

2. Securities Markets

1. A major function of organized securities markets is to facilitate the transfers of securities among investors.

- a. True
- b. False

ANSWER: True

2. A “round lot” is the general unit for trading in a security.

- a. True
- b. False

ANSWER: True

3. The purchase of 53 shares of IBM is an odd lot.

- a. True
- b. False

ANSWER: True

4. If a stock is quoted 20.04-20.25, an investor can sell the stock for 20.25.

- a. True
- b. False

ANSWER: False

5. If a stock is quoted 12.79-13.02, an investor can buy the stock for 13.02.

- a. True
- b. False

ANSWER: True

6. The spread between the bid and ask prices should be viewed as one of the costs of investing.

- a. True
- b. False

ANSWER: True

7. Market makers guarantee to buy and sell at least one round lot at the prices they quote.

- a. True
- b. False

ANSWER: True

8. The level of securities prices is set by market makers.

- a. True
- b. False

ANSWER: False

9. The New York Stock Exchange is an example of a secondary market.

- a. True
- b. False

ANSWER: True

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10. Publicly owned stock that is not listed on an exchange (such as the NYSE) is traded in the over-the-counter markets such as the Nasdaq stock market.

- a. True
- b. False

ANSWER: True

11. Bid and ask price quotations for over-the-counter stocks are not available through the Internet.

- a. True
- b. False

ANSWER: False

12. Stockbrokers set bid and ask prices.

- a. True
- b. False

ANSWER: False

13. Investors who are "bearish" purchase securities.

- a. True
- b. False

ANSWER: False

14. A short sale is a sale that occurs quickly after the stock is purchased.

- a. True
- b. False

ANSWER: False

15. Securities must be paid for by the settlement date.

- a. True
- b. False

ANSWER: True

16. The margin requirement is set by the SEC.

- a. True
- b. False

ANSWER: False

17. The margin requirement sets the maximum cash investment the individual investor must remit.

- a. True
- b. False

ANSWER: False

18. If the investor buys stock on margin and the price subsequently declines, the percentage loss is magnified.

- a. True
- b. False

ANSWER: True

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19. Once securities are purchased, they are usually registered in the brokerage firm's name.

- a. True
- b. False

ANSWER: True

20. After purchasing stock, an investor may place a stop loss order to sell if the stock's price declines.

- a. True
- b. False

ANSWER: True

21. Selling short is selling borrowed securities.

- a. True
- b. False

ANSWER: True

22. Investors are insured against loss from brokerage firm failure by the SEC.

- a. True
- b. False

ANSWER: False

23. A short position is premised on securities prices rising.

- a. True
- b. False

ANSWER: False

24. U. S. citizens may invest in foreign stocks by purchasing American Depository Receipts (ADRs).

- a. True
- b. False

ANSWER: True

25. ADRs pay dividends in foreign currencies.

- a. True
- b. False

ANSWER: False

26. Publicly owned companies must provide the SEC with information that may affect the value of the firm's securities.

- a. True
- b. False

ANSWER: True

27. The purpose of the full disclosure laws is so investors will not make poor investments.

- a. True
- b. False

ANSWER: False

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28. The SEC cannot suspend trading in a firm's stock.

- a. True
- b. False

ANSWER: False

29. The purpose of the federal securities laws is to provide investors with data and facts so they can make informed investment decisions.

- a. True
- b. False

ANSWER: True

30. The Securities Investor Protection Corporation (SIPC) protects individuals from poor investments.

- a. True
- b. False

ANSWER: False

31. The maintenance margin requirement sets the minimum an investor must remit to purchase a stock.

- a. True
- b. False

ANSWER: False

32. If an investor buys stock on margin and the price of the stock rises, the investor will not receive a margin call from the broker.

- a. True
- b. False

ANSWER: True

33. Sarbanes-Oxley created the Public Company Accounting Oversight Board whose task is to regulate securities prices.

- a. True
- b. False

ANSWER: False

34. The objective of Sarbanes-Oxley was to create a stronger firewall between investment banking activities and the role of financial analysts.

