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

**Chapter 8 Stock Markets**

1) A type of absentee ballot that allows a representative to vote on behalf of the stockholder is called a proxy.

Answer: TRUE

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

2) An order to buy shares of stock at a specified price or better is called a limit order.

Answer: TRUE

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

3) Stock splits change the divisor in a price-weighted index but do not result in any net change in the divisor of a value-weighted index.

Answer: TRUE

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-06 Identify the major stock market indexes.

Accessibility: Keyboard Navigation

4) A long-term investor in a high marginal tax bracket will normally prefer a dollar of capital gain to a dollar of dividend yield.

Answer: TRUE

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

5) In the event of bankruptcy, a firm's janitor must be paid all of the salary owed to him before stockholders receive anything.

Answer: TRUE

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

6) At year-end a firm has assets of $100 and debts due of $120. In this situation, the stockholders must pay an additional $20 out of their own pocket.

Answer: FALSE

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

7) In cumulative voting, a stockholder who owns 51 percent of the shares can be assured of the ability to elect the entire board of directors.

Answer: FALSE

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

8) The Dow Jones Industrial Average is a price-weighted index of 30 stocks chosen to represent the overall market.

Answer: TRUE

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-06 Identify the major stock market indexes.

Accessibility: Keyboard Navigation

9) Preferred stockholders have a claim senior to common stock but junior to bondholders.

Answer: TRUE

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-02 Identify the major characteristics of preferred stock.

Accessibility: Keyboard Navigation

10) The market in which firms sell new securities to raise cash is called the secondary market.

Answer: FALSE

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-04 Describe the major secondary stock markets.

Accessibility: Keyboard Navigation

11) The NYSE merged with the London Stock Exchange to form the merged company NYSE Euronext.

Answer: FALSE

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-04 Describe the major secondary stock markets.

Accessibility: Keyboard Navigation

12) Dual class stock refers to firms with both common and preferred stock outstanding.

Answer: FALSE

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

13) If the stock markets are semi-strong efficient, stock prices reflect all historic and current public information about a firm but prices do not reflect inside information.

Answer: TRUE

Difficulty: 2 Medium

Topic: Other Issues Pertaining to Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-08 Explain the three forms of market efficiency.

Accessibility: Keyboard Navigation

14) A seasoned equity offering occurs when an issuer that already has equity publicly trading issues new shares to the public.

Answer: TRUE

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

15) International stock markets provide the potential of diversification to the investor.

Answer: TRUE

Difficulty: 1 Easy

Topic: International Aspects of Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-09 Describe the major characteristics of international stock markets.

Accessibility: Keyboard Navigation

16) From a U.S. investor perspective, diversifying in the international stock markets adds foreign exchange risk and political risk to the portfolio.

Answer: TRUE

Difficulty: 1 Easy

Topic: International Aspects of Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-09 Describe the major characteristics of international stock markets.

Accessibility: Keyboard Navigation

17) A participating preferred stock has a fixed dividend payment every year.

Answer: FALSE

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-02 Identify the major characteristics of preferred stock.

Accessibility: Keyboard Navigation

18) Rights offering provide existing stockholders the opportunity to purchase shares of new issues to maintain their proportional ownership in the corporation.

Answer: TRUE

Difficulty: 2 Medium

Topic: Primary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

19) Individuals and households indirectly invest in corporate stock through investments in mutual funds and pension funds.

Answer: TRUE

Difficulty: 1 Easy

Topic: Stock Market Participants

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-07 Know who the major stock market participants are.

Accessibility: Keyboard Navigation

20) Compared to the market order, a limit order may not be executed if the market is moving fast.

Answer: TRUE

Difficulty: 2 Medium

Topic: Secondary Stock Market

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

21) You buy a stock for $34 per share and sell it for $36 after you collect a $1.00 per share dividend. Your pretax capital gain yield is \_\_\_\_\_\_\_\_ and your pretax dividend yield is \_\_\_\_\_\_\_\_.

A) 2.94 percent; 2.78 percent

B) 8.82 percent; 0.00 percent

C) 5.88 percent; 2.94 percent

D) 5.56 percent; 2.78 percent

E) 4.65 percent; 3.17 percent

Answer: C

Explanation: Pretax capital gain yield = (36 − 34)/34 = 5.88 percent , and pre-tax dividend yield = 1/34 = 2.94%

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

22) Common stocks typically have which of the following that bonds do *NOT* have?

