ch01

Student: ____

1. The material wealth of a society is a function of _________.
A. all financial assets
B. all real assets
C. all financial and real assets
D. all physical assets
E. none of the above

2. _______ are real assets.
A. Land
B. Machines
C. Stocks and bonds
D. Knowledge
E. A, B and D

3. The means by which individuals hold their claims on real assets in a well-developed economy are
A. Investment assets.
B. Depository assets.
C. Derivative assets.
D. Financial assets.
E. Exchange-driven assets.

4. _______ are financial assets.
A. Bonds
B. Machines
C. Stocks
D. A and C
E. A, B and C

5. _________ financial asset(s).
A. Buildings are
B. Land is a
C. Derivatives are
D. U.S. Agency bonds are
E. C and D

6. Financial assets ______.
A. directly contribute to the country's productive capacity
B. indirectly contribute to the country's productive capacity
C. contribute to the country's productive capacity both directly and indirectly
D. do not contribute to the country's productive capacity either directly or indirectly
E. are of no value to anyone

7. In 2009, ____________ was the most significant real asset of U.S. households in terms of total value.
A. consumer durables
B. automobiles
C. real estate
D. mutual fund shares
E. bank loans

8. In 2009, ____________ was the least significant financial asset of U.S. households in terms of total value.
A. real estate
B. mutual fund shares
C. debt securities
D. life insurance reserves
E. pension reserves

9. In 2009, ____________ was the most significant financial asset of U.S. households in terms of total value.
A. real estate
B. mutual fund shares
C. debt securities
D. life insurance reserves
E. pension reserves

10. In 2009, ____________ was the most significant asset of U.S. households in terms of total value.
A. real estate
B. mutual fund shares
C. debt securities
D. life insurance reserves
E. pension reserves

11. In 2009, ____________ was the most significant liability of U.S. households in terms of total value.
A. credit cards
B. mortgages
C. bank loans
D. student loans
E. other debt

12. Which of the following financial assets made up the greatest proportion of the financial assets held by U.S. households?
A. Pension reserves
B. Life insurance reserves
C. Mutual fund shares
D. Debt securities
E. Personal trusts

13. In 2009, _______ of the assets of U.S. households were financial assets as opposed to tangible assets.
A. 20.4%
B. 34.2%
C. 63.0%
D. 71.7%
E. 82.5%

14. The largest component of domestic net worth in 2009 was ____________.
A. non-residential real estate
B. residential real estate
C. inventories
D. consumer durables
E. equipment and software

15. The smallest component of domestic net worth in 2009 was ____________.
A. non-residential real estate
B. residential real estate
C. inventories
D. consumer durables
E. equipment and software

16. The national net worth of the U.S. in 2009 was _________.
A. $15.411 trillion
B. $26.431 trillion
C. $42.669 trillion
D. $39.139 trillion
E. $70.983 trillion

17. A fixed-income security pays ____________.
A. a fixed level of income for the life of the owner
B. a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security
C. a variable level of income for owners on a fixed income
D. a fixed or variable income stream at the option of the owner
E. none of the above

18. A debt security pays ____________.
A. a fixed level of income for the life of the owner
B. a variable level of income for owners on a fixed income
C. a fixed or variable income stream at the option of the owner
D. 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. none of the above

19. Money market securities ____________.
A. are short term
B. are highly marketable
C. are generally very low risk
D. all of the above
E. B and C only.

20. An example of a derivative security is ______.
A. a common share of Microsoft
B. a call option on Intel stock
C. a commodity futures contract
D. B and C
E. A and B

21. The value of a derivative security _______.
A. depends on the value of the related security
B. is unable to be calculated
C. is unrelated to the value of the related security
D. has been enhanced due to the recent misuse and negative publicity regarding these instruments
E. is worthless today

22. Although derivatives can be used as speculative instruments, businesses most often use them to
A. attract customers.
B. appease stockholders.
C. offset debt.
D. hedge risks.
E. enhance their balance sheets.

23. Financial assets permit all of the following except ____________.
A. consumption timing
B. allocation of risk
C. separation of ownership and control
D. elimination of risk
E. all of the above

24. The ____________ refers to the potential conflict between management and shareholders.
A. agency problem
B. diversification problem
C. liquidity problem
D. solvency problem
E. regulatory problem

25. A disadvantage of using stock options to compensate managers is that
A. it encourages mangers to undertake projects that will increase stock price.
B. it encourages managers to engage in empire building.
C. it can create an incentive for mangers 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.
D. all of the above.
E. none of the above.

