***Financial Markets and Institutions, 7e* (Saunders)**

**Chapter 17 Investment Companies**

1) Funds that specialize in municipal bonds and certain types of real estate to minimize tax liabilities are called hybrid funds.

2) Hedge funds can short sell securities, whereas most mutual funds cannot.

3) A hedge fund that goes long in a convertible bond and short in the equity of the same firm is employing a market neutral arbitrage strategy.

4) The shares of a closed-end fund with market value assets of $200 million and two million shares outstanding will always trade at a market value of $100 per share.

5) If you invest $10,000 in a mutual fund with a NAV of $50 per share and a 5.5 percent back-end load, you will receive less than 200 shares in the fund.

6) Because of their ability to hedge, the subprime mortgage crisis did not cause any significant losses to hedge funds.

7) Offshore hedge funds are not subject to taxation on fund distributions nor to U.S. estate taxes.

8) The market value of a fund's net assets divided by the number of mutual fund shares outstanding is called the NAV of the fund.

9) Open-end fund shares often trade at a discount or premium relative to NAV.

10) Load funds typically provide investors with higher rates of return and offer more services such as check writing, transfers between funds, and so forth, than no load funds.

11) A 12b-1 fee is an implicit load charge.

12) Households are the largest owner of money market mutual funds.

13) Hedge funds and REITS often employ significant amounts of leverage, but standard open-end mutual funds do not.

14) The Federal Mutual Fund Commission (FMFC) is the primary regulator of the mutual fund industry.

15) Unit investment trusts (UITs) issue only a fixed number of shares redeemable at a specific termination date.

16) Load funds charge one-time sales commissions that can be paid either upfront or at end of the investing period in the mutual fund.

17) The price of an ETF is determined once a day when the market closes.

18) ETFs are private investment pools, which are exempt from SEC regulations and with the ability to pursue diverse investment choices.

19) Index funds have the highest cost among the different types of mutual funds.

20) Money market mutual funds consist of a mixture of bonds and money market securities.

21) Open-end mutual funds guarantee

A) investors a minimum rate of return.

B) investors a minimum NAV.

C) to redeem investor's shares upon demand at current NAV.

D) to earn the rate promised in the prospectus.

E) None of these options are correct.

22) Hedge funds charge expense fees and performance fees. The average performance fee on hedge funds is \_\_\_\_\_\_\_\_.

A) 5 percent

B) 10 percent

C) 15 percent

D) 20 percent

E) 25 percent

23) ETFs are a direct competitor to \_\_\_\_\_\_\_\_.

A) hedge funds

B) money market mutual funds

C) REITS

D) index funds

E) market neutral funds

24) As the economy weakens, one would expect investment in \_\_\_\_\_\_\_\_ funds to increase and investment in \_\_\_\_\_\_\_\_ funds to decrease, ceteris paribus.

A) money market mutual; equity

B) equity; bond

C) municipal bond; money market mutual

D) corporate bond; municipal bond

E) long-term; short-term

25) Hybrid mutual funds normally invest significant amounts in

A) common stock.

B) commercial paper.

C) long-term bonds.

D) treasury bills.

E) both common stock and long-term bonds.

26) Money market mutual funds (MMMFs) have caused disintermediation at banks at times. This is because MMMFs

A) sometimes pay higher interest rates than bank deposits.

B) are less risky than bank deposits.

C) are now federally insured, like bank deposits.

D) offer guaranteed rates of return.

E) None of these options are correct.

27) Actively managed funds find it difficult to consistently earn higher risk-adjusted returns than a broad stock market index. The difference in return between actively managed funds and passively managed index funds can be explained by which of the following?

I. Lower expense ratios at index funds

II. Higher turnover ratios at index funds

III. Differences in returns in sectors of the market and the overall market return

A) II only

B) I and III only

C) I and II only

D) II and III only

E) I, II, and III

28) By type of fund, there are more \_\_\_\_\_\_\_\_ funds than any other.

