ch1

Student: ____

1. In an efficient and informed capital market environment, those investments with the greatest return tend to have the greatest risk.

   True False

2. Rare painting and baseball cards may be considered as forms of an investment.

   True False

3. Mutual funds are a form of direct equity claims.

   True False

4. Warrants are a form of direct equity claims.

   True False

5. Pension funds are a form of indirect equity claims.

   True False

6. An investor can totally eliminate time consuming investment management activities by participating in a mutual fund or limited partnership.

   True False

7. The riskiness of an investment is measured by the dispersion of possible outcomes.

   True False

8. Unlike the risk free rate, the level of the risk premium varies by investment.

   True False

9. The Ibbotson study showed that high risk investments generate high returns.

   True False

10. Diversification is the process of determining the risk premium.

    True False

11. The tax Act of 2003 offers greater potential for wealth accumulation.

    True False

12. The age and economic circumstance of an investor are important variables in determining an appropriate level of risk.

    True False

13. It is generally thought that young, upwardly mobile people should take less risk than elderly people living on a fixed income.

True False

14. Commodity futures are a form of financial assets.

True False

15. Diamonds represent a form of real assets, but cattle does not.

True False

16. To achieve maximum diversification benefits, an investor should invest in projects which are highly correlated.

True False

17. In general, if inflation is expected to increase, bond prices will increase.

True False

18. The only compensation anticipated from an investment is for inflation protection.

True False

19. Investment is the commitment of current funds in anticipation of receiving a larger future flow of funds.

True False

20. Common stock represents a direct equity claim.

True False

21. Silver is an example of a financial asset.

True False

22. A share in a money market fund is an indirect equity claim.

True False

23. In the financial world, risk is defined as variability of returns.

True False

24. Risk is not correlated with return in the capital markets.

True False

25. Investors desiring to assume low risks would probably invest in short-term securities.

True False

26. An aggressive portfolio might include real assets.

True False

27. Dividends and long-term capital gains are now taxed at the same maximum rate.

    True False

28. Liquidity refers to how little the sales price of an asset has decreased from its cost.

    True False

29. Real assets tend to be more liquid than financial assets.

    True False

30. Those who engage in short-term market tactics are considered traders.

    True False

31. Technical analysis is based on market indicators and charting to determine buy and sell decisions.

    True False

32. Real estate may be favored by investors in high tax brackets.

    True False

33. A public utility is likely to appeal to an income oriented, conservative investor.

    True False

34. A lack of immediate liquidity cannot be justified even if there is an opportunity for large gains.

    True False

35. Common stock is a good example of an investment that lacks liquidity.

    True False

36. Real estate is a good example of an investment that lacks liquidity.

    True False

37. Common stock investments that do not pay dividends are likely to provide relatively low total returns.

    True False

38. Finding high income (yield) and growth in the same investment is a relatively standard practice.

    True False

39. Retirement questions should be asked 5-10 years before retirement.

    True False

40. The "Stocks, Bonds, Bills and Inflation Yearbook" is an annual reference book publishing return data on a variety of securities. The data shows that the large company category had a negative return in only one decade and that was the 1930's.

    True False

41. When comparing returns by decade, the Ibbotson study shows that small stocks outperformed large stocks in every decade since the 1920's.

    True False

42. Those who attempt to engage in short-term market tactics are termed traders.

    True False

43. Research has shown that it is not that difficult to beat the market on a risk-adjusted basis.

    True False

44. Liquidity can be measured by the ability of the investor to convert an investment into cash within a relatively long period of time at its fair book value.

    True False

45. Real assets, because of increasing replacement value and scarcity, tend to perform better than financial assets during periods of high inflation.

    True False

46. One of the problems that investors face in determining required rates of return is the forecasting errors involving interest rates and inflation.

    True False

47. Every investment requires a total return comprised of a real rate of return, compensation for inflationary expectations, and a risk premium.

