

# ch 1

Student: \_\_\_\_\_

1. The total dollar return on an equity investment is defined as:
  - A. All cash flows and gains from an investment, excluding any losses.
  - B. All cash inflows such as dividends and capital gains or losses.
  - C. The increase in the price of an asset.
  - D. Capital gains received.
  - E. Only the capital gains received, not including capital gains not realized.
2. Annual dividend yield at time  $(t + 1)$ ,  $D_{t+1}$ , divided by the stock price at time  $t$ ,  $P_t$  is called the:
  - A. Annualized rate of return
  - B. Capital gain
  - C. Total annual rate of return
  - D. Total dollar return
  - E. Dividend yield
3. Capital gains yield is equal to:
  - A.  $(P_t - P_{t+1})/P_{t+1}$
  - B.  $D_{t+1}/P_t$
  - C.  $(P_{t+1} - P_t)/P_t$
  - D.  $(P_t - P_{t+1})/P_t$
  - E.  $P_t/(P_{t+1} - P_t)$
4. The risk premium is defined as the rate of return on
  - A. A risky asset minus the inflation rate
  - B. The overall market
  - C. A Treasury bill
  - D. A risky asset minus the risk-free rate
  - E. A risk-less investment
5. The variance measures the:
  - A. Total difference between the actual returns and the average returns
  - B. Average difference between the actual squared returns and the risk-free returns
  - C. Average squared difference between the actual returns and the risk-free returns
  - D. Total difference between the average returns and the risk-free returns
  - E. Average squared difference between the actual and the average returns
6. The standard deviation is a measure of:
  - A. Volatility.
  - B. Return.
  - C. Performance.
  - D. Capital gains.
  - E. The risk premium.
7. The risk-free rate that is paid as compensation for waiting is referred to as the:
  - A. Time value of money
  - B. Real rate of return
  - C. Total dollar return
  - D. Average real return
  - E. Financial reward

8. The rate of return on an asset with no uncertainty regarding its return is known as the \_\_\_\_\_. A typical example is the rate of return earned on a Treasury bill.
- Risk premium.
  - Capital gains yield.
  - Risk-free rate.
  - Dividend yield.
  - Compound return.
9. Why is the rate of return on a risk free asset considered to represent the "time value of money"?
- It represents the return for forgoing the use of our money without bearing risk.
  - It has an efficient risk premium when compared to other risk free investments.
  - The yield of the risk free investment increases proportionally with time.
  - The money from the return from your investment won't be created until the future.
  - It represents the minimum amount of time necessary to have the asset become risk free.
10. The arithmetic average return is the return earned in an average year over a multi-year period. For calculation you:
- Add up all the returns and divide by the number of observations minus one.
  - Add one to each return, multiply these values, find the  $1/n$  root, and subtract one.
  - Subtract the lowest return from the highest return.
  - Add up all the returns and divide by the number of observations.
  - Find the return that is exactly in the middle of the highest and lowest return.
11. The geometric average return is the:
- Summation of the returns for a number of years divided by the  $n^{\text{th}}$  root when  $n$  equal the number of years
  - Average compound return earned per year over a multi-year period
  - Compound total return for a period of years divided by the number of years in the period
  - Return earned in an average year over a multi-year period
  - Average squared return earned in a single year
12. The value that is equal to the ending price of a security minus the beginning price is called the:
- Geometric return.
  - Negative dividend.
  - risk premium.
  - capital gain or loss.
  - Percentage return.
13. The average compound return earned per year over a multiyear period when inflows and outflows are considered is called the:
- total return
  - average capital gains yield
  - dollar-weighted average return.
  - arithmetic average return.
  - Percentage return.
14. The dollar-weighted average return is measured by calculating the:
- geometric average return
  - internal rate of rate
  - annual compounded average return.
  - arithmetic average return.
  - percentage return.
15. The fact that higher returns are associated with higher standard deviation is known as the:
- Real return factor
  - Geometric relationship
  - Risk-return tradeoff
  - Market variance
  - Market capitalization