I. Voting rights

II. Fixed cash flows

III. Set maturity date

IV. Tax deductibility of cash flows to investors

A) I only

B) I, II, and IV only

C) II, III, and IV only

D) IV only

E) I, II, III, and IV

Answer: A

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

23) You buy a stock for $30 per share and sell it for $33 after holding it for slightly over a year and collecting a $0.75 per share dividend. Your ordinary income tax rate is 28 percent and your capital gains tax rate is 20 percent. Your after-tax rate of return is \_\_\_\_\_\_\_\_.

A) 8.00 percent

B) 10.25 percent

C) 12.50 percent

D) 9.80 percent

E) 8.75 percent

Answer: D

Explanation: [((33 − 30) × (1 − 0.20)) + (0.75 × (1 − 0.28))]/30 = 2.94/30 = 9.8%

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

24) An investor has a 38 percent ordinary income tax rate and a 20 percent long-term capital gains tax rate. The investor holds stock in a firm that could pay its usual $1 per share dividend or reinvest the cash in the firm. The stock price is currently $30 per share. If the firm does not pay the dividend, the share price will rise. If it pays the dividend, the share price will stay the same. By how much must the share price rise if the dividend is not paid in order to make the investor indifferent between receiving the dividend or not?

A) $1.00

B) $0.59

C) $0.78

D) $0.97

E) $0.50

Answer: C

Explanation: Change in share price required = [1 × (1 − 0.38)]/(1 − (0.20) = $0.78

Difficulty: 3 Hard

Topic: Stock Market Securities

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

25) With \_\_\_\_\_\_\_\_ voting, all directors up for election are voted on by the shareholders at the same time in one general election.

A) straight

B) participating

C) nonparticipating

D) proxy

E) cumulative

Answer: E

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

26) If all preferred dividend payments that have been missed must be paid before any common stock dividend can be paid, the preferred stock is called \_\_\_\_\_\_\_\_ preferred stock.

A) cumulative

B) participating

C) nonparticipating

D) voting

E) dual class

Answer: A

Difficulty: 1 Easy

Topic: Stock Market Securities

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-02 Identify the major characteristics of preferred stock.

Accessibility: Keyboard Navigation

27) In 2007 the NYSE merged with \_\_\_\_\_\_\_\_.

A) NASDAQ

B) Euronext

C) American Exchange

D) Chicago Mercantile Exchange

E) London Stock Exchange

Answer: B

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-04 Describe the major secondary stock markets.

Accessibility: Keyboard Navigation

28) If the net proceeds are greater than the gross proceeds in an underwritten offering, then

A) the investment banker made a profit on the spread.

B) the issuing company underpriced its securities.

C) the issue fails to occur.

D) the SEC rescinds the issue.

E) None of these choices are correct.

Answer: E

Difficulty: 3 Hard

Topic: Primary and Secondary Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

29) The preemptive right is designed to

A) allow management to diffuse stock ownership any voting power.

B) allow managers to preempt a stock offering if they do not like the terms of the deal.

C) allow existing shareholders the right to sell their existing shares before the new offer.

D) allow existing shareholders to buy shares of the new offering if they desire.

E) None of these choices are correct.

Answer: D

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

30) The NASDAQ automatic order execution system for individual traders placing buy or sell orders of 1,000 or fewer shares is called the

A) ECN Network.

B) SOE System.

C) NASDAQ/AMEX Joint Program.

D) Instinet Network.

E) E\*Trade Online Program.

Answer: B

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

31) The preliminary version of a security offer that is circulated to potential buyers before SEC approval (registration) is obtained is called a

A) final prospectus.

B) shelf registration statement.

C) due diligence draft.

D) waiting period offer.

E) red herring prospectus.

Answer: E

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

32) A shelf registration allows firms the opportunity to avoid the normal \_\_\_\_\_\_\_\_ day waiting period by allowing preregistration of securities for up to \_\_\_\_\_\_\_\_ years.

A) 20-; two

B) 10-; one

C) 15-; three

D) 20-; one

E) 30-; two

Answer: A

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

33) Which of the following is/are true about specialists?

