

Student name: _____

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

The material wealth of a society is a function of:

all financial assets.

all real assets.

all financial and real assets.

all physical assets.

all physical and financial assets.

_____ are real assets.

Land and mortgages

Machines and bonds

Stocks and bonds

Knowledge and stocks

Land, machines, and knowledge

The means by which individuals hold their claims on real assets in a well-developed economy are:

investment assets.

depository assets.

derivative assets.

financial assets.

exchange-driven assets.

_____ are financial assets.

Bonds and land

Machines and derivatives

Stocks and intellectual property

Bonds and stocks

Bonds, machines, and stocks

_____ financial asset(s).

Buildings are

Land is a

Derivatives and intellectual property are

U.S. agency bonds and buildings are

Derivatives and U.S. agency bonds are

Financial assets:

directly contribute to the country's productive capacity.

indirectly contribute to the country's productive capacity.

contribute to the country's productive capacity, both directly and indirectly.

do not contribute to the country's productive capacity, either directly or indirectly.

are of no value to anyone.

In 2021, _____ was the most significant real asset of U.S. households in terms of total value.

consumer durables

automobiles

real estate

mutual fund shares

bank loans

In 2021, _____ was the least significant financial asset of U.S. households in terms of total value.

real estate
mutual fund shares
debt securities
life insurance reserves
pension reserves

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mutual fund shares
debt securities
life insurance reserves
pension reserves

In 2021, _____ were the most significant liability of U.S. households in terms of total value.

credit cards
mortgages
bank loans
student loans

other forms of debt

In 2021, which of the following financial assets make up the greatest proportion of the financial assets held by U.S. households?

Pension reserves

Life insurance reserves

Mutual fund shares

Debt securities

Personal trusts

In 2021, _____ of the assets of U.S. households were financial assets.

24.4%

28.9%

58.4%

71.1%

87.2%

The largest component of domestic net worth in 2021 was:

nonresidential real estate.

residential real estate.

inventories.

consumer durables.

equipment and software.

The smallest component of domestic net worth in 2021 was:

nonresidential real estate.

residential real estate.

inventories.

consumer durables.

equipment and software.

The domestic net worth of the U.S. in 2021 was:

\$9.350 trillion.

\$20.813 trillion.

\$45.816 trillion.

\$86.282 trillion.

\$80.983 trillion.

A fixed-income security pays:

a fixed level of income for the life of the owner.

a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security.

a variable level of income for owners on a fixed income.

a fixed or variable income stream at the option of the owner.

None of the choices are correct.

A debt security pays:

a fixed level of income for the life of the owner.

a variable level of income for owners on a fixed income.

a fixed or variable income stream at the option of the owner.

a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security.

Money market securities:

are short term.

are highly marketable.

are generally very low risk.

None of the options are correct.

All of the options are correct.

An example of a derivative security is:

a common share of Microsoft but not a commodity futures contract.

a call option on Intel stock but not a commodity futures contract.

a commodity futures contract or a common share of Microsoft.

a call option on Intel stock or a commodity futures contract.

a common share of Microsoft or a call option on Intel stock.

The value of a derivative security:

depends on the value of the related security.

is unable to be calculated.

is unrelated to the value of the related security.

has been enhanced due to the recent misuse and negative publicity regarding these instruments.

is worthless today.

Although derivatives can be used as speculative instruments, businesses most often use them to:

attract customers.

appease stockholders.

offset debt.

hedge risks.

enhance their balance sheets.

Financial assets permit all of the following except:

consumption timing.

allocation of risk.

separation of ownership and control.

elimination of risk.

All of the choices are correct.

The _____ refers to the potential conflict between management and shareholders.

agency problem

diversification problem

liquidity problem

solvency problem

regulatory problem

A disadvantage of using stock options to compensate managers is that:

it encourages managers to undertake projects that will increase stock price.

it encourages managers to engage in empire building.

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.

All of the choices are correct.

None of the choices are correct.

Which of the following are mechanisms that have evolved to mitigate potential agency problems?

