling
- D. financial engineering
- E. C and D

17. An example of a primitive security is _____.

- A. a common share of General Motors
- B. a call option on Mobil stock
- C. a call option on a stock of a firm based in a Third World country
- D. a U.S. government bond
- E. A and D

18. The _____ refers to the potential conflict between management and shareholders due to management's control of pecuniary rewards as well as the possibility of incompetent performance by managers.

- A. agency problem
- B. diversification problem
- C. liquidity problem
- D. solvency problem
- E. regulatory problem

19. _____ financial asset(s).
- A. Buildings are
 - B. Land is a
 - C. Derivatives are
 - D. U.S. Agency bonds are
 - E. C and D
20. The value of a derivative security _____.
- A. depends on the value of the related primitive security
 - B. can only cause increased risk.
 - C. is unrelated to the value of the related primitive security
 - D. has been enhanced due the recent misuse and negative publicity regarding these instruments
 - E. is worthless today
21. Money market funds were a financial innovation partly inspired to circumvent _____.
- A. Regulation B, which is still in existence
 - B. Regulation D
 - C. DIDMCA
 - D. Regulation M
 - E. Regulation Q, which is no longer in existence
22. _____ are a way U.S. investor can invest in foreign companies.
- A. ADRs
 - B. IRAs
 - C. SDRs
 - D. GNMAAs
 - E. Krugerrands
23. _____ are examples of financial intermediaries.
- A. Commercial banks
 - B. Insurance companies
 - C. Investment companies
 - D. Credit unions
 - E. All of the above
24. Financial intermediaries exist because small investors cannot efficiently _____.
- A. diversify their portfolios
 - B. gather all relevant information
 - C. assess credit risk of borrowers
 - D. advertise for needed investments
 - E. all of the above.

25. Firms that specialize in helping companies raise capital by selling securities are called _____.
- A. commercial banks
 - B. investment banks
 - C. savings banks
 - D. credit unions
 - E. all of the above.
26. Financial assets _____.
- A. directly contribute to the country's productive capacity
 - B. indirectly contribute to the country's productive capacity
 - C. contribute to the country's productive capacity both directly and indirectly
 - D. do not contribute to the country's productive capacity either directly or indirectly
 - E. are of no value to anyone
27. The sale of a mortgage portfolio by setting up mortgage pass-through securities is an example of _____.
- A. credit enhancement
 - B. securitization
 - C. unbundling
 - D. derivatives
 - E. none of the above
28. Corporate shareholders are best protected from incompetent management decisions by
- A. the ability to engage in proxy fights.
 - B. management's control of pecuniary rewards.
 - C. the ability to call shareholder meetings.
 - D. the threat of takeover by other firms.
 - E. one-share/one-vote election rules.
29. The national net worth of the U.S. in 2007 was _____.
- A. \$15.411 trillion
 - B. \$26.431 trillion
 - C. \$42.669 trillion
 - D. \$48.038 trillion
 - E. \$70.983 trillion
30. In 2007, _____ of the assets of U.S. households were financial assets as opposed to tangible assets.
- A. 20.4%
 - B. 34.2%
 - C. 61.1%
 - D. 71.7%
 - E. 82.5%

31. Investment bankers perform the following role(s) _____.
- A. market new stock and bond issues for firms
 - B. provide advice to the firms as to market conditions, price, etc
 - C. design securities with desirable properties
 - D. all of the above
 - E. none of the above
32. Theoretically, takeovers should result in _____.
- A. improved management
 - B. increased stock price
 - C. increased benefits to existing management of taken over firm
 - D. A and B
 - E. A, B, and C
33. Important trends changing the contemporary investment environment are
- A. globalization.
 - B. securitization.
 - C. information and computer networks.
 - D. financial engineering.
 - E. all of the above
34. The means by which individuals hold their claims on real assets in a well-developed economy are
- A. investment assets.
 - B. depository assets.
 - C. derivative assets
 - D. financial assets.
 - E. exchange-driven assets
35. Which of the following financial assets made up the greatest proportion of the financial assets held by U.S. households?
- A. pension reserves
 - B. life insurance reserves
 - C. mutual fund shares
 - D. debt securities
 - E. personal trusts
36. Which of the following are mechanisms that have evolved to mitigate potential agency problems?
- I) compensation in the form of the firm's stock options
 - II) hiring bickering family members as corporate spies
 - III) underperforming management teams being forced out by boards of directors
 - IV) security analysts monitoring the firm closely
 - V) takeover threats
- A. II and V
 - B. I, III, and IV
 - C. I, III, IV, and V
 - D. III, IV, and V
 - E. I, III, and V