- a. True
- b. False

ANSWER: True

35. The primary role of organized securities exchanges is to raise capital (money) for firms.

- a. True
- b. False

ANSWER: False

36. A direct transfer of funds from savers to firms occurs when new securities are issued in the primary market.

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- a. True
- b. False

ANSWER: True

37. The direct sale of new securities to a pension plan is a private placement, and the securities do not have to be registered with the SEC.

- a. True
- b. False

ANSWER: True

38. In an "underwriting" the investment banker guarantees the firm selling the securities a specified amount of funds.

- a. True
- b. False

ANSWER: True

39. In a "best effort" sale of securities, the risk of the sale rests with the investment banker.

- a. True
- b. False

ANSWER: False

40. The syndicate's role in an underwriting is to sell the new issue of securities.

- a. True
- b. False

ANSWER: True

41. If the underwriter overprices a new issue, the market price of the securities will rise.

- a. True
- b. False

ANSWER: False

42. A prospectus is required when a corporation issues new securities that are sold to the general public.

- a. True
- b. False

ANSWER: True

43. The SEC establishes the price of a new issue of stock.

- a. True
- b. False

ANSWER: False

44. The cost of an underwriting (to the firm issuing the securities) is the difference between the price of the securities to the public and the proceeds received by the firm.

- a. True
- b. False

ANSWER: True

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45. A new issue of corporate securities sold to the general public must be registered with the SEC.

- a. True
- b. False

ANSWER: True

46. The SEC establishes the price of a new stock issue.

- a. True
- b. False

ANSWER: False

47. If the price of an initial public offering of stock rises, the windfall gain goes to the firm selling the securities.

- a. True
- b. False

ANSWER: False

48. A "lock-up" refers to a security transaction with an assured profit.

- a. True
- b. False

ANSWER: False

49. A shelf registration involves the selling of new securities without having them registered with the SEC.

- a. True
- b. False

ANSWER: False

50. A broker

- a. stresses one type of investment
- b. makes a market in securities
- c. buys securities for customers' accounts
- d. underwrites stock but not corporate bonds

ANSWER: c

51. The spread is the

- a. difference between the bid and ask prices
- b. commission charged by the broker
- c. difference between the purchase and sale prices
- d. difference between the commissions charged by full service and discount/online brokers

ANSWER: a

52. A market maker

1. sells stock at the ask price
2. buys stock at the ask price
3. sells stock at the bid price
4. buys stock at the bid price

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- a. 1 and 2
- b. 1 and 4
- c. 2 and 3
- d. 3 and 4

ANSWER: b

53. If the quote on stock is reduced, that implies

- 1. supply exceeded demand
 - 2. demand exceeded supply
 - 3. the price was too high
 - 4. the price was too low
- a. 1 and 3
 - b. 1 and 4
 - c. 2 and 3
 - d. 2 and 4

ANSWER: a

54. Daily securities transactions that are reported in the financial media generally include

- 1. the volume of transactions
 - 2. the high and low prices for the day
 - 3. the net change in price from the previous day
- a. 1 and 2
 - b. 1 and 3
 - c. 2 and 3
 - d. all of the above

ANSWER: d

55. A registered representative

- a. makes a market
- b. buys and sells for customers' accounts
- c. represents brokerage firms with the NYSE
- d. sets the spread

ANSWER: b

56. The cost of investing includes

- 1. commissions
 - 2. the spread
 - 3. dividends
- a. 1 and 2
 - b. 1 and 3
 - c. 2 and 3
 - d. all of the above

ANSWER: a

57. Investors are insured from brokerage firm losses by

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- a. the SEC
- b. the Federal Reserve
- c. the SIPC
- d. the FDIC