16. Rate of return is expressed on a \_\_\_\_\_ basis.
- A. Percentage
  - B. Increase
  - C. Equity
  - D. Absolute
  - E. Gain
17. A company's total market capitalization is found by:
- A. The quoted price of its shares divided by the number of shares in issue
  - B. The income stream in the future
  - C. The use of numbers drawn randomly from probability distributions
  - D. The quoted price of its shares times the number of shares in issue
  - E. The technique for minimizing the operating costs
18. A company whose has 1,000,000 shares and a current stock price of \$15.67 would have a market capitalization of:
- A. \$6,380,000
  - B. 6.38%
  - C. 15.67%
  - D. \$15,670,000
  - E. \$1,000,000
19. The reward for bearing risk is known as the:
- A. Excess return.
  - B. Volatility.
  - C. Geometric premium.
  - D. Risk premium.
  - E. Dividend yield.
20. The total percentage return on an equity investment typically has two components known as \_\_\_\_\_ and \_\_\_\_\_.
- A. Principal and interest.
  - B. Capital gains yield and dividend yield.
  - C. Arithmetic yield and geometric yield.
  - D. Dollar gain and capital gains.
  - E. Dividends and cash payments.
21. For proper comparisons among investments, the best measure of return is \_\_\_\_\_ return.
- A. Dollar
  - B. Percentage
  - C. capital gains
  - D. Dividend
  - E. Stock
22. The dividend yield on a stock will be \_\_\_\_\_, while the capital gains yield will be \_\_\_\_\_.
- A. Positive; either positive or zero
  - B. Positive; positive
  - C. Positive; negative, positive or zero
  - D. Positive or zero; positive or zero
  - E. Positive or zero; negative, positive or zero
23. A major difference between dividends and capital gains is that:
- A. Capital gains are always positive.
  - B. Capital gains affect the total return while dividends do not.
  - C. Capital gains are in increase in stock price while dividends are cash payments to stockholders.
  - D. Dividends affect the total return while capital gains do not.
  - E. Capital gains are only accounted for on an annual basis while dividends are accounted for when paid.

24. It is important to account for capital gains:
- A. On an annual basis.
  - B. Whenever the asset is sold and the capital gain is realized.
  - C. Whenever dividends are paid.
  - D. Whenever they occur, whether or not the asset is sold.
  - E. If the asset incurs a loss in value.
25. Which of the following is true regarding capital gains?
- A. Gains must be included whenever they occur regardless the status of the investment
  - B. Gains have to be computed on an annual basis
  - C. Gains are only included when they are realized at the time the investment is sold
  - D. Both (A) and (B)
  - E. Both (B) and (C)
26. If you multiply the number of shares outstanding stock for a firm by the price per share, you are looking for the firm's:
- A. Equity ratio
  - B. Total book value
  - C. Time value
  - D. Market capitalization
  - E. Leverage degree
27. Historically, T-bills as an asset class have had a \_\_\_\_\_ level of risk and \_\_\_\_\_ return compared to large-company stocks.
- A. High; high
  - B. High; low
  - C. Low; high
  - D. Low; low
  - E. Zero; zero
28. In 2008, which of the following would have had the best overall return in the United States?
- A. A portfolio consisting of all stocks
  - B. A portfolio consisting of all bonds
  - C. A portfolio consisting of a mix of stocks and bonds
  - D. A portfolio that had diversified stocks
  - E. None of the above
29. Historically, the higher the risk premium, the \_\_\_\_\_ the average return and the \_\_\_\_\_ the standard deviation of the returns.
- A. Lower; lower
  - B. Lower; higher
  - C. Higher; higher
  - D. Higher; lower
  - E. There is no relationship between the risk premium and the average return
30. The risk premium for risky stocks is the stock return:
- A. Minus the risk-free rate.
  - B. Minus the large company stock return.
  - C. Minus the long-term corporate bond return.
  - D. Plus the risk-free rate.
  - E. Plus the large company stock return.
31. If you want to increase the potential annual return on your investment, you probably will need to:
- A. Increase your investment in bonds and lower your investment in stocks
  - B. Increase your investment in T-bills and lower your investment in corporate bonds
  - C. Reduce the standard deviation of your returns
  - D. Reduce the expected variability of your returns
  - E. Increase your portfolio's level of risk