    True False

48. Beta measures a security's return relative to the market.

    True False

49. Prior to the Taxpayer Relief Act of 1997, the maximum rate on long-term capital gains was 28%.

    True False

50. The tax Act of 2001 lowered the capital gains tax rate.

    True False

51. The Taxpayer Relief Act of 1997 has made stocks that pay high dividends more attractive than they previously were.

    True False

52. An IRA allows an investor to deduct $10,000 or more from taxable income and invest the funds tax-free until withdrawal at retirement.

    True False

53. The commitment of current funds in anticipation of receiving a larger future flow of funds is called

A. A financial asset
B. A real asset
C. An investment
D. Gambling
E. None of the above

54. A(n) _____ is a legally documented claim on an asset, while a _____ is an actual, tangible asset which may be seen, felt, held, or collected.

A. Real asset; financial asset
B. Financial asset; real asset
C. Indirect equity claim; direct equity claim
D. Direct equity claim; indirect equity claim
E. None of the above

55. When ranking security returns, the data shows that the annualized returns are as follows, ranked from highest return to lowest return.

A. Large stocks, small stocks, long-term corporate bonds, long-term government bonds, treasury bills
B. Small stocks, large stocks, long-term corporate bonds, long-term government bonds, treasury bills
C. Small stocks, large stocks, treasury bills, long-term government bonds, long-term corporate bonds
D. Treasury bills, long-term government bonds, long-term corporate bonds, large stocks, small stocks
E. Large stocks, small stocks, long-term government bonds, long-term corporate bonds, treasury bills.

56. When ranking the riskiness of securities using the standard deviation, the highest risk security to the lowest risk security is as follows:

A. Small stocks, large stocks, long-term government bonds, U.S. treasury bills
B. Long-term government bonds, small stocks, large stocks, U.S. treasury bills
C. Large stocks, small stocks, long-term government bonds, U.S. treasury bills
D. Small stocks, long-term government bonds, large stocks, U.S. treasury bills
E. U.S. treasury bills, long-term government bonds, large stocks, small stocks

57. Which of the following statements is the most accurate concerning security returns over the eight decades since the 1920's?

A. Returns on large common stocks were very stable
B. Returns on long-term corporate bonds were very stable
C. Returns on long-term corporate bonds were very stable
D. Returns on treasury bills were very consistent from period to period
E. All securities exhibited very unstable returns over the eight decades in question.

58. A direct equity claim arises through investment in

A. Bonds and other debt instruments
B. Common stocks, warrants and options
C. Preferred stock and commodity futures
D. Mutual funds
E. None of the above

59. Investment in a mutual fund results in

A. An indirect equity claim
B. A direct equity claim
C. A creditor claim
D. None of the above.

60. What factors must be considered in choosing between investment alternatives?

A. Risk and liquidity
B. Interest or dividends vs. capital gains
C. Time frame for managing funds and evaluating performance and tax effects
D. Safety of principle
E. All of the above

61. The ability of the investor to convert an investment into cash in a short period of time is called

A. Short-term orientation
B. Low investment risk
C. Liquidity
D. Capital appreciation
E. None of the above

62. Wealthy investors may prefer the favorable tax treatment of investments such as

A. Corporate bonds
B. Municipal bonds
C. Common stock
D. Preferred stock

63. What is the rate of return on a share of common stock that increased in value from $40 to $50?

A. 5%
B. 10%
C. 20%
D. 25%
E. None of the above

64. What would the rate of return for a stock that increased in value from $60 per share to $63 per share and paid a $3.00 dividend?

A. 12%
B. 11%
C. 10%
D. 1.5%
E. 5%

65. An investment in common stock carries a higher return than a bank certificate of deposit. The difference in returns is called

A. The risk-free rate
B. The real rate of return
C. The risk premium
D. The beta
E. None of the above

66. What are the components in determining the real rate of return?

A. The risk premium
B. The inflation factor
C. The required rate of return
D. Both a) and b) above
E. Neither a) nor b)

67. What is the risk-free rate in an environment where the real rate is 3% and inflation is running at 3%? Use either method found in chapter one.