37. Commercial banks differ from other businesses in that both their assets and their liabilities are mostly
- A. illiquid.
 - B. financial.
 - C. real.
 - D. owned by the government.
 - E. regulated.
38. Which of the following is true about GNMA pass-throughs?
- I) They aggregate individual home mortgages into heterogeneous pools.
 - II) The purchaser of a GNMA receives monthly interest and principal payments received from payments made on the pool.
 - III) The banks that originated the mortgages maintain ownership of them.
 - IV) The banks that originated the mortgages continue to service them.
- A. II, III, and IV
 - B. I, II, and IV
 - C. II and IV
 - D. I, III, and IV
 - E. I, II, III, and IV
39. Although derivatives can be used as speculative instruments, businesses most often use them to
- A. attract customers.
 - B. appease stockholders.
 - C. offset debt.
 - D. hedge.
 - E. enhance their balance sheets.
40. An ETF
- A. limits the diversification potential of investors who hold it.
 - B. may be traded only in the primary market.
 - C. is linked directly to the value of a composite index of futures contracts.
 - D. must be earned as a performance bonus within a corporation rather than purchased.
 - E. tracks the performance of an index of share returns for a particular country or industry sector.
41. A country ETF
- A. invests in real estate in the country.
 - B. invests in small country businesses.
 - C. is linked directly to the value of a composite index of commodity futures contracts.
 - D. is not very popular and is only used by speculators.
 - E. tracks the performance of an index of share returns for a particular country.

42. During the period between 2000 and 2002, a large number of scandals were uncovered. Most of these scandals were related to
- I) Manipulation of financial data to misrepresent the actual condition of the firm.
 - II) Misleading and overly optimistic research reports produced by analysts.
 - III) Allocating IPOs to executives as a quid pro quo for personal favors.
 - IV) Greenmail.
- A. II, III, and IV
 - B. I, II, and IV
 - C. II and IV
 - D. I, III, and IV
 - E. I, II, and III
43. A disadvantage of using stock options to compensate managers is that
- A. it encourages managers to undertake projects that will increase stock price.
 - B. it encourages managers to engage in empire building.
 - C. it can create an incentive for managers to manipulate information to prop up a stock price temporarily, giving them a chance to cash out before the price returns to a level reflective of the firm's true prospects.
 - D. all of the above.
 - E. none of the above.
44. A fixed-income security pays _____.
- A. a fixed level of income for the life of the owner
 - B. a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security
 - C. a variable level of income for owners on a fixed income
 - D. a fixed or variable income stream at the option of the owner
 - E. none of the above
45. Money market securities _____.
- A. are short term
 - B. pay a fixed income
 - C. are highly marketable
 - D. generally very low risk
 - E. all of the above
46. Financial assets permit all of the following except _____.
- A. consumption timing
 - B. allocation of risk
 - C. separation of ownership and control
 - D. elimination of risk
 - E. all of the above
47. The Sarbanes-Oxley Act _____.
- A. requires corporations to have more independent directors
 - B. requires the firm's CFO to personally vouch for the firm's accounting statements
 - C. prohibits auditing firms from providing other services to clients
 - D. A and B are correct.
 - E. A, B, and C are correct.

48. Asset allocation refers to _____.
- A. choosing which securities to hold based on their valuation
 - B. investing only in "safe" securities
 - C. the allocation of assets into broad asset classes
 - D. bottom-up analysis
 - E. all of the above
49. Which of the following portfolio construction methods starts with security analysis?
- A. Top-down
 - B. Bottom-up
 - C. Middle-out
 - D. Buy and hold
 - E. Asset allocation
50. Which of the following portfolio construction methods starts with asset allocation?
- A. Top-down
 - B. Bottom-up
 - C. Middle-out
 - D. Buy and hold
 - E. Asset allocation
51. Discuss the agency problem in detail.
52. Discuss the similarities and differences between real and financial assets.

cha1 Key

1. In 2007, _____ was the most significant real asset of U.S. households in terms of total value.
- A. consumer durables
 - B. automobiles
 - C. real estate**
 - D. mutual fund shares
 - E. bank loans

See Table 1.1.