1. Using the firm's stock options for compensation
2. Hiring bickering family members as corporate spies
3. Boards of directors forcing out underperforming management
4. Security analysts monitoring the firm closely
5. Takeover threats

II and V

I, III, and IV

I, III, IV, and V

III, IV, and V

I, III, and V

Corporate shareholders are best protected from incompetent management decisions by:

the ability to engage in proxy fights.

management's control of pecuniary rewards.

the ability to call shareholder meetings.

the threat of takeover by other firms.

one-share per one-vote election rules.

Theoretically, takeovers should result in:

improved management and decreased stock price.

increased stock price and increased benefits to existing management of the taken-over firm.

increased benefits to existing management of the taken-over firm.

improved management and increased stock price.

All of the options are correct.

During the period between 2000 and 2002, a large number of scandals were uncovered. Most of these scandals were related to:

1. manipulation of financial data to misrepresent the actual condition of the firm.
2. misleading and overly optimistic research reports produced by analysts.
3. allocating IPOs to executives as a quid pro quo for personal favors.
4. greenmail.

II, III, and IV

I, II, and IV

II and IV

I, III, and IV

I, II, and III

The Sarbanes-Oxley Act:

requires corporations to have more independent directors.

requires the firm's CFO to personally vouch for the firm's accounting statements.

prohibits auditing firms from providing other services to clients.

requires corporations to have more independent directors and requires the firm's CFO to personally vouch for the firm's accounting statements.

All of the choices are correct.

Asset allocation refers to:

choosing which securities to hold based on their valuation.

investing only in "safe" securities.

the allocation of assets into broad asset classes.

bottom-up analysis.

All of the choices are correct.

Security selection refers to:

choosing which securities to hold based on their valuation.

investing only in "safe" securities.

the allocation of assets into broad asset classes.

top-down analysis.

All of the choices are correct.

Which of the following portfolio construction methods starts with security analysis?

Top-down

Bottom-up

Middle-out

Buy and hold

None of the choices are correct.

Which of the following portfolio construction methods starts with asset allocation?

Top-down

Bottom-up

Middle-out

Buy and hold

Asset allocation

_____ are examples of financial intermediaries.

Commercial banks

Insurance companies

Investment companies

Credit unions

All of the options are correct.

Financial intermediaries exist because small investors cannot efficiently:

diversify their portfolios.

assess credit risk of borrowers.

advertise for needed investments.

diversify their portfolios and assess credit risk of borrowers.

All of the options are correct.

_____ specialize in helping companies raise capital by selling securities.

Commercial bankers

Investment bankers

Investment issuers

Credit rating agencies

All of the choices are correct.

Commercial banks differ from other businesses in that both their assets and their liabilities are mostly:

illiquid.

financial.

real.

owned by the government.

regulated.

In 2021, _____ was(were) the most significant financial asset(s) of U.S. commercial banks in terms of total value.

loans and leases

cash

real estate

deposits

investment securities

In 2021, _____ was(were) the most significant liability(ies) of U.S. commercial banks in terms of total value.

loans and leases

cash

real estate

deposits

investment securities

In 2021, _____ was(were) the most significant real asset(s) of U.S. nonfinancial businesses in terms of total value.

equipment and software

inventory

real estate

trade credit

marketable securities

In 2021, _____ was(were) the least significant real asset(s) of U.S. nonfinancial businesses in terms of total value.

equipment and software

inventory

real estate

trade credit

marketable securities

In 2021, _____ was(were) the least significant liability(ies) of U.S. nonfinancial businesses in terms of total value.

bonds

bank loans and mortgages

inventories

trade debt

marketable securities

In terms of total value, the most significant liability(ies) of U.S. nonfinancial businesses in 2021 was(were):

bank loans and mortgages.

debt securities.

trade debt.

other loans.

marketable securities.

In 2021, _____ was(were) the least significant financial asset(s) of U.S. nonfinancial businesses in terms of total value.

cash and deposits

trade credit

trade debt

inventory

marketable securities

New issues of securities are sold in the _____ market(s).

primary

secondary

over-the-counter

primary and secondary

All of the choices are correct.

Investors trade previously issued securities in the _____ market(s).

primary

secondary

primary and secondary

derivatives

derivatives and primary

Investment bankers perform which of the following role(s)?

Market new stock and bond issues for firms

Provide advice to the firms as to market conditions, price, etc.

Design securities with desirable properties

All of the options are correct.

None of the options are correct.