A. 14.5% or just 14%
B. 10.21% or just 10%
C. 6.09% or just 6%
D. 9.09% or just 9%
E. 0%

68. Which of the following investments would theoretically always carry the highest risk premium?

A. U.S. treasury bill
B. Common stock
C. Preferred stock
D. Corporate bond
E. Any one of the above

69. _____, because of increasing replacement value and scarcity, perform best in periods of high inflation.

A. Real assets
B. Common stock
C. Preferred stock
D. Financial assets
E. More than one of the above

70. The two components that make up the risk-free rate are

A. Real rate of return and capital gains
B. Risk-free assets and capital gains
C. Real rate of return and the inflation factor
D. Real assets and the inflation factor
E. Capital gains and the inflation factor

71. Which of the following is not one of the considerations in setting investment objectives?

A. Risk versus safety of principal
B. Maximize wealth versus minimize expenses
C. Current income versus capital appreciation
D. Short versus long-term orientation
E. Taxes

72. One of the reasons a short-term trader has difficulty in beating the market is because of

A. Risk
B. Lack of information
C. Large institutional investors
D. Commissions

73. The holding period to qualify for a long-term capital gains is

A. At least 6 months
B. At least 12 months
C. At least 18 months
D. At most 18 months
E. 12 months and a day

74. Common stock dividends are now taxed at a maximum rate of

A. 10 percent
B. 15 percent
C. 20 percent
D. 30 percent
E. 38.8 percent

75. Higher bond prices generally signal expectations of

A. Higher inflation
B. Lower inflation
C. Rising stock prices
D. Higher risk premiums
E. None of the above

76. A stock that pays low or no cash dividends is

A. EBay
B. Duke Power
C. AT&T
D. All of the above

77. Deposits in an IRA are

A. Allowed to grow tax free until withdrawal
B. Deducted from current income tax due
C. Deducted from current income to reduce income tax due
D. A and C

78. An investment requires a total return that comprises

A. A real rate of return and compensation for inflation
B. A real rate of return, compensation for inflation, and a risk premium
C. Compensation for inflation and a risk premium
D. A real rate of return, compensation for inflation, a risk premium, and compensation for time and effort devoted to researching alternative investments
E. None of the above

79. The investor of a high-yielding utility can expect

A. Slow growth in earnings
B. Slow growth in the stock price
C. Slow growth in the stock price with a fast growth in earnings
D. Fast growth in the stock price with a fast growth in earnings
E. Both a and b

80. Because most investors are risk averse

A. The riskier the investment, the more the investor will pay for it
B. The riskier the investment, the less compensation the investor requires
C. Only financial institutions invest in risky assets
D. They will require a higher rate of return for a riskier investment

81. The two types of investments that provide the highest and lowest yields in the Ibbotson study of <u>Stocks, Bonds, Bills and Inflation</u> are

A. Large company stocks; U.S. treasury bills
B. Large company stocks; Long-term government bonds
C. Small company stocks; U.S. Treasury bills
D. Small company stocks; preferred stock
E. U.S. treasury bills; small company stocks

82. Which of the following is not a form of a financial asset?

A. Commercial paper
B. Commodity futures
C. Warrants
D. Personal residence
E. $5 bill

83. Historically, the real rate of return in the U.S. economy has been

A. 1-2%
B. 2-3%
C. 3-4%
D. 4-5%
E. 5-6%

84. Which of the following is not a form of real asset?

A. Rare paintings
B. Baseball cards
C. Diamonds
D. Real estate
E. Commodity futures

85. Under the Economic Growth and Tax Reconciliation Act of 2001, when will estate taxes be eliminated?

A. 2008
B. 2009
C. 2010
D. 2019
E. The estate tax will not be eliminated

86. a) The stock of Trudeau Corporation went from $27 to $40 last year. The firm also paid 1 dollar in dividends during the year. Compute the rate of return.
b) In the following year, the dividend was raised to $1.40. However, a declining market toward the end of the year, caused the stock to fall to $24 per share from $40. Compute the rate of return (gain or loss) to the stockholder in the following year.