*Bodie - Chapter 01 #1
Difficulty: Easy*

2. In 2007, _____ was the least significant financial asset of U.S. households in terms of total value.
- A. real estate
 - B. mutual fund shares
 - C. debt securities
 - D. life insurance reserves**
 - E. pension reserves

See Table 1.1.

*Bodie - Chapter 01 #2
Difficulty: Easy*

3. In 2007, _____ was the most significant asset of U.S. households in terms of total value.
- A. real estate**
 - B. mutual fund shares
 - C. debt securities
 - D. life insurance reserves
 - E. pension reserves

See Table 1.1.

*Bodie - Chapter 01 #3
Difficulty: Easy*

4. In 2007, _____ was the most significant liability of U.S. households in terms of total value.

- A. credit cards
- B. mortgages**
- C. bank loans
- D. student loans
- E. other debt

See Table 1.1.

*Bodie - Chapter 01 #4
Difficulty: Easy*

5. The largest component of domestic net worth in 2007 was _____.

- A. non-residential real estate
- B. residential real estate**
- C. inventories
- D. consumer durables
- E. equipment and software

See Table 1.2.

*Bodie - Chapter 01 #5
Difficulty: Moderate*

6. In 2007, _____ was the most significant real asset of U.S. nonfinancial businesses in terms of total value.

- A. equipment and software
- B. inventory
- C. real estate**
- D. trade credit
- E. marketable securities

See Table 1.4.

*Bodie - Chapter 01 #6
Difficulty: Easy*

7. In 2007, _____ was the least significant real asset of U.S. nonfinancial businesses in terms of total value.
- A. equipment and software
 - B. inventory**
 - C. real estate
 - D. trade credit
 - E. marketable securities

See Table 1.4.

*Bodie - Chapter 01 #7
Difficulty: Easy*

8. In 2007, _____ was the least significant liability of U.S. nonfinancial businesses in terms of total value.
- A. bonds and mortgages
 - B. bank loans**
 - C. inventories
 - D. trade debt
 - E. marketable securities

See Table 1.4.

*Bodie - Chapter 01 #8
Difficulty: Easy*

9. In terms of total value, the most significant liability of U.S. nonfinancial businesses in 2007 was _____.
- A. bank loans
 - B. bonds and mortgages**
 - C. trade debt
 - D. other loans
 - E. marketable securities.

See Table 1.4.

*Bodie - Chapter 01 #9
Difficulty: Easy*

10. In 2007, _____ was the most significant financial asset of U.S. nonfinancial businesses in terms of total value.
- A. cash
 - B. trade credit**
 - C. trade debt
 - D. inventory
 - E. marketable securities

See Table 1.4.

*Bodie - Chapter 01 #10
Difficulty: Easy*

11. The material wealth of a society is equal to the sum of _____.
- A. all financial assets
 - B. all real assets**
 - C. all financial and real assets
 - D. all physical assets
 - E. none of the above

Financial assets do not directly contribute the productive capacity of the economy.

*Bodie - Chapter 01 #11
Difficulty: Easy*

12. _____ of an investment bank.
- A. Citigroup is an example
 - B. Merrill Lynch is an example
 - C. Goldman is an example
 - D. B and C are each examples
 - E. Each of the above is an example**

Merrill Lynch, Citigroup, and Goldman are all examples of investment banks.

*Bodie - Chapter 01 #12
Difficulty: Easy*

13. _____ are financial assets.
- A. Bonds
 - B. Machines
 - C. Stocks
 - D. A and C**
 - E. A, B and C

Machines are real assets; stocks and bonds are financial assets.

*Bodie - Chapter 01 #13
Difficulty: Easy*

14. An example of a derivative security is _____.

- A. a common share of General Motors
- B. a call option on Mobil stock
- C. a commodity futures contract
- D.** B and C
- E. A and B

The values of B and C are derived from that of an underlying financial asset; the value of A is based on the value of the firm only.

*Bodie - Chapter 01 #14
Difficulty: Easy*

15. _____ was the first to introduce mortgage pass-through securities.

- A. Chase Manhattan
- B. Citicorp
- C. FNMA
- D.** GNMA
- E. None of the above

GNMA introduced mortgage pass through securities in 1970.