26. Which of the following are mechanisms that have evolved to mitigate potential agency problems?
I) Compensation in the form of the firm's stock options
II) Hiring bickering family members as corporate spies
III) Underperforming management teams being forced out by boards of directors
IV) Security analysts monitoring the firm closely
V) Takeover threats
A. II and V
B. I, III, and IV
C. I, III, IV, and V
D. III, IV, and V
E. I, III, and V

27. Corporate shareholders are best protected from incompetent management decisions by
A. the ability to engage in proxy fights.
B. management's control of pecuniary rewards.
C. the ability to call shareholder meetings.
D. the threat of takeover by other firms.
E. one-share/one-vote election rules.

28. Theoretically, takeovers should result in ___________.
A. improved management
B. increased stock price
C. increased benefits to existing management of taken over firm
D. A and B
E. A, B, and C

29. During the period between 2000 and 2002, a large number of scandals were uncovered. Most of these scandals were related to
I) Manipulation of financial data to misrepresent the actual condition of the firm.
II) Misleading and overly optimistic research reports produced by analysts.
III) Allocating IPOs to executives as a quid pro quo for personal favors.
IV) Greenmail.
A. II, III, and IV
B. I, II, and IV
C. II and IV
D. I, III, and IV
E. I, II, and III

30. The Sarbanes-Oxley Act ____________.
A. requires corporations to have more independent directors
B. requires the firm's CFO to personally vouch for the firm's accounting statements
C. prohibits auditing firms from providing other services to clients
D. Only A and B are correct.
E. A, B, and C are correct.

31. Asset allocation refers to ____________.
A. choosing which securities to hold based on their valuation
B. investing only in "safe" securities
C. the allocation of assets into broad asset classes
D. bottom-up analysis
E. all of the above

32. Security selection refers to ____________.
A. choosing which securities to hold based on their valuation
B. investing only in "safe" securities
C. the allocation of assets into broad asset classes
D. top-down analysis
E. all of the above

33. Which of the following portfolio construction methods starts with security analysis?
A. Top-down
B. Bottom-up
C. Middle-out
D. Buy and hold
E. Asset allocation

34. Which of the following portfolio construction methods starts with asset allocation?
A. Top-down
B. Bottom-up
C. Middle-out
D. Buy and hold
E. Asset allocation

35. _______ are examples of financial intermediaries.
A. Commercial banks
B. Insurance companies
C. Investment companies
D. Credit unions
E. All of the above

36. Financial intermediaries exist because small investors cannot efficiently ________.
A. diversify their portfolios
B. assess credit risk of borrowers
C. advertise for needed investments
D. all of the above.
E. A and B only.

37. ________ specialize in helping companies raise capital by selling securities.
A. commercial bankers
B. investment bankers
C. investment issuers
D. credit raters
E. all of the above.

38. Commercial banks differ from other businesses in that both their assets and their liabilities are mostly
A. illiquid.
B. financial.
C. real.
D. owned by the government.
E. regulated.

39. In 2009, ____________ was the most significant financial asset of U.S. commercial banks in terms of total value.
A. loans and leases
B. cash
C. real estate
D. deposits
E. investment securities

40. In 2009, ____________ was the most significant liability of U.S. commercial banks in terms of total value.
A. loans and leases
B. cash
C. real estate
D. deposits
E. investment securities

41. In 2009, ____________ was the most significant real asset of U.S. nonfinancial businesses in terms of total value.
A. equipment and software
B. inventory
C. real estate
D. trade credit
E. marketable securities

42. In 2009, ____________ was the least significant real asset of U.S. nonfinancial businesses in terms of total value.
A. equipment and software
B. inventory
C. real estate
D. trade credit
E. marketable securities

43. In 2009, ____________ was the least significant liability of U.S. nonfinancial businesses in terms of total value.
A. bonds and mortgages
B. bank loans
C. inventories
D. trade debt
E. marketable securities

44. In terms of total value, the most significant liability of U.S. nonfinancial businesses in 2009 was _______.
A. bank loans
B. bonds and mortgages
C. trade debt
D. other loans
E. marketable securities

45. In 2009, ____________ was the least significant financial asset of U.S. nonfinancial businesses in terms of total value.
A. cash and deposits
B. trade credit
C. trade debt
D. inventory
E. marketable securities

46. New issues of securities are sold in the ________ market(s).
A. primary
B. secondary
C. over the counter
D. primary and secondary
E. A and C.