87. (a) The stock of Furniture Unlimited went from \$90 to \$99 last year. The firm also paid 80 cents in dividends. Compute the rate of return.
(b) During the next year, the dividend paid was 1.60 cents per share and the stock closed at \$93 per share, down from \$99 per share at the beginning of the year. Compute the annual gain or loss for the second year holding period.

88. Assume the real rate of return in the economy is 4.25 percent, the expected rate of inflation is 3.5 percent and the risk premium is 6.75 percent. Compute the risk free rate and required rate of return.

89. Assume the real rate of return for the economy is 3.75% and the expected rate of inflation is 6.75%. What is the risk free rate?
If the risk premium is 6%, calculate the required rate of return.

90. Assume the real return in the economy is 5.0 percent. It is anticipated that the consumer price index will go from 340 to 363.8. Shares of common stock for the market in general are assumed to have a required rate of return 1/4th higher than the risk-free rate. Compute the required return on common stock.

ch1 Key

1. In an efficient and informed capital market environment, those investments with the greatest return tend to have the greatest risk.

   TRUE

   Hirt - Chapter 001 #1

2. Rare painting and baseball cards may be considered as forms of an investment.

   TRUE

   Hirt - Chapter 001 #2

3. Mutual funds are a form of direct equity claims.

   FALSE

   Hirt - Chapter 001 #3

4. Warrants are a form of direct equity claims.

   TRUE

   Hirt - Chapter 001 #4

5. Pension funds are a form of indirect equity claims.

   TRUE

   Hirt - Chapter 001 #5

6. An investor can totally eliminate time consuming investment management activities by participating in a mutual fund or limited partnership.

   FALSE

   Hirt - Chapter 001 #6

7. The riskiness of an investment is measured by the dispersion of possible outcomes.

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   Hirt - Chapter 001 #7

8. Unlike the risk free rate, the level of the risk premium varies by investment.

   TRUE

   Hirt - Chapter 001 #8

9. The Ibbotson study showed that high risk investments generate high returns.

   TRUE

   Hirt - Chapter 001 #9

10. Diversification is the process of determining the risk premium.

FALSE

Hirt - Chapter 001 #10

11. The tax Act of 2003 offers greater potential for wealth accumulation.

TRUE

Hirt - Chapter 001 #11

12. The age and economic circumstance of an investor are important variables in determining an appropriate level of risk.

TRUE

Hirt - Chapter 001 #12

13. It is generally thought that young, upwardly mobile people should take less risk than elderly people living on a fixed income.