*Bodie - Chapter 01 #15
Difficulty: Easy*

16. A bond issue is broken up so that some investors will receive only interest payments while others will receive only principal payments, which is an example of _____.

- A. bundling
- B. credit enhancement
- C. unbundling
- D. financial engineering
- E.** C and D

Unbundling is one of many examples of financial engineering that offer more alternatives to the investor.

*Bodie - Chapter 01 #16
Difficulty: Easy*

17. An example of a primitive security is _____.
- A. a common share of General Motors
 - B. a call option on Mobil stock
 - C. a call option on a stock of a firm based in a Third World country
 - D. a U.S. government bond
 - E.** A and D

A primitive security's return is based only upon the earning power of the issuing agency, such as stock in General Motors and the U.S. government.

*Bodie - Chapter 01 #17
Difficulty: Easy*

18. The _____ refers to the potential conflict between management and shareholders due to management's control of pecuniary rewards as well as the possibility of incompetent performance by managers.
- A.** agency problem
 - B. diversification problem
 - C. liquidity problem
 - D. solvency problem
 - E. regulatory problem

The agency problem describes potential conflict between management and shareholders. The other problems are those of firm management only.

*Bodie - Chapter 01 #18
Difficulty: Easy*

19. _____ financial asset(s).
- A. Buildings are
 - B. Land is a
 - C. Derivatives are
 - D. U.S. Agency bonds are
 - E.** C and D

A and B are real assets.

*Bodie - Chapter 01 #19
Difficulty: Easy*

20. The value of a derivative security _____.
- A. depends on the value of the related primitive security
 - B. can only cause increased risk.
 - C. is unrelated to the value of the related primitive security
 - D. has been enhanced due the recent misuse and negative publicity regarding these instruments
 - E. is worthless today

Of the factors cited above, only A affects the value of the derivative and/or is a true statement.

*Bodie - Chapter 01 #20
Difficulty: Easy*

21. Money market funds were a financial innovation partly inspired to circumvent _____.
- A. Regulation B, which is still in existence
 - B. Regulation D
 - C. DIDMCA
 - D. Regulation M
 - E. Regulation Q, which is no longer in existence

Regulation Q limited the amount of interest that banks could pay to depositors; money market funds were not covered by Regulation Q and thus could pay a higher rate of interest. Although Regulation Q no longer exists, money market funds continue to be popular.

*Bodie - Chapter 01 #21
Difficulty: Easy*

22. _____ are a way U.S. investor can invest in foreign companies.
- A. ADRs
 - B. IRAs
 - C. SDRs
 - D. GNMAAs
 - E. Krugerrands

Only ADRs represent an indirect investment in a foreign company.

*Bodie - Chapter 01 #22
Difficulty: Easy*

23. _____ are examples of financial intermediaries.

- A. Commercial banks
- B. Insurance companies
- C. Investment companies
- D. Credit unions
- E. All of the above**

All are institutions that bring borrowers and lenders together.

*Bodie - Chapter 01 #23
Difficulty: Easy*

24. Financial intermediaries exist because small investors cannot efficiently _____.

- A. diversify their portfolios
- B. gather all relevant information
- C. assess credit risk of borrowers
- D. advertise for needed investments
- E. all of the above.**

The individual investor cannot efficiently and effectively perform any of the tasks above without more time and knowledge than that available to most individual investors.

*Bodie - Chapter 01 #24
Difficulty: Easy*

25. Firms that specialize in helping companies raise capital by selling securities are called _____.

- A. commercial banks
- B. investment banks**
- C. savings banks
- D. credit unions
- E. all of the above.

An important role of investment banks is to act as middlemen in helping firms place new issues in the market.

*Bodie - Chapter 01 #25
Difficulty: Easy*

26. Financial assets _____.
- A. directly contribute to the country's productive capacity
 - B.** indirectly contribute to the country's productive capacity
 - C. contribute to the country's productive capacity both directly and indirectly
 - D. do not contribute to the country's productive capacity either directly or indirectly
 - E. are of no value to anyone

Financial assets indirectly contribute to the country's productive capacity because these assets permit individuals to invest in firms and governments. This in turn allows firms and governments to increase productive capacity.

