Chapter 2

Buying and Selling Securities

EASY

D 1. Placing an order to buy or sell stocks involves
a. fixed-size commission fees
b. identical call money rates
c. an NYSE-certified brokerage firm
d. round lots, odd lots, or both

C 2. When an investor specifies a time limit on the order, it indicates the
a. time that the exchange is open
b. amount of price movement allowed by the investor
c. time to fill the order during the day it was entered
d. commission based on the time it takes to fill the order

B 3. The type of order in which the broker attempts to fill the order the day in which it is entered is known as a ____ order.
a. market
b. day
c. limit
d. stop

A 4. Good-till-canceled orders expire when they are
a. either filled or canceled by the investor
b. below the market price at the time of the order
c. executed with a stop order
d. priced greater than the limit price

D 5. A _____ account is like a checking account that has overdraft privileges.
a. cash
b. market
c. restricted
d. margin

D 6. When opening a margin account with a brokerage firm, an investor must sign a ______ agreement.
a. commission-waiver
b. hold-harmless
c. limit order
d. hypothecation

C 7. The minimum percentage of the purchase price that must come from the investor's own funds is known as the
   a. maintenance margin
   b. margin account
   c. initial margin requirement
   d. debit balance

B 8. When an investor sells a security first and buys it back later, it is known as
   a. margin selling
   b. a short sale
   c. discounting
   d. a wash

A 9. The trading rule which states that a short sale must be made on a plus- or zero-tick is known as the
   a. up-tick rule.
   b. down-tick rule.
   c. maintenance margin.
   d. circuit breaker.

D 10. If the broker does not hold the stock that a client wishes to sell short, another method to obtain the securities for the sale is through
   a. margin buying
   b. stock swaps
   c. securities lending
   d. credit buying

C 11. When multiple margin purchases are made, the transactions are ______ in one account in order to determine whether the account is undermargined, restricted, or overmargined.
   a. collateralized
   b. indexed
   c. aggregated
   d. arbitraged

B 12. Hedge funds are designed to make money regardless of the
   a. amount of the commission
   b. overall direction of the market
   c. country in which they are purchased
   d. risk preference of the investor

D 13. Since stock brokerage commissions have been deregulated,
   a. discount brokers have become illegal.
   b. all brokers must provide research.
   c. commission rates have risen for institutional investors.
   d. commission rates have risen for small investors.

Chapter 2

B 14. When an investor places an order with a brokerage firm, he or she does not need to specify
a. name of the security's company.
b. market on which the security is traded.
c. type of order.
d. whether to buy or to sell shares.

A 15. A buy order for 50 shares is called a(an)
a. odd lot.
b. multiple lot.
c. round lot.
d. small lot.

B 16. Open stock orders are also known as
a. fill-or-kill.
b. good-till-cancelled.
c. day orders.
d. limit orders.

C 17. A stop sell order
a. must be executed within one day.
b. will limit profits if the price rises.
c. is used to lock in paper profits.
d. also includes a limit price.

D 18. The amount borrowed during a margin purchase is referred to as the investor's
a. hypothecation agreement.
b. asset balance
c. negative credit.
d. debit balance.

A 19. The minimum initial margin requirement is controlled by the
a. Federal Reserve Board.
b. SIPC.
c. NASD.
d. FDIC.

B 20. Investments held at brokerage firms are insured by
a. FDIC.
b. SIPC.
c. CUNA.
d. FSLIC.

D 21. An investor's securities held at a brokerage firm are insured for a value of at least
- a. $2,500,000.
- b. $1,000,000.
- c. $100,000.
- d. $500,000.

A 22. The margin to purchase Treasury securities is
- a. typically lower than common stock.
- b. higher than convertible bonds.
- c. the same as common stock.
- d. not allowable.

D 23. The minimum maintenance margin for common stocks is set by
- a. the Federal Reserve Board.
- b. individual brokerage firms.
- c. SIPC.
- d. individual exchanges.

C 24. To resolve a margin call, an investor could
- a. borrow more money.
- b. buy more of the security.
- c. deposit more cash.
- d. sell the stock short.

D 25. To be certain that order will be executed in the market, an investor will place a
- a. limit order.
- b. stop order.
- c. stop limit order.
- d. market order.

A 26. If an investor holds common stocks in street name, he or she
- a. still receives the dividends.
- b. gives up voting rights.
- c. will not receive an annual report.
- d. can't open a margin account.

C 27. Short sellers
- a. have a six month time limit to return the shares.
- b. do not have a margin requirement.
- c. feel that the security price will drop.
- d. receive the dividend during the short sale.

B 28. An investor uses 50% margin to invest, and the stock price rises by 10%. His rate of return (ignoring interest charges and dividends) would be
- a. 50%.
- b. 20%.
- c. 10%.
- d. 30%.

A 29. Professionally managed hedge funds
- a. take both short and long portions.
- b. are not allowed to receive interest on their short margin.
- c. are publicly traded organizations.
- d. have traditionally had returns lower than the market.

B 30. The most a short seller can lose is
- a. the value of dividends during the short sale period.
- b. unlimited.
- c. the original stock sales price.
- d. 50% of the original investment.

MEDIUM

B 31. After purchasing common stock on margin, an investor can calculate his Actual Margin by
- a. loan/equity.
- b. equity/market value.
- c. market value/loan.
- d. loan/market value.

A 32. For a short sale, the Actual Margin is
- a. equity/loan.
- b. market value/loan.
- c. loan/market value.
- d. market value/equity.

D 33. An investor uses 50% margin to invest and the stock price drops by 15%. His rate of return (ignoring interest charges and dividends) would be
- a. -10%.
- b. -20%.
- c. -30%.
- d. -40%.

