UNIVERSITY OF ESSEX DEPARTMENT OF ECONOMICS

EC 247 FINANCIAL INSTRUMENTS AND CAPITAL MARKETS

MULTIPLE CHOICE TEST

29/11/2011

Time Allowed: **50 MIN**

There are **TWENTY FIVE** multiple choice questions, **ALL** of which should be answered

DO NOT START UNTIL YOU ARE INSTRUCTED TO BEGIN

Enter your registration number in the answer sheet

For each question, mark the most appropriate selection on the answer sheet

Calculators (hand held, containing no textual information) are permitted

Only the answer sheet is to be returned. You should keep the question paper (this document)

The purpose of the test is solely formative for students to gauge their understanding of the course material. The mark will carry no weight in your overall result for the course.

1) Every financial market performs the following function:

A) It determines the level of interest rates.

B) It allows loans to be made.

C) It allows common stock to be traded.

D) It channels funds from lenders-savers to borrowers-spenders.

2) Adverse selection is a problem associated with equity and debt contracts arising from

A) the lender's relative lack of information about the borrower's potential returns and risks of his investment activities.

B) the borrower's lack of incentive to seek a loan for highly risky investments.

C) the lender's inability to legally require sufficient collateral to cover a 100 percent loss if the borrower defaults.

D) none of the above.

3) Intermediaries who are agents of investors and match buyers with sellers of securities are called

A) investment bankers.

B) brokers.

C) traders.

D) dealers.

E) none of the above.

4) Which of the following are true for a coupon bond?

A) The price of a coupon bond and the yield to maturity are negatively related.

B) When the coupon bond is priced at its face value, the yield to maturity equals the coupon rate.

C) The yield to maturity is greater than the coupon rate when the bond price is below the par value.

D) All of the above are true.

E) Only A and B of the above are true.

5) During business cycle expansions when income and wealth are rising, the demand for bonds _________ and the demand curve shifts to the _________.

A) rises; right   B) falls; right   C) rises; left   D) falls; left

6) When the expected inflation rate increases, the demand for bonds _________, the supply of bonds _________, and the interest rate _________.

A) decreases; decreases; falls   B) decreases; increases; rises

C) increases; increases; rises   D) increases; decreases; falls

7) The risk structure of interest rates is

A) the structure of how interest rates move over time.

B) the relationship among interest rates on bonds with different maturities.

C) the relationship among the terms to maturity of different bonds.

D) the relationship among interest rates of different bonds with the same maturity.

8) A decrease in marginal tax rates would likely have the effect of _________ the demand for municipal bonds and _________ the demand for U.S. government bonds.

A) increasing; decreasing

B) increasing; increasing

C) decreasing; decreasing

D) decreasing; increasing

9) According to the expectations theory of the term structure,

A) when the yield curve is downward-sloping, short-term interest rates are expected to remain relatively stable in the future.

B) investors have strong preferences for short-term relative to long-term bonds, explaining why yield curves typically slope upward.

C) when the yield curve is steeply upward-sloping, short-term interest rates are expected to rise in the future.

D) all of the above.

E) only A and B of the above.

10) According to the market segmentation theory of the term structure,

A) bonds of one maturity are not substitutes for bonds of other maturities; therefore, interest rates on bonds of different maturities do not move together over time.

B) investors' strong preference for short-term relative to long-term bonds explains why yield curves typically slope upward.

C) the interest rate for bonds of one maturity is determined by supply and demand for bonds of that maturity.

D) all of the above.

E) none of the above.

11) Which of the following statements are true of Treasury bills?

A) The market for Treasury bills is extremely deep and liquid.

B) Occasionally, investors find that earnings on T-bills do not compensate them for changes in purchasing power due to inflation.

C) By volume, most Treasury bills are sold to individuals who submit noncompetitive bids.

D) All of the above are true.

E) Only A and B of the above are true.

12) The Federal Reserve can influence the federal funds interest rate by buying securities, which ________ reserves, thereby ________ the federal funds rate.

A) adds; raising B) adds; lowering C) removes; lowering D) removes; raising

13) The primary reason that individuals and firms choose to borrow long-term is to reduce the risk that interest rates will ________ before they pay off their debt.

A) fall B) rise

C) become more volatile D) become more stable

14) Which of the following statements about money market securities are true?

A) The secondary market for Treasury bills is extensive and well developed.

B) The interest rates on all money market instruments move very closely together over time.

C) There is no well-developed secondary market for commercial paper.

D) All of the above are true.

E) Only A and B of the above are true.

15) Typically, the interest rate on corporate bonds will be ________ the more restrictions are placed on management through restrictive covenants, because ________.

A) higher; the bonds will be considered safer by bondholders

B) lower; corporate earnings will be higher with more restrictions in place

C) higher; corporate earnings will be limited by the restrictions

D) lower; the bonds will be considered safer by buyers

16) The current yield is a less accurate approximation of the yield to maturity the ________ the time to maturity of the bond and the ________ the price is from/to the par value.

A) shorter; closer B) longer; farther C) longer; closer D) shorter; farther

17) The current yield on a $5,000, 8 percent coupon bond selling for $4,000 is

A) 8%.

B) 20%.

C) 10%.

D) 5%.

E) none of the above.

18) Mortgage-backed securities

A) have been growing in popularity in recent years as institutional investors look for attractive investment opportunities.

B) are securities collateralized by both insured and uninsured mortgages.

C) are securities collateralized by a pool of mortgages.

D) all of the above.

E) only A and B of the above.

19) The percentage of the total loan paid back immediately when a mortgage loan is obtained and lowers the annual interest rate on the debt is called

A) collateral. B) loan terms. C) down payment. D) discount points.

20) When the value of the dollar changes from £0.5 to £0.75, then the pound has ________ and the dollar has ________.

A) appreciated; depreciated B) depreciated; appreciated

C) appreciated; appreciated D) depreciated; depreciated

21) If the dollar depreciates relative to the Swiss franc,

A) American computers will become less expensive in Switzerland.

B) Swiss chocolate will become more expensive in the United States.

C) Swiss chocolate will become cheaper in the United States.

D) both A and B of the above.

22) The theory of purchasing power parity is a theory of how exchange rate are determined in

A) the short run. B) the long run. C) both A and B. D) none of the above.

23) The theory of purchasing power parity states that exchange rates between any two currencies will adjust to reflect changes in

A) fiscal policies of the two countries.

B) the current account balances of the two countries.

C) the price levels of the two countries.

D) the trade balances of the two countries.

24) When Americans and foreigners expect the return on dollar deposits to be high relative to the return on foreign deposits, there is a ________ demand for dollar deposits and a correspondingly ________ demand for foreign deposits.

A) lower; higher B) higher; higher C) lower; lower D) higher; lower

25) An increase in the foreign interest rate shifts the expected return schedule for _________ deposits to the _________ and causes the domestic currency to depreciate.

A) foreign; right B) domestic; right C) domestic; left D) foreign; left