

University of Alabama

FI 414 (514)
Investments

Dr. Anup Agrawal

Quiz 1 (Sample)

Name _____ SS# _____
Print

Part A: Problem solving (20 points)

Instructions: Please show all work.

1. You purchased 100 shares of ABC common stock on margin at \$50 per share. Assume the initial margin is 50% and the maintenance margin is 30%. Assume the stock pays no dividend and ignore interest on margin.
 - a. Suppose the stock goes to \$70. What are your % margin and rate of return?
 - b. What are your % margin and rate of return if the stock goes to \$40?
 - c. Below what stock price would you get a margin call?

Part B: Multiple choice problems (20 problems, 4 points each)

Instructions: Encircle the *one* correct answer to each problem.

1. Which of the following is not a money market instrument?
 - A) treasury bill
 - B) commercial paper
 - C) preferred stock
 - D) banker's acceptance

2. A dollar denominated deposit at a London bank is called _____.
 - A) eurodollars
 - B) LIBOR
 - C) fed funds
 - D) banker's acceptance

3. Money market securities are sometimes referred to as "cash equivalent" because
 - A) they are marketable
 - B) they are liquid
 - C) they are low-risk
 - D) all of the above

4. The most important feature of municipal bonds is their _____.
 - A) safety
 - B) liquidity
 - C) tax-exempt status
 - D) convertibility

5. _____ voting of common stock gives minority shareholders the most representation on the board of directors.
 - A) Majority
 - B) Cumulative
 - C) Rights
 - D) Proxy

6. _____ computes over 50 country indexes.
 - A) Dow Jones
 - B) The Federal Reserve
 - C) NASDAQ
 - D) MSCI

7. _____ would not be included in the EAFE index.
- A) Australia
 - B) Canada
 - C) France
 - D) Japan
8. _____ is a true statement regarding the Dow Jones Industrial Average.
- A) It is a value-weighted average of 30 large industrial stocks
 - B) It is a price-weighted average of 30 large industrial stocks
 - C) It is a price-weighted average of 100 large stocks traded on the New York Stock Exchange
 - D) It is a value-weighted average of all stocks traded on the New York Stock Exchange
9. Under firm commitment underwriting the _____ assumes the full risk that the shares cannot be sold to the public at the stipulated offering price.
- A) red herring
 - B) issuing company
 - C) initial stockholder
 - D) underwriter
10. Barnegat Light sold 200,000 shares in an initial public offering. The underwriter's explicit fees were \$70,000. The offering price for the shares was \$25, but immediately upon issue, the share price jumped to \$41. What is the best estimate of the total cost to Barnegat Light of the equity issue?
- A) \$ 70,000
 - B) \$3,200,000
 - C) \$3,270,000
 - D) \$8,200,000
11. The largest and most liquid companies trading over-the-counter are _____.
- A) listed on pink sheets
 - B) posted on the OTC Bulletin Board
 - C) listed on the NASDAQ National Market System
 - D) listed on the NASDAQ Small Cap Market

12. An ECN is _____.
- A) an Easy Cash Network
 - B) a European Community Nationalbank
 - C) part of the fourth market
 - D) a special regulatory unit of the SEC
13. The computer-linked price quotation system for the OTC is called _____.
- A) CRSP
 - B) DAX
 - C) NASDAQ
 - D) the Big Board
14. The market collapse of 1987 prompted _____ as a suggestion for regulatory reform.
- A) Blue Sky laws
 - B) circuit breakers to halt trading
 - C) the Securities Investor Protection Act
 - D) All of the above
15. Initial margin requirements on stocks are set by _____.
- A) the Federal Deposit Insurance Corporation
 - B) the Federal Reserve
 - C) the New York Stock Exchange
 - D) the Securities and Exchange Commission
16. A ___ is a private investment pool, open to wealthy or institutional investors, that is exempt from SEC regulation and can therefore pursue more speculative policies than mutual funds.
- A) commingled pool
 - B) unit trust
 - C) hedge fund
 - D) none of the above
17. In 1999 the SEC established rules that should make a mutual fund prospectus _____.
- A) easier to read and understand
 - B) much more detailed
 - C) disappear over the next 10 years
 - D) none of the above

18. Investment companies can provide investor's with access to the market at lower transaction costs because _____.
- A) they trade large blocks of securities
 - B) the managers are usually stockbrokers
 - C) under SEC rule 17a-2 domestic exchanges must process trades placed by qualifying investment companies at lower commission rates
 - D) All of the above are true
19. Assume that you have recently purchased 10,000 shares in an investment company that is reporting \$15 million in assets, \$5 million in liabilities, and has 100,000 shares outstanding. What is the Net Asset Value (NAV) of these shares?
- A) \$150
 - B) \$100
 - C) \$50
 - D) \$10
20. Investors who wish to liquidate their holdings in a closed-end fund may _____.
- A) sell their shares back to the fund at a discount
 - B) sell their shares back to the fund at net asset value
 - C) sell their shares on the open market
 - D) None of the above

Solutions to Quiz 1 (Sample)

Part A

1. Initial Balance sheet

Assets		Liab.	
Stock	\$50	Debt	\$25
		Equity	\$25
	<u>\$50</u>		<u>\$50</u>

a.

A		L	
Stock	\$70	Debt	\$25
		Equity	\$45
	<u>\$70</u>		<u>\$70</u>

Margin = $\frac{\text{Equity}}{\text{Stock}} = \frac{\$45}{\$70} = .643 \approx 64.3\%$

Return = $\frac{\text{Equity}_{\text{end}}}{\text{Equity}_{\text{init}}} - 1 = \frac{45}{25} - 1 = .8 \approx 80\%$

b.

A		L	
Stock	\$40	Debt	\$25
		Equity	\$15
	<u>\$40</u>		<u>\$40</u>

Margin = $\frac{15}{40} = .375 \approx 37.5\%$

Return = $\frac{15}{25} - 1 = -.4 \approx -40\%$

c. Let price of margin call be \$X

A		L	
Stock	\$X	Debt	\$25
		Equity	X - 25
	<u>\$X</u>		<u>\$X</u>

Margin = $\frac{X - 25}{X} = .3$

$\therefore .3X = X - 25$

$\therefore X = \frac{25}{.7} = \35.71

Answer Key (Part B)

1. C
2. A
3. D
4. C
5. B
6. D
7. B
8. B
9. D
10. C
11. C
12. C
13. C
14. B
15. B
16. C
17. A
18. A
19. B
20. C