Until 1999, the _____ Act(s) prohibited banks in the United States from both accepting deposits and underwriting securities.

Sarbanes-Oxley

Glass-Steagall

SEC

Sarbanes-Oxley and SEC

None of the options are correct.

The spread between the LIBOR and the Treasury-bill rate is called the:

term spread.

T-bill spread.

LIBOR spread.

TED spread.

All of the choices are correct.

Mortgage-backed securities were created when _____ began buying mortgage loans from originators and bundling them into large pools that could be traded like any other financial asset.

GNMA

FNMA

FHLMC

FNMA and FHLMC

GNMA and FNMA

The sale of a mortgage portfolio by setting up mortgage pass-through securities is an example of:
credit enhancement.

credit swap.

unbundling.

derivatives.

All of the choices are correct.

Which of the following is true about mortgage-backed securities?

1. They aggregate individual home mortgages into homogeneous pools.
2. The purchaser receives monthly interest and principal payments received from payments made on the pool.
3. The banks that originated the mortgages maintain ownership of them.
4. The banks that originated the mortgages may continue to service them.

II, III, and IV

I, II, and IV

II and IV

I, III, and IV

I, II, III, and IV

_____ were designed to concentrate the credit risk of a bundle of loans on one class of investor, leaving the other investors in the pool relatively protected from that risk.

Stocks

Bonds

Derivatives

Collateralized debt obligations

All of the options are correct.

_____ are, in essence, an insurance contract against the default of one or more borrowers.

Credit default swaps

CMOs

ETFs

Collateralized debt obligations

All of the options are correct.

The technology behind cryptocurrencies that is ideal for secure digital transactions is called _____.

bitcoin

blockchain

distributed ledgers

ethereum

All of the options are correct.

A major problem experienced by cryptocurrency, which makes it problematic to store value is _____.

distributed ledgers

blockchain

price volatility

transaction security

All of the options are correct.

Which country(ies) has banned initial coin offerings?

China and South Korea

Germany and Austria

Japan

USA

All of the options are correct.

The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 exempted smaller banks from which rule?

Liquidity

Reserves

Demand deposit

Volcker

All of the options are correct.

According to the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 many larger banks are no longer considered _____.

insurable

high risk

insolvent

systematically important

All of the options are correct.

Answer Key

Test name: Ch1_Investments_13e

B

The material wealth of a society is a function of all real assets.

E

Land, machines, and knowledge are real assets; stocks and bonds are financial assets.

D

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 the auto company than to own an auto company directly.

D

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

E

Buildings and land are real assets.

B

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.

C

Assets	\$	%	Liabilities and	\$	%
	Billio	Total	Net Worth	Billio	Total
	n			n	
Real assets			Liabilities		
Real estate	\$	24.	Mortgages	\$	7.4
	37,5	4%		11,3	%
	58			31	
Consumer durables	6,36	4.1	Consumer credit	4,16	2.7
	2	%		3	%
Other	679	0.4	Bank and other	1,12	0.7
		%	loans	5	%
Total real assets	\$	28.	Other	624	0.4
	44,5	9%			%
	99				
			Total	\$	11.
			liabilities	17,2	2%
				44	
Financial assets					
Deposits and money	\$	11.			
market shares	17,3	3%			
	74				
Life insurance	1,85	1.2			
reserves	4	%			
Pension reserves	29,8	19.			
	76	4%			
Corporate equity	28,2	18.			
	85	3%			
Equity in	13,1	8.5			
noncorporate business	14	%			
Mutual fund shares	11,6	7.6			
	61	%			
Debt securities	5,77	3.7			
	2	%			
Other	1,62	1.1			
	6	%			
Total financial	\$	71.	Net worth	136,	88.
assets	109,	1%		917	8%
	562				

Total				
	\$	1	\$	100
	154,	0	154,	.0%
	161	0	161	
		.		
		0		
		%		

Balance sheet of U.S. households

Note: Column sums may differ from total because of rounding error.

Source: *Flow of Funds Accounts of the United States*, Board of Governors of the Federal Reserve System, June 2021.

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B

Assets	\$ Billion
Commercial real estate	\$ 20,842.9
Residential real estate	45,816.3
Equipment and intellectual property	10,316.2
Inventories	2,944.5
Consumer durables	6,361.9
Total	\$ 86,282

Note: Column sums may differ from total because of rounding error.