ANSWER: c

58. Securities regulations protect investors by
- a. requiring disclosures of information by firms
 - b. stopping investors from buying overpriced stock
 - c. reducing competition among brokers
 - d. establishing commission schedules

ANSWER: a

59. Inside information
- a. is obtained from inside brokerage firms
 - b. is reported in a firm's financial statements
 - c. must be disclosed to the SEC
 - d. may not be legally used to obtain security profits

ANSWER: d

60. If a stock is bought on margin,
- a. part of the cost of the investment is borrowed
 - b. the commissions on the investment are increased
 - c. the cost of the investment is reduced
 - d. the interest on the borrowed funds is set by the Securities and Exchange Commission (SEC)

ANSWER: a

61. The margin requirement is set by the
- a. Federal Reserve
 - b. SEC
 - c. FDIC
 - d. SIPC

ANSWER: a

62. Short selling is
- a. selling borrowed securities
 - b. selling stock owned for less than a year
 - c. selling an odd lot
 - d. selling against the advice of the investor's broker

ANSWER: a

63. American Depositary Receipts represent
- a. American stocks traded abroad
 - b. European stocks traded in Europe

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- c. foreign stocks traded in the U.S.
- d. American and foreign stocks traded OTC

ANSWER: c

64. Short selling requires

- 1. no collateral
- 2. a margin payment
- 3. delivering securities owned
- 4. borrowing securities to deliver

- a. 1 and 3
- b. 1 and 4
- c. 2 and 3
- d. 2 and 4

ANSWER: d

65. Gains will result from a short sale if

- a. stock prices rise
- b. stock prices fall
- c. stock prices remain stable
- d. The answer is indeterminate.

ANSWER: b

66. The Sarbanes-Oxley law

- a. reduces potential conflicts of interest between securities analysts and investment bankers
- b. legalizes the sale of securities by investment bankers
- c. requires corporate directors to own stock
- d. mandates that securities analysts file their recommendations with the SEC

ANSWER: a

67. Which of the following is not part of the underwriting process?

- a. the prospectus
- b. the originating house
- c. the SIPC
- d. the SEC

ANSWER: c

68. The syndicate

- 1. facilitates the sale of new securities
- 2. is formed by the originating house
- 3. creates a secondary market in stocks

- a. 1 and 2
- b. 1 and 3
- c. 2 and 3
- d. all of the above

ANSWER: a

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69. If the offer price of a new issue is too low,

1. demand will exceed supply
 2. supply will exceed demand
 3. the price of the securities will rise
 4. the price of the securities will fall
- a. 1 and 3
 - b. 1 and 4
 - c. 2 and 3
 - d. 2 and 4

ANSWER: a

70. The final prospectus does not include

- a. the firm's balance sheet
- b. the price of the securities sold to the public
- c. the underwriter's profit on the sale
- d. the underwriting discount

ANSWER: c

71. A new issue of corporate securities sold to the general public must be

- a. registered with the SEC
- b. initially sold through brokers
- c. offered initially to existing stockholders
- d. bought by specialists in corporate securities

ANSWER: a

72. Concerning a new issue of stock, a lock-up refers to

- a. a guaranteed profit on the initial purchase
- b. a guaranteed profit to the underwriter
- c. the requirement that shares purchased by insiders prior to an initial public offering must retain those shares for a specified period
- d. initial buyers of the stock in the IPO must hold the shares for a specified period of time

ANSWER: c

73. Regarding the short-interest ratio,

- a. it measures the number of shares sold each day
- b. it may be used to forecast subsequent movements in the price of a stock
- c. an increase in the ratio suggests short sellers expect the price of the stock to rise
- d. a reduction in the ratio may be interpreted that stock prices will be stable

ANSWER: b

74. An investor purchased Orange Computer on margin for \$30 a share. The stock's price subsequently increased to \$50 a share at which time the investor sold the stock. If the margin requirement were 60 percent and the interest rate on borrowed funds were 7 percent, what would be the percentage earned on the investor's funds (excluding commissions)? What would have been the return if the investor had not bought the stock on margin?