*Bodie - Chapter 01 #26
Difficulty: Easy*

27. The sale of a mortgage portfolio by setting up mortgage pass-through securities is an example of _____.
- A. credit enhancement
 - B.** securitization
 - C. unbundling
 - D. derivatives
 - E. none of the above

The financial asset is secured by the mortgages backing the instrument.

*Bodie - Chapter 01 #27
Difficulty: Easy*

28. Corporate shareholders are best protected from incompetent management decisions by
- A. the ability to engage in proxy fights.
 - B. management's control of pecuniary rewards.
 - C. the ability to call shareholder meetings.
 - D.** the threat of takeover by other firms.
 - E. one-share/one-vote election rules.

Proxy fights are expensive and seldom successful, and management may often control the board or own significant shares. It is the threat of takeover of underperforming firms that has the strongest ability to keep management on their toes.

*Bodie - Chapter 01 #28
Difficulty: Moderate*

29. The national net worth of the U.S. in 2007 was _____.
- A. \$15.411 trillion
 - B. \$26.431 trillion
 - C. \$42.669 trillion
 - D.** \$48.038 trillion
 - E. \$70.983 trillion

See Table 1.2.

*Bodie - Chapter 01 #29
Difficulty: Moderate*

30. In 2007, _____ of the assets of U.S. households were financial assets as opposed to tangible assets.
- A. 20.4%
 - B. 34.2%
 - C.** 61.1%
 - D. 71.7%
 - E. 82.5%

See Table 1.1.

*Bodie - Chapter 01 #30
Difficulty: Moderate*

31. Investment bankers perform the following role(s) _____.
- A. market new stock and bond issues for firms
 - B. provide advice to the firms as to market conditions, price, etc
 - C. design securities with desirable properties
 - D.** all of the above
 - E. none of the above

Investment bankers perform all of the roles described above for their clients.

*Bodie - Chapter 01 #31
Difficulty: Easy*

32. Theoretically, takeovers should result in _____.
- A. improved management
 - B. increased stock price
 - C. increased benefits to existing management of taken over firm
 - D.** A and B
 - E. A, B, and C

Theoretically, when firms are taken over, better managers come in and thus increase the price of the stock; existing management often must either leave the firm, be demoted, or suffer a loss of existing benefits.

*Bodie - Chapter 01 #32
Difficulty: Easy*

33. Important trends changing the contemporary investment environment are
- A. globalization.
 - B. securitization.
 - C. information and computer networks.
 - D. financial engineering.
 - E.** all of the above

All of these are examples of important trends in the contemporary investment environment.

*Bodie - Chapter 01 #33
Difficulty: Easy*

34. The means by which individuals hold their claims on real assets in a well-developed economy are
- A. investment assets.
 - B. depository assets.
 - C. derivative assets
 - D.** financial assets.
 - E. exchange-driven assets

Financial assets allocate the wealth of the economy. Example: it is easier for an individual to own shares of an auto company than to own an auto company directly.

*Bodie - Chapter 01 #34
Difficulty: Easy*

35. Which of the following financial assets made up the greatest proportion of the financial assets held by U.S. households?
- A. pension reserves
 - B. life insurance reserves
 - C. mutual fund shares
 - D. debt securities
 - E. personal trusts

See Table 1.1.

Bodie - Chapter 01 #35
Difficulty: Moderate

36. Which of the following are mechanisms that have evolved to mitigate potential agency problems?
- I) compensation in the form of the firm's stock options
 - II) hiring bickering family members as corporate spies
 - III) underperforming management teams being forced out by boards of directors
 - IV) security analysts monitoring the firm closely
 - V) takeover threats
- A. II and V
 - B. I, III, and IV
 - C. I, III, IV, and V
 - D. III, IV, and V
 - E. I, III, and V

All but the second option have been used to try to limit agency problems.

Bodie - Chapter 01 #36
Difficulty: Moderate

37. Commercial banks differ from other businesses in that both their assets and their liabilities are mostly
- A. illiquid.
 - B. financial.
 - C. real.
 - D. owned by the government.
 - E. regulated.

See Table 1.3.