FALSE

Hirt - Chapter 001 #13

14. Commodity futures are a form of financial assets.

TRUE

Hirt - Chapter 001 #14

15. Diamonds represent a form of real assets, but cattle does not.

FALSE

Hirt - Chapter 001 #15

16. To achieve maximum diversification benefits, an investor should invest in projects which are highly correlated.

FALSE

Hirt - Chapter 001 #16

17. In general, if inflation is expected to increase, bond prices will increase.

FALSE

Hirt - Chapter 001 #17

18. The only compensation anticipated from an investment is for inflation protection.

FALSE

Hirt - Chapter 001 #18

19. Investment is the commitment of current funds in anticipation of receiving a larger future flow of funds.

TRUE

Hirt - Chapter 001 #19

20. Common stock represents a direct equity claim.

<u>TRUE</u>

Hirt - Chapter 001 #20

21. Silver is an example of a financial asset.

<u>FALSE</u>

Hirt - Chapter 001 #21

22. A share in a money market fund is an indirect equity claim.

<u>FALSE</u>

Hirt - Chapter 001 #22

23. In the financial world, risk is defined as variability of returns.

<u>TRUE</u>

Hirt - Chapter 001 #23

24. Risk is not correlated with return in the capital markets.

<u>FALSE</u>

Hirt - Chapter 001 #24

25. Investors desiring to assume low risks would probably invest in short-term securities.

<u>TRUE</u>

Hirt - Chapter 001 #25

26. An aggressive portfolio might include real assets.

<u>TRUE</u>

Hirt - Chapter 001 #26

27. Dividends and long-term capital gains are now taxed at the same maximum rate.

<u>TRUE</u>

Hirt - Chapter 001 #27

28. Liquidity refers to how little the sales price of an asset has decreased from its cost.

<u>FALSE</u>

Hirt - Chapter 001 #28

29. Real assets tend to be more liquid than financial assets.

<u>FALSE</u>

Hirt - Chapter 001 #29

30. Those who engage in short-term market tactics are considered traders.

<u>TRUE</u>

Hirt - Chapter 001 #30

31. Technical analysis is based on market indicators and charting to determine buy and sell decisions.

TRUE

Hirt - Chapter 001 #31

32. Real estate may be favored by investors in high tax brackets.

TRUE

Hirt - Chapter 001 #32

33. A public utility is likely to appeal to an income oriented, conservative investor.

TRUE

Hirt - Chapter 001 #33

34. A lack of immediate liquidity cannot be justified even if there is an opportunity for large gains.

FALSE

Hirt - Chapter 001 #34

35. Common stock is a good example of an investment that lacks liquidity.

FALSE

Hirt - Chapter 001 #35

36. Real estate is a good example of an investment that lacks liquidity.

TRUE

Hirt - Chapter 001 #36

37. Common stock investments that do not pay dividends are likely to provide relatively low total returns.

FALSE

Hirt - Chapter 001 #37

38. Finding high income (yield) and growth in the same investment is a relatively standard practice.

FALSE

Hirt - Chapter 001 #38

39. Retirement questions should be asked 5-10 years before retirement.

FALSE

Hirt - Chapter 001 #39

40. The "Stocks, Bonds, Bills and Inflation Yearbook" is an annual reference book publishing return data on a variety of securities. The data shows that the large company category had a negative return in only one decade and that was the 1930's.

TRUE

Hirt - Chapter 001 #40

41. When comparing returns by decade, the Ibbotson study shows that small stocks outperformed large stocks in every decade since the 1920's.

FALSE

Hirt - Chapter 001 #41

42. Those who attempt to engage in short-term market tactics are termed traders.

TRUE

Hirt - Chapter 001 #42

43. Research has shown that it is not that difficult to beat the market on a risk-adjusted basis.

FALSE

Hirt - Chapter 001 #43

44. Liquidity can be measured by the ability of the investor to convert an investment into cash within a relatively long period of time at its fair book value.

FALSE

Hirt - Chapter 001 #44

45. Real assets, because of increasing replacement value and scarcity, tend to perform better than financial assets during periods of high inflation.

TRUE

Hirt - Chapter 001 #45

46. One of the problems that investors face in determining required rates of return is the forecasting errors involving interest rates and inflation.

TRUE

Hirt - Chapter 001 #46

47. Every investment requires a total return comprised of a real rate of return, compensation for inflationary expectations, and a risk premium.

TRUE

Hirt - Chapter 001 #47

48. Beta measures a security's return relative to the market.

TRUE

Hirt - Chapter 001 #48

49. Prior to the Taxpayer Relief Act of 1997, the maximum rate on long-term capital gains was 28%.

TRUE

Hirt - Chapter 001 #49

50. The tax Act of 2001 lowered the capital gains tax rate.

FALSE

Hirt - Chapter 001 #50

51. The Taxpayer Relief Act of 1997 has made stocks that pay high dividends more attractive than they previously were.

<u>FALSE</u>

Hirt - Chapter 001 #51

52. An IRA allows an investor to deduct $10,000 or more from taxable income and invest the funds tax-free until withdrawal at retirement.

<u>FALSE</u>

Hirt - Chapter 001 #52

53. The commitment of current funds in anticipation of receiving a larger future flow of funds is called

A. A financial asset
B. A real asset
<u>C.</u> An investment
D. Gambling
E. None of the above

Hirt - Chapter 001 #53

54. A(n) _____ is a legally documented claim on an asset, while a _____ is an actual, tangible asset which may be seen, felt, held, or collected.