C 34. An investor uses 70% margin to buy stock with a market price of $50. If the price goes to $60, the investor's rate of return is
a. 17%.
b. 20%.
c. 29%.
d. 34%.

D 35. If the initial margin requirement is lowered, the margin investor will
a. not receive dividends.
b. pay a higher interest rate.
c. borrow less dollars.
d. have an increased volatility in the potential rate of return.

A 36. An investor who has purchased several stocks on margin through one brokerage house has his margin deposit requirements calculated on
a. the aggregate or total present market value.
b. the lowest value stock.
c. the original purchase price of each stock.
d. each individual stock's present market value.

B 37. You purchase 400 shares of stock at a price of $20 per share. Using the minimum margin requirement of 70%, your equity would be
a. $ 2,400.
b. $ 5,600.
c. $ 7,200.
d. $ 8,000.

A 38. A broker buys 500 shares of IBM stock at $80 a share on margin. The initial margin is 50% and the maintenance margin requirement is 30%. To what price may the IBM stock fall before the broker receives a margin call?
a. $57.14
b. $56.08
c. $48.00
d. $52.85

B. 39. A broker buys 200 shares of Walmart on margin at $70 per share. The initial margin is 50% and the annual interest on margin loans is 8%. The stock price rises to $90 over the next year. What is the broker’s return on the investment?
a. 24.6%
b. 49.1%
c. 28.6%
d. 39.1%

C 40 ___ orders are canceled if the broker is unable to fully execute them immediately.

a. Good-till-canceled
b. Open
c. Fill-or-kill
d. Discretionary

D 41. A broker places an order to sell Intel short which is currently selling for $189.50. The lowest price at which the broker's order can be executed is

a. $189
b. $189.25
c. $189.75
d. $189.50

A 42. The advantage of market orders versus limit orders is the former offers immediacy of execution at an uncertain price while the latter offers uncertain execution with a ______ price.

a. bounded
b. unbounded
c. certain
d. uncertain

B 43. Street name registration allows a brokerage firm to

a. claim all dividends and financial reports for the investors as its own.
b. pledge or lend an investor's securities.
c. undertake cash account transactions.
d. hedge foreign currency exposure.

C 44. The Securities Exchange Act of 1934 set a minimum percentage of the purchase price that must come from the investor's own fund to avoid

a. market conditions that restrain activity.
b. excessive short sales in the market.
c. excessive margin buying.
d. market conditions that increase volatility.

D 45. Undermargined is a situation in which the ______ margin account has fallen below the ________ margin requirement.

a. maintenance, initial
b. initial, maintenance
c. maintenance, actual
d. actual, maintenance

A 46. According to the actual margin equation, it can be seen that at the time of the margin purchase, the actual and the initial margin are the _____.
- a. same
- b. same as the maintenance margin
- c. loan value of the assets
- d. collateral on the margin account

B 47. One problem associated with commission-based transactions is that the arrangement provides
- a. greater costs to the investor.
- b. the temptation to recommend frequent changes in the investor's holdings.
- c. more commissions if the investor's portfolio appreciates in value.
- d. institutional investors a greater advantage over smaller investors.

C 48. Call money rate is the interest rate paid by brokerage firms to banks on
- a. loans used to finance short purchases by the brokerage firm's customers.
- b. lines of credit for margin purchases
- c. loans used to finance margin purchases by the brokerage firm's customers.
- d. initial margin deposits.

D. 49. Marked to market is a method used to
- a. destabilize a market and produce price volatility
- b. protect the exchange from investor fraud
- c. maximize a brokerage firm's value
- d. reduce the frequency of investor defaults

A 50. One method the exchange has to prevent insolvency in margin accounts is to place the investor's account on a ______ status.
- a. restricted
- b. overmargined
- c. undermargined
- d. unrestricted

DIFFICULT

C 51. You purchase shares with a market price of $60 using an 80% margin requirement. If the margin maintenance is 30%, before you would have a margin call the market price could fall to
- a. $8.
- b. $12.
- c. $17.
- d. $24.

C 52. You purchase 200 shares with a market price of $60 per share using an 80% margin requirement. The market price goes to $80 per share. The amount of your margin deposit you could withdraw is
a. $4,000.
b. $2,800.
c. $800.
d. $1,200.

D 53. A minimum margin requirement of 75% means an investor
a. does not receive 75% of the total share price.
b. can borrow up to 75% of the total share price.
c. must pay an interest of 75% of Treasury Bill rates on a loan.
d. must supply at least 75% of the total share price.

A 54. An investor purchases 200 shares at $60 per share using an 80% margin requirement. The margin loan is at a 10% rate and in one year the price is at $80 per share. Ignoring dividends, the one year rate of return is
a. 39%.
b. 33%.
c. 25%.
d. 18%.

C 55. An investor purchases 200 shares at $60 per share using an 80% margin requirement. The margin loan is at a 10% rate, and in one year the price is at $50 per share. Ignoring dividends, the one year rate of return is
a. +18%.
b. -12%.
c. -23%.
d. +36%.

A 56. A restricted margin account means
a. no transactions can be made to decrease the actual margin.
b. the investor must supply additional margin dollars.
c. the market price of the security has risen since it was purchased.
d. the investor will receive a margin call.

D. 57. You purchase 200 shares of XYZ on margin at $80 per share. You also short sell 100 shares of ABC at $30 per share. With an initial margin requirement of 70%, find your original equity:
a. $ 7,800.
b. $ 2,100.
c. $ 5,800.
d. $13,300.