I. Investment banks generally cannot be specialists.

II. Specialists are used by the NASDAQ system.

III. Market and limit orders are transacted at specialist posts, but the specialist's own account orders are executed elsewhere.

IV. Specialists help maintain continuous trading.

A) I, II, and III only

B) I and IV only

C) II, III, and IV only

D) I only

E) III only

Answer: B

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

34) As of December 2005, trading licenses are required to conduct trades on the floor of the NYSE. Which of the following statements about these trading licenses is/are correct?

I. Licenses are auctioned off in a special type of auction called a Dutch auction.

II. Only a member organization of the NYSE is eligible to bid for a trading license.

III. The SEC determines the maximum bid price.

IV. Trading licenses are good for 10 years.

A) II and III only

B) I and II only

C) I and III only

D) II and IV only

E) I, II, III, and IV

Answer: B

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

35) Which of the following information is *NOT* usually found in a *Wall Street Journal* stock quote?

A) Dividend yield

B) Price-earnings ratio

C) Closing price of the stock

D) Stock rating

E) Ticker symbol

Answer: D

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

36) In terms of volume of trading and market value of firms traded, the \_\_\_\_\_\_\_\_ is the largest U.S. stock market. In terms of number of firms traded, the \_\_\_\_\_\_\_\_ is the largest in the United States.

A) NYSE; NYSE

B) NASDAQ; NYSE

C) NYSE; AMEX

D) NYSE; NASDAQ

E) NASDAQ; AMEX

Answer: D

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-04 Describe the major secondary stock markets.

Accessibility: Keyboard Navigation

37) On the NASDAQ system, the inside quotes are the

A) lowest ask and lowest bid.

B) lowest bid and highest ask.

C) highest bid and highest ask.

D) highest bid and lowest ask.

E) None of these choices are correct.

Answer: D

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

38) NYSE listing has traditionally benefited a firm by

A) improving the stock's price.

B) generating increased publicity for the firm.

C) providing easier access to primary market capital.

D) generating increased publicity for the firm and providing easier access to primary market capital.

E) improving the stock's price, generating increased publicity for the firm, and providing easier access to primary market capital.

Answer: E

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-04 Describe the major secondary stock markets.

Accessibility: Keyboard Navigation

39) Which of the following indexes are value-weighted?

I. NYSE Composite

II. S&P 500

III. NASDAQ Composite

IV. Dow Jones Industrial Average

A) I, II, III, and IV

B) I only

C) II only

D) II, III, and IV only

E) I, II, and III only

Answer: E

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-06 Identify the major stock market indexes.

Accessibility: Keyboard Navigation

40) The largest single type of holder of common stock ($) is

A) pension funds.

B) households.

C) mutual funds.

D) brokers and dealers.

E) life insurance firms.

Answer: B

Difficulty: 1 Easy

Topic: The Stock Markets: Chapter Overview; Stock Market Participants

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-07 Know who the major stock market participants are.

Accessibility: Keyboard Navigation

41) A firm is using cumulative voting and four director spots are up for election. There are 3.6 million shares outstanding. How many shares must a minority owner own or control to ensure that he or she can gain control of one seat on the board of directors?

A) 900,001

B) 880,001

C) 720,001

D) 1,800,001

E) 1,750,001

Answer: C

Explanation: [((1/(4 + 1)) × 3.6 million] + 1

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

42) Today, Stock A is worth $20 and has 1,000 shares outstanding. Stock B costs $30 and has 500 shares outstanding. Stock C is priced at $50 per share and has 1,200 shares outstanding. If, tomorrow, Stock A is priced at $22, Stock B at $35, and Stock C is worth $48, what would the value-weighted index amount equal? (The index has a base period value of 100.)

A) 35.00

B) 105.00

C) 108.44

D) 101.45

E) 102.21

Answer: E

Explanation: {(22 × 1000) + (35 × 500) + (48 × 1200)} / {(20 × 1000) + (30 × 500) + (50 × 1200)} = 102.21

Difficulty: 3 Hard

Topic: Primary and Secondary Stock Markets

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 08-06 Identify the major stock market indexes.