32. Which of the following is false?
- A. Risky assets have a risk premium on average.
  - B. In general, the greater the risk, the greater the return.
  - C. Standard deviation is a commonly used measure of risk.
  - D. Risk and return have historically exhibited a direct relationship.
  - E. None of the above.
33. Which of the following is not a financial asset?
- A. Stocks.
  - B. Real estate.
  - C. Bonds.
  - D. Options.
  - E. Futures.
34. Returns that have been adjusted for inflation are called:
- A. Nominal returns
  - B. Holding period returns
  - C. Total dollar returns
  - D. Effective returns
  - E. Real returns
35. To invest in any financial instruments, you would like to check their:
- A. Percentage returns
  - B. Minimum returns
  - C. Maximum returns
  - D. Standard deviations of returns
  - E. All of the above
36. The historic risk premium for equities in Canada, from 1900 to 2005, is:
- A. 7.41%
  - B. 7.54%
  - C. 5.88%
  - D. 16.71%
  - E. 11.7%
37. In the last 25 years, US large-company stocks historically produced \_\_\_\_\_ returns compared with the Canadian counterparts.
- A. Substantially higher
  - B. Marginally higher
  - C. Identical
  - D. Much lower
  - E. Slightly lower
38. In Canada, the average historic return on \_\_\_\_\_ has been slightly higher than the average historic inflation rate.
- A. Large company stocks
  - B. Treasury bills
  - C. Long-term government bonds
  - D. Long-term corporate bonds
  - E. Small company stocks
39. Which one of the following had the highest risk premium for the period 1926-2009?
- A. U.S. Treasury bills
  - B. long-term government bonds
  - C. large-company stocks
  - D. small-company stocks
  - E. intermediate-term government bonds

40. Some investors would avoid investing in small capitalization stocks because:
- A. Of the historically low risk premium.
  - B. Of their volatility.
  - C. They do not provide an adequate return.
  - D. Their historic return is about the same as the historic rate of inflation.
  - E. Investors prefer assets that are non-financial.
41. The Investment bubble, historically known as tulipmania easily arises when:
- A. Risky investments do not always pay more than risk-free investments.
  - B. Market is full of speculators.
  - C. Investors become irrational.
  - D. Manic buying and selling occur.
  - E. All of the above.
42. A common measure of inflation is:
- A. Small company stock returns.
  - B. Treasury bills.
  - C. The Consumer Price Index.
  - D. The risk-free rate.
  - E. The standard deviation of stocks.
43. The asset commonly used as the risk-free asset is:
- A. Small company stocks.
  - B. Gold.
  - C. The Consumer Price Index.
  - D. Long-term corporate bonds.
  - E. Treasury bills.
44. A portfolio had a value of \$50,000 ten years ago. If the average annual arithmetic return was 10.2 percent, what is the ending value of the portfolio?
- A. \$120,406
  - B. \$126,532
  - C. \$132,064
  - D. \$138,846
  - E. Insufficient information.
45. A portfolio had a value of \$50,000 ten years ago. If the average annual arithmetic return was 10.2 percent, what is the ending value of the portfolio?
- A. \$120,406
  - B. \$126,532
  - C. \$132,064
  - D. \$138,846
  - E. Insufficient information.
46. You have the returns for a stock over the last twenty years. Assuming the returns are different each year, you know:
- A. the arithmetic return will always be larger.
  - B. the geometric return will always be larger.
  - C. the arithmetic return will be larger if there are no negative returns.
  - D. the geometric return will be larger if there are no negative returns.
  - E. it is uncertain whether the arithmetic or geometric return will be larger.
47. When we refer to the rate of return on an investment, we are generally referring to the:
- A. capital gains yield
  - B. effective annual rate of return.
  - C. total percentage return.
  - D. dividend yield.
  - E. annualized dividend yield.

48. \_\_\_\_\_ is an annualized return rate on an investment using compound interest techniques.
- A. Bond equivalent yield
  - B. Annual market yield
  - C. Average percentage yield
  - D. Effective annual yield
  - E. Compounded annual yield
49. To annualize a two-year holding-period-return, you need to assume that:
- A. All cash receipts in the first year are ignored in the calculation
  - B. All cash receipts in the first year are reinvested
  - C. The arithmetic average will be smaller than the geometric average
  - D. There are no outliers in the returns
  - E. Nothing
50. The geometric return on an asset is approximately equal to the arithmetic return:
- A. Plus one-half the standard deviation
  - B. Plus one-half the variance
  - C. Minus one-half the standard deviation
  - D. Minus one-half the variance
  - E. Times one-half
51. A stock has varying annual rates of return over a 10-year period and a positive geometric average return for the same period. Given this, you know the arithmetic return will be:
- A. Positive but less than the geometric average return
  - B. Less than the geometric return and can be negative, zero or positive
  - C. Equal to the geometric average return
  - D. Either equal to or greater than the geometric average return
  - E. Greater than the geometric average return
52. You purchased 100 shares of a stock at the beginning of the year for \$43.20 per share. The share price at the end of the year is \$46.10 and the stock paid an annual dividend of \$1.10 per share. What was your dividend yield for the year?
- A. 2.23%
  - B. 2.39%
  - C. 2.55%
  - D. 2.67%
  - E. 2.81%
53. You purchased 100 shares of a stock at the beginning of the year for \$43.20 per share. The share price at the end of the year is \$46.10 and the stock paid an annual dividend of \$1.10 per share. What was your capital-gain yield for the year?
- A. 2.55%
  - B. 3.12%
  - C. 4.86%
  - D. 5.34%
  - E. 6.71%
54. You purchased 100 shares of a stock at the beginning of the year for \$43.20 per share. The share price at the end of the year is \$46.10 and the stock paid an annual dividend of \$1.10 per share. What was your total percentage return for the year?
- A. 7.16%
  - B. 7.73%
  - C. 8.68%
  - D. 9.26%
  - E. 10.39%