A. Real asset; financial asset
<u>B.</u> Financial asset; real asset
C. Indirect equity claim; direct equity claim
D. Direct equity claim; indirect equity claim
E. None of the above

Hirt - Chapter 001 #54

55. When ranking security returns, the data shows that the annualized returns are as follows, ranked from highest return to lowest return.

A. Large stocks, small stocks, long-term corporate bonds, long-term government bonds, treasury bills
<u>B.</u> Small stocks, large stocks, long-term corporate bonds, long-term government bonds, treasury bills
C. Small stocks, large stocks, treasury bills, long-term government bonds, long-term corporate bonds
D. Treasury bills, long-term government bonds, long-term corporate bonds, large stocks, small stocks
E. Large stocks, small stocks, long-term government bonds, long-term corporate bonds, treasury bills.

Hirt - Chapter 001 #55

56. When ranking the riskiness of securities using the standard deviation, the highest risk security to the lowest risk security is as follows:

<u>A.</u> Small stocks, large stocks, long-term government bonds, U.S. treasury bills
B. Long-term government bonds, small stocks, large stocks, U.S. treasury bills
C. Large stocks, small stocks, long-term government bonds, U.S. treasury bills
D. Small stocks, long-term government bonds, large stocks, U.S. treasury bills
E. U.S. treasury bills, long-term government bonds, large stocks, small stocks

Hirt - Chapter 001 #56

57. Which of the following statements is the most accurate concerning security returns over the eight decades since the 1920's?

A. Returns on large common stocks were very stable
B. Returns on long-term corporate bonds were very stable
C. Returns on long-term corporate bonds were very stable
D. Returns on treasury bills were very consistent from period to period
E. All securities exhibited very unstable returns over the eight decades in question.

Hirt - Chapter 001 #57

58. A direct equity claim arises through investment in

A. Bonds and other debt instruments
B. Common stocks, warrants and options
C. Preferred stock and commodity futures
D. Mutual funds
E. None of the above

Hirt - Chapter 001 #58

59. Investment in a mutual fund results in

A. An indirect equity claim
B. A direct equity claim
C. A creditor claim
D. None of the above.

Hirt - Chapter 001 #59

60. What factors must be considered in choosing between investment alternatives?

A. Risk and liquidity
B. Interest or dividends vs. capital gains
C. Time frame for managing funds and evaluating performance and tax effects
D. Safety of principle
E. All of the above

Hirt - Chapter 001 #60

61. The ability of the investor to convert an investment into cash in a short period of time is called

A. Short-term orientation
B. Low investment risk
C. Liquidity
D. Capital appreciation
E. None of the above

Hirt - Chapter 001 #61

62. Wealthy investors may prefer the favorable tax treatment of investments such as

A. Corporate bonds
B. Municipal bonds
C. Common stock
D. Preferred stock

Hirt - Chapter 001 #62

63. What is the rate of return on a share of common stock that increased in value from $40 to $50?

A. 5%
B. 10%
C. 20%
D. 25%
E. None of the above

$$\frac{\$50-\$40}{\$40}=.25 \quad or \quad 25\%$$

Hirt - Chapter 001 #63

64. What would the rate of return for a stock that increased in value from $60 per share to $63 per share and paid a $3.00 dividend?

A. 12%
B. 11%
C. 10%
D. 1.5%
E. 5%

$$\frac{(\$63-\$60)+\$3}{\$60}=.10 \quad or \quad 10\%$$

Hirt - Chapter 001 #64

65. An investment in common stock carries a higher return than a bank certificate of deposit. The difference in returns is called

A. The risk-free rate
B. The real rate of return
C. The risk premium
D. The beta
E. None of the above

Hirt - Chapter 001 #65

66. What are the components in determining the real rate of return?

A. The risk premium
B. The inflation factor
C. The required rate of return
D. Both a) and b) above
E. Neither a) nor b)

Hirt - Chapter 001 #66

67. What is the risk-free rate in an environment where the real rate is 3% and inflation is running at 3%? Use either method found in chapter one.