Accessibility: Keyboard Navigation

43) Suppose that over the last 10 to 15 years significantly large numbers of investors have been able to earn abnormal returns from using the firm's publicly available financial information to forecast growth in earnings and dividends. This would be evidence that the markets are not

I. weak form efficient.

II. semi-strong form efficient.

III. strong form efficient.

A) I only

B) I and II only

C) III only

D) II and III only

E) I, II, and III

Answer: B

Difficulty: 3 Hard

Topic: Stock Market Participants

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-08 Explain the three forms of market efficiency.

Accessibility: Keyboard Navigation

44) In a \_\_\_\_\_\_\_\_ the firm preregisters with the SEC any securities it wishes to sell over the next two years.

A) rights

B) full underwritten

C) general cash

D) shelf registration

E) best efforts

Answer: D

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

45) The stamp on a prospectus accompanying a new issue that indicates the issue has not yet been approved for sale by the SEC is called the

A) green hornet.

B) seal of approval.

C) red herring.

D) eagle stamp.

E) Reg FD.

Answer: C

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

46) The NYSE specialists are charged with

I. trading for their own account.

II. ensuring public limit orders are executed.

III. facilitating processing public market orders.

A) I only

B) I and II only

C) II and III only

D) I and III only

E) I, II, and III

Answer: E

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 08-04 Describe the major secondary stock markets.

Accessibility: Keyboard Navigation

47) The age group that holds the most stock as of April 2016 is the \_\_\_\_\_\_\_\_ group.

A) under 35

B) 35–54

C) 55 and older

D) 65 and older

Answer: C

Difficulty: 1 Easy

Topic: Stock Market Participants

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-07 Know who the major stock market participants are.

Accessibility: Keyboard Navigation

48) The electronic-based market for less actively traded U.S. securities is the

A) ADR market.

B) OTC Bulletin Board.

C) Pink Sheet stocks.

D) NYSE Low Volume Market.

E) ECN Market.

Answer: B

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

49) Computerized markets that automatically match orders between buyers and sellers and are used primarily by institutions traders are called

A) OTC bulletin boards.

B) SPIDRS.

C) index markets.

D) ECNs.

E) specialists.

Answer: D

Difficulty: 1 Easy

Topic: Primary and Secondary Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

50) Ethanol Lawn Mowers issued 500,000 shares to the public. The gross proceeds were $31,250,000 and the net proceeds were $30 million. Merrel Bench was the lead underwriter and deal negotiator, but 10 other investment bankers (one of which was Golden Sax) were also used to put up capital and help sell the issue. Which of the following statements is/are correct?

I. The public paid $62.50 a share.

II. Golden Sax was the originating house.

III. The spread per share was $3.50.

IV. Merrel Bench is the sole book running manager.

 V. This offer was a syndicated deal.

A) I, II, and IV only

B) III and V only

C) I, IV, and V only

D) II and III only

E) I and V only

Answer: C

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Understand; Analyze; Apply

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

51) Which of the following ADRs is considered the most risky type of ADR?

A) Level 1 ADR

B) Level 2 ADR

C) Level 3 ADR

D) Level 4 ADR

E) Level 5 ADR

Answer: A

Difficulty: 2 Medium

Topic: International Aspects of Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-09 Describe the major characteristics of international stock markets.

Accessibility: Keyboard Navigation

52) According to the strong form of efficient market hypothesis:

A) Private information is of no help in earning abnormally high returns.

B) Using past price and volume information one can earn abnormally high returns from stocks.

C) Using insider information one can earn abnormally high returns from stocks.

D) Financial statement analysis can be used to earn abnormally high returns from stocks.

E) Equity Analysts are always correct in predicting the best stocks.

Answer: A

Difficulty: 2 Medium

Topic: Market efficiency

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-08 Explain the three forms of market efficiency.

Accessibility: Keyboard Navigation

53) A publicly traded company gave its existing shareholders the opportunity to purchase from the new stocks that it will issue. The existing shareholders can purchase 3 new shares at a price of $10 per share for every 8 shares held. This is an example of:

A) Private placement

B) Rights offering

C) Shelf registration

D) Initial public offering

E) Syndicate offering

Answer: B

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

54) Suppose you own 500,000 shares of common stock in a firm with 40 million total shares outstanding. The firm announces a plan to sell an additional 5 million shares through a rights offering. The market value of the stock is $32.5 before the rights offering and the new shares are being offered to existing shareholders at a $2.50 discount. If you exercise your preemptive rights, how many of the new shares can you purchase?