47. Investors trade previously issued securities in the ________ market(s).
A. primary
B. secondary
C. primary and secondary
D. derivatives
E. A and D.

48. Investment bankers perform the following role(s) ___________.
A. market new stock and bond issues for firms
B. provide advice to the firms as to market conditions, price, etc
C. design securities with desirable properties
D. all of the above
E. none of the above

49. Until 1999, the ________ Act(s) prohibited banks in the United States from both accepting deposits and underwriting securities.
A. Sarbanes-Oxley
B. Glass-Steagall
C. SEC
D. A and C
E. none of the above

50. The spread between the LIBOR and the Treasury-bill rate is called the ________.
A. term spread
B. T-bill spread
C. LIBOR spread
D. TED spread
E. none of the above

51. 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.
A. GNMA
B. FNMA
C. FHLMC
D. B and C
E. A and B

52. The sale of a mortgage portfolio by setting up mortgage pass-through securities is an example of ________.
A. credit enhancement
B. securitization
C. unbundling
D. derivatives
E. none of the above

53. Which of the following is true about mortgage-backed securities?
I) They aggregate individual home mortgages into homogeneous pools.
II) The purchaser receives monthly interest and principal payments received from payments made on the pool.
III) The banks that originated the mortgages maintain ownership of them.
IV) The banks that originated the mortgages continue to service them.
A. II, III, and IV
B. I, II, and IV
C. II and IV
D. I, III, and IV
E. I, II, III, and IV

54. ________ 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. Stocks
B. Bonds
C. Derivatives
D. Collateralized debt obligations
E. all of the above.

55. ________ are in essence an insurance contract against the default of one or more borrowers.
A. Credit default swaps
B. CMOs
C. ETFs
D. Collateralized debt obligations
E. all of the above.

56. Discuss the agency problem in detail.

57. Discuss the similarities and differences between real and financial assets.

58. Discuss securitization as it relates to the field of investments.

ch01 Key

1. B
2. E
3. D
4. D
5. E
6. B
7. C
8. D
9. E
10. A
11. B
12. A
13. C
14. B
15. C
16. D
17. B
18. D
19. D
20. D
21. A
22. D
23. D
24. A
25. C
26. C
27. D
28. D
29. E

30. E

31. C

32. A

33. B

34. A

35. E

36. D

37. B

38. B

39. A

40. D

41. C

42. B

43. B

44. B

45. A

46. A

47. B

48. D

49. B

50. D

51. D

52. B

53. B

54. D

55. A

56. Managers are the agents of the shareholders, and should act on their behalf to maximize shareholder wealth (the value of the stock). A conflict (the agency conflict) arises when managers take self-interested actions to the detriment of shareholders. The roles of the board of directors selected by the shareholders are to oversee management and to minimize agency problems. However, often these boards are figureheads, and individual shareholders do not own large enough blocks of the shares to override management actions. One potential resolution of an agency problem occurs when inefficient management actions cause the price of the stock to be depressed. The firm may then become a takeover target. If the acquisition is successful, managers may be replaced and potentially, stockholders benefit.

57. Real assets represent the productive capacity of the firm, and appear as assets on the firm's balance sheet. Financial assets are claims against the firm, and thus appear as liabilities on the firm's balance sheet. On the other hand, financial assets are listed on the asset side of the balance sheet of the individuals who own them. Thus, when financial statements are aggregated across the economy, the financial assets cancel out, leaving only the real assets, which directly contribute to the productive capacity of the economy. Financial assets contribute indirectly only.

58. Securitization refers to aggregating underlying financial assets, such as mortgages, into pools and then offering a security that represents a claim on these underlying assets. Example: mortgage-backed securities. Securitization allows investors to hold partial ownership in financial assets that would otherwise be beyond their reach (e.g., mortgages).
Financial engineering involves bundling or unbundling. Bundling involves combining separate securities.

ch01 Summary

Category	*# of Questions*
AACSB: Analytic	55
AACSB: Reflective Thinking	3
Blooms: Analyze	3
Blooms: Remember	43
Blooms: Understand	12
Bodie - Chapter 01	58
Difficulty: Basic	40
Difficulty: Intermediate	18
Topic: Asset Types	6
Topic: Assets	18
Topic: Financial Institutions	11
Topic: Financial Management	9
Topic: Financial Markets	4
Topic: Portfolio	1
Topic: Portfolios	1
Topic: Regulation	2
Topic: Securities	6