A) equity

B) bond

C) taxable money market

D) tax-exempt money market

E) hybrid

29) The largest proportion of long-term mutual fund assets is held by \_\_\_\_\_\_\_\_.

A) bank trusts and estates

B) the household sector

C) nonfinancial corporate business

D) private pension funds

E) life insurance firms

30) The market value of a mutual fund's assets divided by the number of fund shares outstanding is equal to the

A) load charge.

B) NAV.

C) expense ratio.

D) 12b-1 fee.

E) management fee.

31) Rank the following in asset size from largest to smallest in 2016.

I. Mutual funds

II. Insurance companies

III. Depository institutions

A) I, II, III

B) I, III, II

C) II, III, I

D) III, II, I

E) III, I, II

32) You have $10,000 to invest and you are considering investing in a fund. The fund charges a front-end load of 5.75 percent and an annual expense fee of 1.25 percent of the average asset value over the year. You believe the fund's gross rate of return will be 11 percent per year. If you make the investment, what should your investment be worth in one year?

A) $10,135.48

B) $10,337.46

C) $10,461.75

D) $10,556.23

E) $10,578.92

33) A fund has a NAV of $30 per share but the shares are currently selling for $32. This fund must be

A) an open-ended fund.

B) a closed-end fund.

C) a balanced fund.

D) an aggressive growth fund.

E) a money market mutual fund.

34) An open-end mutual fund owns 1,500 shares of Krispy Kreme priced at $12. The fund also owns 1,000 shares of Ben & Jerry's priced at $43, and 2,000 shares of Pepsi priced at $50. The fund itself has 3,500 of its own shares outstanding. What is the NAV of a fund's share?

A) $66

B) $56

C) $46

D) $36

E) $26

35) You have $16,000 to invest in a mutual fund with a NAV = $45. You choose a fund with a 4 percent front load, a 1 percent management fee, and a 0.25 percent 12b-1 fee. Assume that the management and 12b-1 fees are charged on year-end assets. The gross annual return on the fund's shares was 9 percent. What was your net annual rate of return to the nearest basis point?

A) 3.33 percent

B) 7.64 percent

C) 6.25 percent

D) 4.52 percent

E) 4.64 percent

36) Investors pay load charges to receive

A) higher returns on their investments.

B) additional services from funds.

C) voting shares of stock.

D) advice on which fund to buy.

E) 12b-1 remunerations.

37) A money market mutual fund's total assets increase from $100 to $105 when the fund has 100 shares outstanding. Which of the following will happen?

A) The fund's NAV will rise from $100 to $105.

B) The fund's NAV per share will rise from $1 to $1.05.

C) The fund will issue a total of five new shares.

D) The fund's NAV will fall 5 percent.

E) The fund will close to new investors.

38) The primary regulator of mutual funds is the

A) NASD.

B) CFTC.

C) NYSE.

D) SEC.

E) NSMIA.

39) You have $12,500 to invest and you are considering investing in Fund X. The fund charges a front-end load of 3 percent and an annual expense fee of 2.25 percent of the ending asset value over the year. You believe the fund's gross rate of return will be 8 percent per year. If you make the investment, what should your investment be worth in one year?

A) $12,125.20

B) $13,095.00

C) $12,654.80

D) $12,800.36

E) $13,162.50

40) You have $15,000 to invest in a mutual fund. You choose a fund with a 3.5 percent front load, a 1.75 percent management fee, and a 0.5 percent 12b-1 fee. Assume, for simplicity, that the management and 12b-1 fees are charged on year-end assets. The gross annual return on the fund's shares was 12.50 percent. What was your net annual rate of return to the nearest basis point?

A) 9.97 percent

B) 6.12 percent

C) 9.25 percent

D) 5.42 percent

E) 8.56 percent

41) Which one of the following fund types is likely to have the lowest annual expense ratio?

A) Index funds

B) Equity funds

C) Bond funds

D) Balanced funds

E) Hybrid funds

42) A(n) \_\_\_\_\_\_\_\_ fund must hold substantial cash reserves in order to meet fund redemptions from shareholders.