Bodie - Chapter 01 #37
Difficulty: Easy

38. Which of the following is true about GNMA pass-throughs?
- I) They aggregate individual home mortgages into heterogeneous pools.
 - II) The purchaser of a GNMA receives monthly interest and principal payments received from payments made on the pool.
 - III) The banks that originated the mortgages maintain ownership of them.
 - IV) The banks that originated the mortgages continue to service them.
- A. II, III, and IV
 - B. I, II, and IV**
 - C. II and IV
 - D. I, III, and IV
 - E. I, II, III, and IV

III is not correct because the bank no longer owns the mortgage investments.

*Bodie - Chapter 01 #38
Difficulty: Moderate*

39. Although derivatives can be used as speculative instruments, businesses most often use them to
- A. attract customers.
 - B. appease stockholders.
 - C. offset debt.
 - D. hedge.**
 - E. enhance their balance sheets.

Firms may use forward contracts and futures to protect against currency fluctuations or changes in commodity prices. Interest-rate options help companies control financing costs.

*Bodie - Chapter 01 #39
Difficulty: Easy*

40. An ETF
- A. limits the diversification potential of investors who hold it.
 - B. may be traded only in the primary market.
 - C. is linked directly to the value of a composite index of futures contracts.
 - D. must be earned as a performance bonus within a corporation rather than purchased.
 - E. tracks the performance of an index of share returns for a particular country or industry sector.**

ETFs allow investors to trade portfolios in the secondary markets.

*Bodie - Chapter 01 #40
Difficulty: Moderate*

41. A country ETF
- A. invests in real estate in the country.
 - B. invests in small country businesses.
 - C. is linked directly to the value of a composite index of commodity futures contracts.
 - D. is not very popular and is only used by speculators.
 - E.** tracks the performance of an index of share returns for a particular country.

Country ETFs allow investors to trade portfolios that mimic foreign indices in the secondary markets.

*Bodie - Chapter 01 #41
Difficulty: Moderate*

42. During the period between 2000 and 2002, a large number of scandals were uncovered. Most of these scandals were related to
- I) Manipulation of financial data to misrepresent the actual condition of the firm.
 - II) Misleading and overly optimistic research reports produced by analysts.
 - III) Allocating IPOs to executives as a quid pro quo for personal favors.
 - IV) Greenmail.
- A. II, III, and IV
 - B. I, II, and IV
 - C. II and IV
 - D. I, III, and IV
 - E.** I, II, and III

I, II, and III are all mentioned as causes of recent scandals.

*Bodie - Chapter 01 #42
Difficulty: Moderate*

43. A disadvantage of using stock options to compensate managers is that
- A. it encourages managers to undertake projects that will increase stock price.
 - B. it encourages managers to engage in empire building.
 - C.** it can create an incentive for managers to manipulate information to prop up a stock price temporarily, giving them a chance to cash out before the price returns to a level reflective of the firm's true prospects.
 - D. all of the above.
 - E. none of the above.

A is a desired characteristic. B is not necessarily a good or bad thing in and of itself. C creates an agency problem.

*Bodie - Chapter 01 #43
Difficulty: Easy*

44. A fixed-income security pays _____.
- A. a fixed level of income for the life of the owner
 - B.** a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security
 - C. a variable level of income for owners on a fixed income
 - D. a fixed or variable income stream at the option of the owner
 - E. none of the above

Only answer B is correct.

*Bodie - Chapter 01 #44
Difficulty: Easy*

45. Money market securities _____.
- A. are short term
 - B. pay a fixed income
 - C. are highly marketable
 - D. generally very low risk
 - E.** all of the above

All answers are correct.

*Bodie - Chapter 01 #45
Difficulty: Easy*

46. Financial assets permit all of the following except _____.
- A. consumption timing
 - B. allocation of risk
 - C. separation of ownership and control
 - D.** elimination of risk
 - E. all of the above

Financial assets do not allow risk to be eliminated. However, they do permit allocation of risk, consumption timing, and separation of ownership and control.

*Bodie - Chapter 01 #46
Difficulty: Moderate*

47. The Sarbanes-Oxley Act _____.
- A. requires corporations to have more independent directors
 - B. requires the firm's CFO to personally vouch for the firm's accounting statements
 - C. prohibits auditing firms from providing other services to clients
 - D. A and B are correct.
 - E. A, B, and C are correct.**

The Sarbanes-Oxley Act does all of the above.

