Quiz

1. Which of the following are given as possible means of creating valuable financing opportunities?
I. packaging securities in a manner which receives the greatest value
II. finding a means of reducing the issue costs of new securities
III. packaging securities in a manner which lowers taxes
IV. creating a new security to meet the needs of an unsatisfied clientele

A. I, II, and III
B. I, III, and IV
C. I, II, and IV
D. II, III, and IV
E. I, II, III, and IV

Option IV is also correct.

2. A subsidy provided by the local government to entice a firm to locate in its community is considered one means of _____ in an attempt to create a valuable _____ opportunity.

A. increasing firm revenues; financing
B. increasing firm revenues; capital budgeting
C. reducing firm costs; financing
D. reducing firm costs; capital budgeting
E. creating a new security; financing

A government subsidy reduces costs for a firm.

3. The City of Water Town has agreed to provide Creekside Industries $1.2 million in 3-year industrial, tax-exempt bonds if Creekside Industries will agree to build a new facility within the city limits. The bonds will have a coupon rate of 4.80 percent and pay interest annually. Creekside Industries normally has a cost of debt of 9 percent. What is the net present value of this subsidy? Ignore taxes.

A. $0
B. $54,240
C. $**127,577**
D. $142,852
E. $158,607

The discount rate is 9 percent and the annual interest is $57,600.

4. The City of Detroit is trying to convince a local auto parts manufacturer that they should expand and also modernize their facility. As an economic incentive, the city has offered $3 million of 10-year industrial bonds. The interest rates on these bonds will be 3.5 percent as compared to the firm's normal cost of debt of 8.15 percent. What is the value of the economic incentive being offered by the City of Detroit?

A. $105,000
B. $244,500
C. $629,438
D. $819,929
E. $929,756

The discount rate is 8.15 percent and the annual interest is $105,000.

5. Which one of the following statements is correct if the financial markets are efficient?

A. Stock prices take an average of 24 hours to adjust to new information.
B. If you hear an announcement by a firm and place a trade within the next twenty minutes, you can earn an abnormal rate of return.

C. Firms can only receive an overvalued price for their securities if they fool the investors.
D. Investors should expect to earn a normal rate of return.
E. Investors on average will earn less than the normal rate of return.

Investors should expect to earn the normal rate of return.

6. Which one of the following pricing patterns reflects an overreaction and reversion in an inefficient stock market? Assume the prices occur over six days and only one event occurred which affects the stock price. That event occurred at the beginning of day two.

A. $20, $23, $24, $25, $25, $25
B. $20, $25, $24, $23, $23, $23
C. $20, $20, $20, $23, $23, $23
D. $20, $18, $18, $18, $18, $18
E. $20, $20, $20, $22, $22, $22

This is a delayed response.

7. A delayed response indicates that:

A. investors are slow to react to new information.
B. investors jump to conclusions and then modify those conclusions over time.
C. investors trade on rumors rather than delay until an actual announcement is made.
D. firms delay making official announcements until the market has corrected its over adjustment to the news as leaked through informal outlets.
E. the markets are fully efficient as investors need time to analyze new data as it becomes available.

This isdelayed response is an indication of an inefficient market.

8. Which of the following are conditions that independently can cause market efficiency?

I. independent deviations from rationality
II. dividend distributions
III. rationality
IV. arbitrage

A. I and III only
B. II and IV only
C. I, III, and IV only
D. II, III, and IV only
E. I, II, III, and IV

Dividend distributions do not cause market efficiency.

9. Assume the capital markets are efficient. If you research a stock and identify a specific trading pattern:

A. you will be able to earn excess profits on that stock for an extended period of time.
B. that pattern will exist for a period of time but will slowly disappear.
C. you can delay responding to the opportunity since you know it will be there for a few days.
D. that pattern will rapidly disappear.
E. you should earn excessive profits as the same pattern should exist with similar securities.

Trading patterns quickly disappear in an efficient market.

10. The efficient market hypothesis (EMH) suggests that:

A. it takes between one and two hours for new information to be reflected in stock prices.
B. investors should expect to earn less than normal rates of return over the long-term.
C. a graph of stock prices will look like rounded hills and valleys.
D. **stock prices adjust before individual investors can respond to news announcements**.
E. investors can be fooled over the short-term.

EMH states that investors cannot be fooled.