A) closed-end

B) REIT

C) open-end mutual

D) ETF

E) unit trusts

43) You wish to invest $17,445 in a mutual fund with a NAV of $26.03. The fund charges a front-end load of 4.50 percent. How many fund shares will you receive?

A) 595

B) 640

C) 616

D) 668

E) 628

44) A fund that has a fixed number of shares outstanding and is traded on an exchange is called a(n)

A) open-end mutual fund.

B) hybrid fund.

C) market timing fund.

D) index fund.

E) closed-end fund.

45) ETFs have several advantages over index funds, including the ability to

I. trade throughout the day at continuously updated prices.

II. purchase ETF shares on margin.

III. sell ETF shares short.

IV. sell the shares back to the fund.

A) I, II, and III only

B) I, III, and IV only

C) II, III, and IV only

D) II and III only

E) I, II, III, and IV

46) You are considering purchasing shares in a typical mutual fund that has three classes of shares outstanding: Class A, Class B, and Class C. If you purchase Class A shares, you will pay

A) a back-end load and no 12b-1 fees.

B) a front-end load and a small 12b-1 fee.

C) no front-end load but a back-end load.

D) a back-end load and full 12b-1 fees.

E) a front-end load and full 2b-1 fees.

47) You are considering purchasing shares in a typical mutual fund that has three classes of shares outstanding: Class A, Class B, and Class C. If you purchase Class C shares, you will pay

A) a back-end load and no 12b-1 fees.

B) a front-end load and a small 12b-1 fee, but eventually your shares will be converted to Class A shares.

C) no front-end load but a back-end load.

D) a back-end load and full 12b-1 fees.

E) a front-end load and full 12b-1 fees.

48) One of the recent trading abuses in the mutual fund industry was allowing selected investors to rapidly trade in and out of a mutual fund in order to profit on stale prices. This practice is called

A) diluted brokerage.

B) front running.

C) directed order flow.

D) soft dollar commissions.

E) market timing.

49) Which of the following is not considered an abusive activity in mutual funds investing?

A) Market timing

B) Late trading

C) Directed brokerage

D) Indexing

E) Improper assessment of fees

50) Which of the following is not an advantage of a mutual fund?

A) Cheaper transactions costs

B) Diversification

C) Monitoring activities at lower costs

D) No default risk

E) All of these choices are correct.

51) Why are mutual funds popular with individual investors?

52) What is the purpose of index funds? How does this differ from other equity mutual funds? Why are index funds growing in popularity?

53) How are money market mutual funds similar to and different from bank deposits?

54) How do closed-end investment companies differ from open-end mutual funds?

55) What are the four main categories of mutual fund trading abuses mentioned in the text? Explain the problem with each.

56) On Monday an equity mutual fund has cash of $150 and stocks worth $900. The fund has 100 shares outstanding. On Tuesday the stocks fall in value to $800 and 10 shares are then redeemed by the fund. Assuming that the fund uses its cash first to cover redemptions, what is the one-day rate of return to the remaining fund shareholders, and how much cash and stock does the fund now have?

57) An investor is considering two mutual funds. Fund A has a 5.75 percent front-end load and a 1.25 percent expense ratio. Fund B is no-load, but has a 2.25 percent expense ratio. If the investor plans on being in either fund for six years, which should they choose given that they have $16,000 to invest and both funds have gross returns of 12 percent per year? Fees are applied at each year-end to year-end asset values, but the load is taken out up front only once.

58) Why do many mutual funds now offer three different classes of shares? What are the differences and what should you consider in choosing the classes?

59) Why is it important to regulate the mutual fund industry?

60) In what ways are hedge funds different from mutual funds?

61) What new rules have resulted from the mutual fund trading abuses?

62) What are the primary differences between index funds and ETFs? What are two examples of ETFs?

63) Hedge funds may be classified into three types based on their investment strategies and risk level. What are the three types and their broad risk levels? Many different strategies exist in each type. List one example strategy in each type.

64) How are hedge fund expenses different from mutual fund expenses? What are hurdle rates and high water marks at a hedge fund? Why are these used?