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#### **Chapter 2: Financial Markets and Financial Instruments**

Name:		

### TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 1) Financial markets only involve buyers and sellers of financial instruments.
- 2) A college education can be considered an investment.
- 3) When calculating a holding period of return, dividends are excluded.
- 4) Stock prices are based upon the future value of cash flows.
- 5) Bond prices are indexed relative to 100.
- 6) The current yield of a bond is the rate of return on a bond if you hold it until maturity.
- 7) Interest expense is tax deductible but dividends are not.
- 8) More shares are traded on the Nasdaq on a daily basis than the NYSE.
- 9) A market maker is someone who works for someone wanting to sell her stock.
- 10) A bond with a rating of AA is better than a bond rated AAA.
- 11) As interest rates decline, the prices of outstanding bonds rise.
- 12) The return on commercial paper is guaranteed by the federal government.
- 13) Most stock trading occurs on the secondary market.
- 14) The bid price is the price a broker will give you for the stock you want to sell.
- 15) Forward contracts are easier to sell than a futures contract.
- 16) American hospitality companies really don't have to worry about foreign currency.
- 17) Insurance companies have decreased their loans to hospitality firms in recent years.
- 18) Futures contracts only are used with physical commodities.
- 19) The annual returns of the Dow Jones Industrial Average and the S&P 500 index are highly positively correlated.

20) We measure the uncertainty of an investment by its mean (average) return.

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

- 21) People invest
  - A) to make a lot of money.
  - B) so they can buy things now.
  - C) to increase future consumption.
  - D) to keep up with the times.
- 22) If a \$1,000 bond is selling for 97, what is the selling price in dollars?
  - A) \$970
  - B) \$97
  - C) \$1,030
  - D) \$1,070
- 23) Assume you buy a share of stock for \$20 and hold it for one year. During the year you receive \$1.20 in dividends. At the end of the year you sell the stock for \$19. What is your holding period return (pre-tax)?
  - A) 6.32%
  - B) 1%
  - C) 6.0%
  - D) 5.0%
- 24) What are the three factors that affect the present value of future cash flows?
  - A) timing, magnitude, and size
  - B) timing, magnitude, and risk
  - C) date cash flows are received, date stock was purchased, and taxes
  - D) type of cash flows, size of firm, and amount
- 25) Which of the following is considered to have the lowest risk?
  - A) an Aa bond from Hilton Hotels
  - B) a Ba bond from Cendant Corporation
  - C) commercial paper from McDonald's
  - D) a treasury bill from the U.S. government
- 26) You currently hold a bond from Marriott International that pays you 8 percent. If interest rates rise the price of your bond will:
  - A) increase.
  - B) decrease.
  - C) only decrease if interest rates go above 8 percent.
  - D) be unchanged because the price depends on the risk of the company.
- 27) The first stock issue available to the public is called

- A) a first sale.
- B) secondary trading.
- C) an IPO.
- D) stock hedging.
- 28) A government agency involved in the secondary mortgage market is
  - A) FDIC.
  - B) Fannie Mae.
  - C) GAO.
  - D) IRS.
- 29) The best way for a large hospitality firm to hedge a price increase in a commodity would be to
  - A) do nothing and hope the price will decrease.
  - B) dramatically increase the price on your menu.
  - C) buy a futures contract.
  - D) buy a lot of the product now from a local purveyor with a lot of cash.
- 30) How can we get out of a futures contract?
  - A) Take an equal and opposite position in another contract.
  - B) Just let the contract expire.
  - C) Sell the contract.
  - D) Both a and c.
- 31) You run a hotel in Belgium that is owned by an American company. If the Euro strengthens against the dollar, your converted dollar profits will be
  - A) higher.
  - B) lower.
  - C) the same because we report our profits in Euros.
  - D) can't tell from information given.
- 32) You manage a McDonald's in Germany. At the beginning of the year, the exchange rate was \$1 = 1Euro. At the end of the year, the exchange rate is \$1 = .90Euro. You report profits of 450,000 Euros. How much have your profits increased in terms of dollars from the exchange rate change during the year?
  - A) 10%
  - B) 90%
  - C) 11.11%
  - D) unkown from information given
- 33) Given a two-year loan of \$50,000 and an annual interest rate of 8 percent, how much interest will accrue during the life of the loan? (Assume no principal payments during the term.)
  - A) \$4,000
  - B) \$8,000
  - C) \$400

- D) None of the above
- 34) A measure of uncertainty in stock returns is
  - A) weighted average.
  - B) mean.
  - C) correlation coefficient.
  - D) standard deviation.
- 35) You own the following portfolio of stocks that have achieved the following returns.

Stock	Percentage of Portfolio	Return Percentage
A	25%	8%
В	65%	4%
$\mathbf{C}$	10%	-5%

The weighted average return is

- A) approximately 4.33 percent.
- B) approximately 4.10 percent.
- C) approximately 2.33 percent.
- D) approximately 33 percent.
- 36) An 81/2 09 bond is currently selling for 102.50. The principal amount is \$1,000.

The current yield on the bond is

- A) 8.5 percent.
- B) 9 percent.
- C) 8.29 percent.
- D) none of the above.

### **ANSWER KEY—Chapter 2: Financial Markets and Financial Instruments**

- 1) FALSE
- 2) TRUE
- 3) FALSE
- 4) FALSE
- 5) TRUE
- 6) FALSE
- 7) TRUE
- 8) TRUE
- 9) FALSE
- 10) FALSE
- 11) TRUE
- 12) FALSE
- 13) TRUE
- 14) FALSE
- 15) FALSE
- 16) FALSE
- 17) TRUE
- 18) FALSE

- 19) TRUE
- 20) FALSE
- 21) C
- 22) A
- 23) B
- 24) B
- 25) D
- 26) B
- 27) C
- 28) A, B
- 29) C
- 30) D
- 31) A
- 32) C
- 33) B
- 34) D
- 35) B
- 36) D