55. You purchased a stock at the beginning of the year for \$80.25. Your total return for the year was 10.2%, and the stock had a dividend yield of 1.8%. What was the end of year stock price?
- A. \$84.73
  - B. \$85.02
  - C. \$86.99
  - D. \$88.44
  - E. \$89.56
56. You have an asset that has an arithmetic average return of 10.9 percent over the past five years. The annual returns for four years were 8%, 16%, - 9%, and 13%. What was the asset's return for the fifth year?
- A. 15.6%
  - B. 17.8%
  - C. 20.7%
  - D. 22.8%
  - E. 26.5%
57. A stock had a price at the beginning of the year of \$48.20. The end of year stock price was \$43.12 and your total return was - 8.15%. What dividend did the stock pay during the year?
- A. \$0.87
  - B. \$0.96
  - C. \$1.09
  - D. \$1.15
  - E. \$1.23
58. You purchased 500 shares of stock at a price of \$86.34 and received a dividend of \$0.97 per share. You sold the stock for \$92.14. What was your total dollar return?
- A. \$2,900.00
  - B. \$3,163.00
  - C. \$3,385.00
  - D. \$3,504.00
  - E. \$3,723.00
59. A stock had returns of 8 percent, - 6 percent, 18 percent and 27 percent over the past four years. What was the geometric return?
- A. 10.31%
  - B. 10.67%
  - C. 11.06%
  - D. 11.43%
  - E. 11.75%
60. An asset has a return of 10.5 percent and a variance of 70 percent square. What range of returns would you expect to see two-thirds of the time?
- A. - 73.17% to 94.17%
  - B. - 6.24% to 27.24%
  - C. - 31.2% to 51.7%
  - D. - 43.8% to 62.8%
  - E. - 59.5% to 80.5%
61. You invested \$20,000 eight years ago. With a geometric average return of 12.2 percent per year, what was your ending portfolio value?
- A. \$47,043
  - B. \$48,162
  - C. \$50,231
  - D. \$52,406
  - E. \$54,693

62. You own a stock that dropped in price from \$86.50 to \$79.12. The dividend yield was 1.8 percent. What was your total return?
- A. - 7.53%
  - B. - 6.73%
  - C. - 6.05%
  - D. - 5.48%
  - E. - 5.09%
63. An initial investment of \$10,000 twenty years ago is worth \$119,379 today. What was the geometric average return per year over this 20-year period?
- A. 10.5%
  - B. 11.1%
  - C. 11.7%
  - D. 12.4%
  - E. 13.2%
64. An asset has annual returns of 14 percent, 8 percent, - 6 percent, 27 percent and 18 percent. What is the geometric average return?
- A. 11.64%
  - B. 12.20%
  - C. 13.05%
  - D. 14.16%
  - E. 15.25%
65. An asset has annual returns of 14 percent, 8 percent, - 6 percent, 27 percent and 18 percent. What is the arithmetic return?
- A. 11.64%
  - B. 12.20%
  - C. 13.05%
  - D. 14.16%
  - E. 15.25%
66. An asset has annual returns of 11 percent, 17 percent, - 21 percent, 3 percent and 18 percent. What is the variance?
- A. .01210
  - B. .01329
  - C. .02568
  - D. .02748
  - E. .01964
67. An asset has annual returns of 11 percent, 17 percent, - 21 percent, 3 percent and 18 percent. What is the standard deviation?
- A. 11.05%
  - B. 12.30%
  - C. 14.31%
  - D. 15.12%
  - E. 16.02%
68. A stock has had returns of - 8 percent, 11 percent, 12 percent, 7 percent and 9 percent over the past five years. What is the variance of returns for this stock during the last five years?
- A. .019502
  - B. .000667
  - C. .028134
  - D. .031644
  - E. .034625