A. 14.5% or just 14%
B. 10.21% or just 10%
C. 6.09% or just 6%
D. 9.09% or just 9%
E. 0%

Hirt - Chapter 001 #67

68. Which of the following investments would theoretically always carry the highest risk premium?

A. U.S. treasury bill
<u>B.</u> Common stock
C. Preferred stock
D. Corporate bond
E. Any one of the above

Hirt - Chapter 001 #68

69. _____, because of increasing replacement value and scarcity, perform best in periods of high inflation.

<u>A.</u> Real assets
B. Common stock
C. Preferred stock
D. Financial assets
E. More than one of the above

Hirt - Chapter 001 #69

70. The two components that make up the risk-free rate are

A. Real rate of return and capital gains
B. Risk-free assets and capital gains
<u>C.</u> Real rate of return and the inflation factor
D. Real assets and the inflation factor
E. Capital gains and the inflation factor

Hirt - Chapter 001 #70

71. Which of the following is not one of the considerations in setting investment objectives?

A. Risk versus safety of principal
<u>B.</u> Maximize wealth versus minimize expenses
C. Current income versus capital appreciation
D. Short versus long-term orientation
E. Taxes

Hirt - Chapter 001 #71

72. One of the reasons a short-term trader has difficulty in beating the market is because of

A. Risk
B. Lack of information
C. Large institutional investors
<u>D.</u> Commissions

Hirt - Chapter 001 #72

73. The holding period to qualify for a long-term capital gains is

A. At least 6 months
<u>B.</u> At least 12 months
C. At least 18 months
D. At most 18 months
E. 12 months and a day

Hirt - Chapter 001 #73

74. Common stock dividends are now taxed at a maximum rate of

A. 10 percent
B. 15 percent
C. 20 percent
D. 30 percent
E. 38.8 percent

Hirt - Chapter 001 #74

75. Higher bond prices generally signal expectations of

A. Higher inflation
B. Lower inflation
C. Rising stock prices
D. Higher risk premiums
E. None of the above

Hirt - Chapter 001 #75

76. A stock that pays low or no cash dividends is

A. EBay
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Hirt - Chapter 001 #76

77. Deposits in an IRA are

A. Allowed to grow tax free until withdrawal
B. Deducted from current income tax due
C. Deducted from current income to reduce income tax due
D. A and C

Hirt - Chapter 001 #77

78. An investment requires a total return that comprises

A. A real rate of return and compensation for inflation
B. A real rate of return, compensation for inflation, and a risk premium
C. Compensation for inflation and a risk premium
D. A real rate of return, compensation for inflation, a risk premium, and compensation for time and effort devoted to researching alternative investments
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Hirt - Chapter 001 #78

79. The investor of a high-yielding utility can expect

A. Slow growth in earnings
B. Slow growth in the stock price
C. Slow growth in the stock price with a fast growth in earnings
D. Fast growth in the stock price with a fast growth in earnings
E. Both a and b

Hirt - Chapter 001 #79

80. Because most investors are risk averse

A. The riskier the investment, the more the investor will pay for it
B. The riskier the investment, the less compensation the investor requires
C. Only financial institutions invest in risky assets
D. They will require a higher rate of return for a riskier investment

Hirt - Chapter 001 #80

81. The two types of investments that provide the highest and lowest yields in the Ibbotson study of Stocks, Bonds, Bills and Inflation are

A. Large company stocks; U.S. treasury bills
B. Large company stocks; Long-term government bonds
C. Small company stocks; U.S. Treasury bills
D. Small company stocks; preferred stock
E. U.S. treasury bills; small company stocks