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ANSWER: Cost of the stock: \$30
 Margin requirement: $(.6)(\$30)=\18
 Amount borrowed: $\$30-\$18=\$12$
 Percentage return when the investor used margin:
 Profit on the trade= $\text{Sale}-\text{Cost}-\text{Interest}$
 $=\$50-\$30-.07(\$12)=\19.16
 Percentage earned on the investor's funds:
 $\$19.16/\$18=106.4\%$
 Percentage return when the investor did not use margin:
 Profit in the trade= $\$50-\$30=\$20$
 Percentage earned on the investor's funds: $\$20/\$30=66.7\%$.

75. An investor bought 100 shares of Copier Corp. on margin for \$85 a share. The firm paid an annual dividend of \$4 a share; the margin requirement was 60 percent with an interest rate of 8 percent on borrowed funds, and commissions on the purchase and sale were \$75. The price of the stock rose to \$120 in one year.

- a. What is the percentage earned on the investment if the stock is bought for cash (i.e., the investor did not use margin)?
 b. What is the percentage earned on the investment if the stock is bought on margin?

ANSWER: a. Profit= $\text{Cash inflow}-\text{Cash outflow}$
 $=\text{Sale}-\text{Commissions}-(\text{Cost}+\text{Commissions})+\text{Dividends}$
 $=\$12,000-\$75-(\$8,500+\$75)+\$400=\$1,750$
 Percentage earned on investor's funds:
 $\$3,750/\$8,075=46.44\%$
 b. Margin required: $(.6)(\$8,500+\$75)=\$5,145$
 Amount borrowed: $(.4)(\$8,500+\$75)=\$3,430$
 Interest cost: $(.08)(\$3,430)=\274.40
 Profit= $\text{Sale}-\text{Commissions}-(\text{Cost}+\text{Commissions})+\text{Dividends}-\text{Interest}$
 $=\$12,000-\$75-(\$8,500+\$75)+\$400-\274.40
 $=\$3,475.60$
 Percentage earned on investor's funds:
 $\$3,475.60/\$5,145=67.55\%$

76. An investor sells 100 shares short at \$43. The sale requires a margin deposit equal to 60 percent of the proceeds of the sale. If the investor closes the position at \$49, what was the percentage earned or lost on the investment? If the position had been closed when the price of the stock was \$27, what would have been the percent earned or lost on the position?

ANSWER: Proceeds of the sale $\$43 \times 100 = \$4,300$
 Margin requirement: $.6 \times \$4,300 = \$2,580$

When the price of the stock rises to \$49, the investor loses \$600 ($\$4,300 - \$4,900$). The percentage lost on the invested funds is
 $(\$600)/\$2,580 = (23.2\%)$.

When the price of the stock falls to \$27, the investor earns a profit of \$1,600 ($\$4,300 - \$2,700$). The percentage return is
 $\$1,600/\$2,580 = 62.0\%$.

These percentage returns do not consider (1) commissions, (2) any interest if the investor borrowed the funds to meet the margin requirement, and (3) any dividends the short seller must pay to the investor from whom the shares were borrowed.

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77. An investor sells 100 shares short at \$43. The sale requires a margin deposit equal to 60 percent of the proceeds of the sale. The company paid a cash dividend of \$2 per share. If the investor closed the position at \$36, what was the percentage earned or lost on the investment?

ANSWER: This problem repeats the previous problems and adds a dividend payment that the short seller must cover.

Proceeds of the sale $\$43 \times 100 = \$4,300$

Margin requirement: $.6 \times \$4,300 = \$2,580$

When the price of the stock falls to \$36, the investor earns a profit of \$700 ($\$4,300 - \$3,600$). However, the short seller must cover the \$2 dividend, so the net gain is \$500 ($\$700 - \$200 = \500). The percentage return is $\$500 / \$2,580 = 19.4\%$.