69. You own a stock with an average historical risk premium of 6.8%. The risk-free rate next year is expected to be 4.6%. What rate of return should you expect on your stock for next year?
- A. 4.60%
  - B. 11.38%
  - C. 11.87%
  - D. 11.40%
  - E. 2.20%
70. You find a stock with returns of 14.2%, - 10.1%, 8.7%, 29.7%, and 18.2%. The risk-free rate over this period was 6.4%, 6.8%, 5.2%, 4.4% and 5.3%. What was the arithmetic average risk premium?
- A. 5.57%
  - B. 5.86%
  - C. 6.52%
  - D. 7.01%
  - E. 7.34%
71. You find a stock with returns of 14.2%, - 10.1%, 8.7%, 29.7%, and 18.2%. The risk-free rate over this period was 6.4%, 6.8%, 5.2%, 4.4% and 5.3%. What was the variance of the returns?
- A. .01876
  - B. .02139
  - C. .02647
  - D. .02968
  - E. .03192
72. You find a stock with returns of 14.2%, - 10.1%, 8.7%, 29.7%, and 18.2%. The risk-free rate over this period was 6.4%, 6.8%, 5.2%, 4.4% and 5.3%. What was the standard deviation of the risk premium?
- A. 10.59%
  - B. 11.86%
  - C. 13.16%
  - D. 14.02%
  - E. 15.41%
73. You own a stock with an average historical risk premium of 7.4 percent. The risk-free rate next year will be 4.1 percent. What do you expect the stock return to be next year?
- A. 4.1%
  - B. 7.4%
  - C. 9.8%
  - D. 10.6%
  - E. 11.5%
74. A stock has a return of 13.2 percent, and the risk-free rate is 4.6 percent. What is the risk premium for this stock?
- A. 4.6%
  - B. 6.4%
  - C. 8.6%
  - D. 13.2%
  - E. 17.8%
75. A portfolio had an original value of \$15,000 twenty years ago. The current value of the portfolio is \$92,780. What was the geometric average return of the portfolio?
- A. 8.63%
  - B. 9.54%
  - C. 10.81%
  - D. 11.16%
  - E. 11.87%

76. You plan to buy a stock and hold it for one year. You expect the stock price to be \$68 per share in one year, and the stock will pay an annual dividend of \$1.25. If you want a 14 percent return, what is the maximum amount you are willing to pay for the stock today?
- A. \$58.32
  - B. \$59.65
  - C. \$60.75
  - D. \$62.12
  - E. \$68.00
77. An asset had returns of 14%, 26%, - 13%, 8%, and 12% over the past five years. What was the arithmetic average return of the asset?
- A. 8.94%
  - B. 9.40%
  - C. 10.05%
  - D. 10.63%
  - E. 11.75%
78. An asset had returns of 14%, 26%, - 13%, 8%, and 12% over the past five years. What was the variance of the returns?
- A. .01287
  - B. .01614
  - C. .02018
  - D. .02632
  - E. .03512
79. An asset had returns of 14%, 26%, - 13%, 8%, and 12% over the past five years. What was the standard deviation of the returns?
- A. 11.34%
  - B. 12.70%
  - C. 14.21%
  - D. 16.22%
  - E. 18.74%
80. A particular stock had year-end prices of \$45, \$43, \$54, and \$61 over the past four years, respectively. What was the arithmetic average return of the stock?
- A. 7.90%
  - B. 8.52%
  - C. 10.04%
  - D. 10.67%
  - E. 11.37%
81. A particular stock had year-end prices of \$45, \$43, \$54, and \$61 over the past four years, respectively. What was the geometric average return of the stock?
- A. 7.90%
  - B. 8.52%
  - C. 10.04%
  - D. 10.67%
  - E. 11.37%
82. Which of the following is more appealing? Why?
- Stock X bought at \$34 a share and sold for \$36 in three months.  
Stock Y bought at \$120 a share and sold for \$130 in six months.  
No dividend is paid for either stock.
- A. Y as it has a higher holding period percentage return
  - B. X because of the lower investment cost
  - C. X due to its higher effective annual return
  - D. Y since it provides a better dollar return
  - E. X and Y are equally attractive

