

1. The rate of exchange between future consumption and current consumption is
- the nominal risk-free rate.
 - the coefficient of investment exchange.
 - the pure rate of interest.
 - the consumption/investment paradigm.
 - the expected rate of return.

ANS: c

2. The coefficient of variation is a measure of
- central tendency.
 - absolute variability.
 - absolute dispersion.
 - relative variability.
 - relative return.

ANS: d

3. The nominal risk free rate of interest is a function of
- the real risk free rate and the investment's variance.
 - the prime rate and the rate of inflation.
 - the T-bill rate plus the inflation rate.
 - the tax free rate plus the rate of inflation.
 - the real risk free rate and the rate of inflation.

ANS: e

4. In the phrase 'nominal risk free rate', nominal means
- computed.
 - historical.
 - market.
 - average.
 - risk adverse.

ANS: c

5. If a significant change is noted in the yield of a T-bill, the change is most likely attributable to
- a downturn in the economy.
 - a static economy.
 - a change in the expected rate of inflation.
 - a change in the real rate of interest.
 - a change in risk aversion.

ANS: c

6. Which of the following is not a component of the risk premium?
- business risk
 - financial risk
 - liquidity risk
 - exchange rate risk
 - unsystematic market risk

ANS: e

7. The variability of operating earnings is associated with

- a. business risk.
- b. liquidity risk.
- c. exchange rate risk.
- d. financial risk.
- e. market risk.

ANS: a

8. What will happen to the security market line (SML) if the following events occur, other things constant: (1) inflation expectations increase, and (2) investors become more risk averse?

- a. shift up and keep the same slope
- b. shift up and have less slope
- c. shift up and have a steeper slope
- d. shift down and keep the same slope
- e. shift down and have less slope

ANS: c

9. A decrease in the expected real growth in the economy, all other things constant, will cause the security market line to

- a. shift up.
- b. shift down.
- c. have a steeper slope.
- d. have a flatter slope.
- e. remain unchanged.

ANS: b

10. Unsystematic risk refers to risk that is

- a. undiversifiable.
- b. diversifiable.
- c. due to fundamental risk factors.
- d. due to market risk.
- e. none of the above

ANS: b

11. Two factors that influence the nominal risk-free rate are

- a. the relative ease or tightness in capital markets and the expected rate of inflation.
- b. the expected rate of inflation and the set of investment opportunities available in the economy.
- c. the relative ease or tightness in capital markets and the set of investment opportunities available in the economy.
- d. time preference for income consumption and the relative ease or tightness in capital markets.
- e. time preference for income consumption and the set of investment opportunities available in the economy.

ANS: a

12. Measures of risk for an investment include

- a. variance of returns and business risk.
- b. coefficient of variation of returns and financial risk.
- c. business risk and financial risk.

- d. variance of returns and coefficient of variation of returns.
- e. all of the above.

ANS: d

13. Modern portfolio theory assumes that most investors are

- a. risk averse.
- b. risk neutral.
- c. risk seekers.
- d. risk tolerant.
- e. none of the above.

ANS: a

14. Which of the following is not a component of the required rate of return?

- a. expected rate of inflation
- b. time value of money
- c. risk
- d. holding period return
- e. all of the above are components of the required rate of return

ANS: d

15. All of the following are major sources of uncertainty EXCEPT

- a. business risk.
- b. financial risk.
- c. default risk.
- d. country risk.
- e. liquidity risk.

ANS: c