*Bodie - Chapter 01 #47
Difficulty: Moderate*

48. Asset allocation refers to _____.
- A. choosing which securities to hold based on their valuation
 - B. investing only in "safe" securities
 - C. the allocation of assets into broad asset classes**
 - D. bottom-up analysis
 - E. all of the above

Asset allocation refers to the allocation of assets into broad asset classes.

*Bodie - Chapter 01 #48
Difficulty: Moderate*

49. Which of the following portfolio construction methods starts with security analysis?
- A. Top-down
 - B. Bottom-up**
 - C. Middle-out
 - D. Buy and hold
 - E. Asset allocation

Bottom-up refers to using security analysis to find securities that are attractively priced. Top-down refers to using asset allocation as a starting point.

*Bodie - Chapter 01 #49
Difficulty: Moderate*

50. Which of the following portfolio construction methods starts with asset allocation?
- A. Top-down**
 - B. Bottom-up
 - C. Middle-out
 - D. Buy and hold
 - E. Asset allocation

Bottom-up refers to using security analysis to find securities that are attractively priced.

*Bodie - Chapter 01 #50
Difficulty: Moderate*

51. Discuss the agency problem in detail.

Managers are the agents of the shareholders, and should act on their behalf to maximize shareholder wealth (the value of the stock). A conflict (the agency conflict) arises when managers take self-interested actions to the detriment of shareholders. The roles of the board of directors selected by the shareholders are to oversee management and to minimize agency problems. However, often these boards are figureheads, and individual shareholders do not own large enough blocks of the shares to override management actions. One potential resolution of an agency problem occurs when inefficient management actions cause the price of the stock to be depressed. The firm may then become a takeover target. If the acquisition is successful, managers may be replaced and potentially, stockholders benefit. Feedback: The question is designed to ascertain that the student understands the corporate relationship between shareholders, management, and the board of directors. In addition, this problem has been addressed extensively in recent years, both in the popular financial press during the mergers and acquisitions mania of the 1980s, and in the academic literature as agency theory.

*Bodie - Chapter 01 #51
Difficulty: Moderate*

52. Discuss the similarities and differences between real and financial assets.

Real assets represent the productive capacity of the firm, and appear as assets on the firm's balance sheet. Financial assets are claims against the firm, and thus appear as liabilities on the firm's balance sheet. On the other hand, financial assets are listed on the asset side of the balance sheet of the individuals who own them. Thus, when financial statements are aggregated across the economy, the financial assets cancel out, leaving only the real assets, which directly contribute to the productive capacity of the economy. Financial assets contribute indirectly only.

Feedback: The purpose of this question is to ascertain if the student understands the difference between real and financial assets, both in the aggregate balance sheet context and the relative contribution of the two types of assets to the productive capacity of the economy.

*Bodie - Chapter 01 #52
Difficulty: Moderate*

53. Discuss the euro in relation to its impact on globalization. How is it currently used and what are the plans for its future use?

The euro was introduced in 1999 as a new currency and has replaced the currencies of twelve participating countries so there will be one common European currency in the participating countries. A common currency is expected to facilitate global trade and encourage the integration of markets across national boundaries.

Feedback: The purpose of this question is to test the student's understanding of the use and impact of the euro.

*Bodie - Chapter 01 #53
Difficulty: Moderate*

54. Discuss the following ongoing trends as they relate to the field of investments: globalization, financial engineering, securitization, and computer networks.

Globalization offers a wider array of investment choices than what would be available to investors who could only choose domestic securities. As efficient communication technology has become available, globalization of markets has been significantly enhanced. There are many mechanisms by which one country's investors can hold foreign companies' securities. Some examples are ADRs, WEBS, and direct purchase of foreign securities.

Securitization refers to aggregating underlying financial assets, such as mortgages, into pools and then offering a security that represents a claim on these underlying assets. Examples are GNMA's. Securitization allows investors to hold partial ownership in financial assets that would otherwise be beyond their reach (e.g., mortgages).

Financial engineering involves bundling or unbundling. Bundling involves combining separate securities together into one composite security. Examples are combining primitive and derivative securities, and combining three primitive securities such as common stock, preferred stock, and bonds. Unbundling is the opposite - two or more security classes are created by separating a composite security into parts.

Computer networks have permitted online trading, online information dissemination and automated trade crossing. Each of these major breakthroughs has significant implications for investments.

Feedback: The purpose of this question is to test the student's understanding of the major trends that impact the field of investments.

cha1 Summary

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