83. Suppose that you purchased a growth stock paying no dividend six months ago at \$30.85 per share and sold the stock at \$43.57 yesterday. What was your annualized return?
- A. 10.28%
  - B. 49.57%
  - C. 73.12%
  - D. 99.46%
  - E. 41.23%
84. While you purchased a zero-coupon bond at \$30.85 two years, you were lucky enough to sell the bond at \$43.57 yesterday. What was your annualized return?
- A. 9.19%
  - B. 21.62%
  - C. 37.12%
  - D. 41.23%
  - E. 18.84%
85. A Treasury bill with a face value of \$1,000 is selling for \$990. If this instrument matures in 30 days, what is its annualized return?
- A. 11.04%
  - B. 12.68%
  - C. 13.01%
  - D. 11.61%
  - E. 12.87%
86. The geometric return on a stock over the past 15 years has been 9.3%. The arithmetic return over the same period was 11.1%. What is the best estimate of the return on this stock over the next 10 years?
- A. 11.04%
  - B. 10.20%
  - C. 9.94%
  - D. 10.61%
  - E. 11.87%
87. Tom decides to begin investing some portion of his annual bonus, beginning this year with \$5,000. In the first year he earns a 10% return and adds \$3,500 to his investment. In the second his portfolio loses 5% but, sticking to his plan, he adds \$500 to his portfolio. In this year his portfolio returns 2%. What is Tom's dollar-weighted average return on his investments?
- A. 0.34%
  - B. 1.02%
  - C. 1.54%
  - D. 2.23%
  - E. 2.58%
88. A stock has an arithmetic average return of 10.4% and a geometric average return of 8.8% based on the annual returns for the last 25 years. What is the best estimate of the annual return on this stock over the next 5 years?
- A. 11.04%
  - B. 12.68%
  - C. 13.01%
  - D. 10.13%
  - E. 12.87%

89. You own a stock that has produced an average geometric return of 9.7% and an average arithmetic return of 11.4% over the past 18 years. What annual rate of returns should you expect to earn on this security over the next 6 years?
- A. 11.04%
  - B. 12.68%
  - C. 13.01%
  - D. 11.61%
  - E. 10.90%
90. You know that historically small capitalization stocks have provided the highest average return. Given this fact, why doesn't everyone invest in small stocks?
91. What are the two most important lessons from capital market history?
92. Should we consider the capital gain as part of your return whether or not you have actually sold the security?
93. Historically, stocks have outperformed bonds. Given this, why do investors still purchase bonds?

## ch 1 Key

1. B
2. E
3. C
4. D
5. E
6. A
7. A
8. C
9. A
10. D
11. B
12. D
13. C
14. B
15. C
16. A
17. D
18. D
19. D
20. B
21. B
22. E
23. C
24. D
25. A
26. D
27. D
28. B
29. C
30. A
31. E
32. E
33. B
34. E
35. D
36. B

37. B  
38. B  
39. D  
40. B  
41. E  
42. C  
43. E  
44. E  
45. E  
46. A  
47. B  
48. D  
49. E  
50. D  
51. E  
52. C  
53. E  
54. D  
55. C  
56. E  
57. D  
58. C  
59. C  
60. A  
61. C  
62. B  
63. E  
64. A  
65. B  
66. C  
67. E  
68. B  
69. D  
70. C  
71. B  
72. E  
73. E  
74. C

75. B

76. C

77. B

78. C

79. C

80. E

81. D

82. C

83. D

84. E

85. C

86. C

87. B

88. D

89. E

90. A good answer would explain the risk-return tradeoff. Not every investor has a high risk tolerance. Investors with a low risk tolerance are willing to invest in T-bills, bonds, or other lower risk investments and forego the possibility of higher returns.

91. First, risky assets earn a risk premium on average. This is the reward for bearing risk. Second, the greater the potential reward from a risky investment, the greater is the risk.

92. Since the capital gain is not a "paper" gain, it is amount you actually earn. Therefore, you must count it as part of your return. Whether you want to keep the security and do not sell is irrelevant because you could have converted it to cash realizing the gain if you had wanted to.

93. Bonds provide a steady stream of income that is attractive to many investors. Moreover, bonds may involve less risk than stocks. Investors purchase securities that match their risk-tolerance level as some investors are more risk-averse than others.

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