Hirt - Chapter 001 #81

82. Which of the following is not a form of a financial asset?

A. Commercial paper
B. Commodity futures
C. Warrants
D. Personal residence
E. $5 bill

Hirt - Chapter 001 #82

83. Historically, the real rate of return in the U.S. economy has been

A. 1-2%
B. 2-3%
C. 3-4%
D. 4-5%
E. 5-6%

Hirt - Chapter 001 #83

84. Which of the following is not a form of real asset?

A. Rare paintings
B. Baseball cards
C. Diamonds
D. Real estate
E. Commodity futures

Hirt - Chapter 001 #84

85. Under the Economic Growth and Tax Reconciliation Act of 2001, when will estate taxes be eliminated?

A. 2008
B. 2009
C. 2010
D. 2019
E. The estate tax will not be eliminated

Hirt - Chapter 001 #85

86. a) The stock of Trudeau Corporation went from \$27 to \$40 last year. The firm also paid 1 dollar in dividends during the year. Compute the rate of return.
b) In the following year, the dividend was raised to \$1.40. However, a declining market toward the end of the year, caused the stock to fall to \$24 per share from \$40. Compute the rate of return (gain or loss) to the stockholder in the following year.

(a) <u>(\$40 - \$27) + \$1.00</u> = Rate of Return
\$27
<u>\$14</u> = 51.85%
\$27
(b) <u>(\$24 - \$40) + \$1.40</u> = Rate of Return
\$27
<u>-\$14.60</u> = (36.50%) loss
\$40

Hirt - Chapter 001 #86

87. (a) The stock of Furniture Unlimited went from \$90 to \$99 last year. The firm also paid 80 cents in dividends. Compute the rate of return.
(b) During the next year, the dividend paid was 1.60 cents per share and the stock closed at \$93 per share, down from \$99 per share at the beginning of the year. Compute the annual gain or loss for the second year holding period.

(a) <u>(\$99 - \$90) + \$.80</u> = Rate of Return
\$90
<u>\$9.80</u> = 10.9%
\$90
(b) <u>(\$93 - \$99) + \$1.60</u> = Rate of Return
\$99
<u>-\$4.40</u> = (4.4%) loss
\$99

Hirt - Chapter 001 #87

88. Assume the real rate of return in the economy is 4.25 percent, the expected rate of inflation is 3.5 percent and the risk premium is 6.75 percent. Compute the risk free rate and required rate of return.

Risk free rate R_f = (1 + .0425)(1 + .035) - 1
= 1.079 - 1
= .079 or 7.9%
or
R_f = 4.25% + 3.5%
= 7.75%
Required Rate of Return = (1.0425)(1.035)(1.0675) - 1
= 1.1518 - 1
= .1518 or 15.18%
or
Required Rate of Return = 4.25% + 3.5% + 6.75%
= 14.50%

Hirt - Chapter 001 #88

89. Assume the real rate of return for the economy is 3.75% and the expected rate of inflation is 6.75%. What is the risk free rate?
If the risk premium is 6%, calculate the required rate of return.

Risk free rate R_f = (1 + .0375)(1 + .0675) - 1
= 1.1075 - 1
= .1075 or 10.75%
or
R_f = 3.75% + 6.75%
= 10.5%
Required Rate of Return = (1.0375)(1.0675)(1.06) - 1
= 1.17398 - 1
= .17398 or 17.398%
or
Required Rate of Return = 3.75% + 6.75% + 6.0%
= 16.5%

Hirt - Chapter 001 #89

90. Assume the real return in the economy is 5.0 percent. It is anticipated that the consumer price index will go from 340 to 363.8. Shares of common stock for the market in general are assumed to have a required rate of return 1/4th higher than the risk-free rate. Compute the required return on common stock.

Inflation rate = <u>363.8 - 340</u>
340
= 23.8/340
= .07 or 7.0%
Risk free rate R_f = (1 + .05)(1 + .07) - 1
= 1.1235 - 1
= .1235 or 12.35%
or
R_f = 5.0% + 7.0%
= 12.0%
Risk Premium = (1.25)(Risk free rate) - (Risk free rate)
= (1.25)(12.35) - 12.35%
= 15.4375% - 12.35%
= .030875 or 3.1%
Required Rate of Return = (1.05)(1.07)(1.031) - 1
on common stock
= 1.1583 - 1
= .1583 or 15.83%

Hirt - Chapter 001 #90

ch1 Summary

Category	*# of Questions*
Hirt - Chapter 001	90