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A fixed-income security pays a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security.

D

A debt security pays a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security.

E

All answers are correct.

D

The values of a call option on Intel stock and a commodity futures contract are derived from that of an underlying asset; the value of a common share of Microsoft is based on the value of the firm only.

A

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

D

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.

D

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

A

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

C

Encouraging managers to undertake projects that will increase stock price is a desired characteristic. Encouraging managers to engage in empire building is not necessarily a good or bad thing in and of itself. Creating an incentive for managers to manipulate information to prop up a stock price temporarily creates an agency problem.

C

All the options except hiring bickering family members as corporate spies have been used to try to limit agency problems.

D

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.

D

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.

E

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

E

The Sarbanes-Oxley Act does all of the above.

C

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

A

Security selection refers to choosing which securities to hold based on their valuation.

B

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.

A

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

E

All are institutions that bring borrowers and lenders together.

E

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.

B

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

B

Assets	\$	%	Liabilities and Net	\$	%
	Billion	Total	Worth	Billion	Total
		1			1
Real assets			Liabilities		
Equipment and premises	\$ 187.5	0.8 %	Deposits	\$ 18,458.8	81.8 %
Other real estate	4.4	0.0	Debt and other borrowed funds	595.6	2.6
Total real assets	\$ 191.9	0.9 %	Federal funds and repurchase agreements	297.8	1.3
			Other	959.1	4.3
			Total liabilities	\$ 20,311.2	90.0 %
Financial assets					
Cash	\$ 3,628.6	16.1 %			
Investment securities	5,479.3	24.3			
Loans and leases	10,610.7	47.0			
Other financial assets	1,371.4	6.1			
Total financial assets	\$ 21,090.1	93.5 %			
Other assets					
Intangible assets	\$ 392.0	1.7 %			
Other	890.2	3.9			

Total other	\$	5.7	Net worth	\$	10.
assets	1,28	%		2,253	0%
	2.2			.0	
Total	\$	100		\$	100
	22,5	.0%		22,56	.0%
	64.2			4.2	

Balance sheet of FDIC-insured commercial banks and savings institutions

Note: Column sums may differ from total because of rounding error.

Source: Federal Deposit Insurance Corporation, www.fdic.gov, June 2021.

A

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C

Assets	\$	%	Liabilities and	\$	%
	Billion	Total	Net Worth	Billion	Total
		1			
Real assets			Liabilities		
Equipment and intellectual property	\$ 8,428	16.6%	Debt securities	\$ 7,387	14.5%
Real estate	14,859	29.2%	Bank loans and mortgages	1,772	3.5%
Inventories	2,687	5.3%	Other loans	2,077	4.1%
Total real assets	\$ 25,974	51.1%	Trade debt	3,121	6.1%
			Other	10,319	20.3%
			Total liabilities	\$ 24,676	48.5%
Financial assets					
Deposits and cash	\$ 2,326	4.6%			
Marketable securities	4,032	7.9%			
Trade and consumer credit	4,296	8.4%			
Other	14,229	28.0%			
Total financial assets	\$ 24,883	48.9%	Net worth	\$ 26,181	51.5%
Total	\$ 50,856	100.0%		\$ 50,856	100.0%

Balance sheet of U.S. nonfinancial corporations

Note: Column sums may differ from total because of rounding error.

Source: *Flow of Funds Accounts of the United States*, Board of Governors of the Federal Reserve System, June 2021.

B

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A

New issues of securities are sold in the primary market.

B

Investors trade previously issued securities in the secondary market.

D

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

B

Until 1999, the Glass-Steagall Act prohibited banks in the United States from both accepting deposits and underwriting securities.

D

The spread between the LIBOR and the Treasury-bill rate is called the TED spread.

D

Mortgage-backed securities were created when FNMA and FHLMC began buying mortgage loans from originators and bundling them into large pools that could be traded like any other financial asset.

B

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

B

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

D

Collateralized debt obligations were designed to concentrate the credit risk of a bundle of loans on one class of investor, leaving the other investors in the pool relatively protected from that risk.

A

Credit default swaps are in essence an insurance contract against the default of one or more borrowers.

B

C

A

D

D