A) 100,000 shares

B) 50,000 shares

C) 62,500 shares

D) 32,500 shares

E) 45,000 shares

Answer: C

Explanation: Current ownership is 500,000/40,000,000 = 0.0125 or 1.25%

With the preemptive rights you can purchase 0.0125 × 5,000,000 = 62,500 shares at $30 each.

Difficulty: 3 Hard

Topic: Primary and Secondary Stock Markets

Bloom's: Apply

AACSB: Analytical Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

55) Suppose a firm has 10 million shares of common stock outstanding and seven candidates are up for election to three seats on the board of directors. If the firm uses cumulative voting to elect its board, what is the minimum number of votes needed to ensure election to the board?

A) 3,000,000

B) 4,285,715

C) 5,000,000

D) 7,500,001

E) 10,000,000

Answer: D

Explanation: Number of votes available 3 × 10 = 30 million votes

The minimum number of votes needed to ensure 1 election on the board is [(1 × 30,000,000 )/4] + 1 = 7,500,001 votes, because no matter how the other votes are casted among the rest of the 6 candidates, the candidate with 7,500,001 votes will be elected on the board.

Difficulty: 3 Hard

Topic: Stock Market Securities

Bloom's: Apply

AACSB: Analytical Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

56) Data show that since 1942, only 8 of the 14 recessions predicted by the stock market actually occurred. Although stocks are a leading economic indicator, what are some reasons why a stock price decline might not indicate an upcoming recession?

Answer: Stock prices might drop because equity risk premiums temporarily rise, depressing stock prices without foreshadowing lower growth. It may also be that current stock prices are overly optimistic about future growth; when the over-optimism is corrected, stock prices fall, sometimes sharply. This may occur even if no change in underlying economic growth takes place. One might also observe slower growth than expected that does not result in a recession. More succinctly, expectations may change more rapidly than actual economic growth rates.

Difficulty: 2 Medium

Topic: Other Issues Pertaining to Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-08 Explain the three forms of market efficiency.

Accessibility: Keyboard Navigation

57) What are weak form, semi-strong form, and strong form efficiency? Does one form of efficiency imply another?

Answer: Weak form efficiency implies that past price and trading information is contained in today's stock price and is of no value to an investor. Semi-strong efficiency implies that an investor cannot use any publicly available information to predict tomorrow's price change. Strong form efficiency implies that public and inside information is of no value in predicting tomorrow's price change. Strong form efficiency implies that the markets are also weak and semi-strong form efficient. Likewise, semi-strong form efficiency implies that the markets are also weak form efficient.

Difficulty: 2 Medium

Topic: Other Issues Pertaining to Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-08 Explain the three forms of market efficiency.

Accessibility: Keyboard Navigation

58) Answer the following questions concerning the given partial stock quote:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Name | Symbol | | | Close | | | | Volume | | | | Div | | | | P/E | | | | YTD  %Chg | | |
| Abbott Laboratories |  | ABT |  | | $ | 53.75 |  | |  | 4,905,983 |  | |  | 1.3 |  | |  | 44 |  | |  | 10.3 | |  |

a. What was the dividend yield?

b. What was the most recent four quarters of earnings per share?

c. Valued at the closing price, what was the total dollar volume of shares traded?

d. What was the stock price at the beginning of the year?

Answer:

a. The dividend yield = $1.3/$53.75 = 2.4%

b. The most recent four quarters of earnings per share = $53.75/EPS = 44; EPS = $1.22

c. Valued at the close, the total $ volume of shares traded = $53.75 × 4,905,983 = $263,696,586

d. The stock price at the beginning of the year was ($53.75 − Pbegin)/Pbegin = 0.103; Pbegin = $53.75/(1 + 0.103) = $48.73

Difficulty: 3 Hard

Topic: Primary and Secondary Stock Markets

Bloom's: Understand; Analyze; Apply

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

59) What are the advantages and disadvantages of foreign investing? How does an ADR help overcome the disadvantages?

Answer: International investing can reduce risk by generating additional diversification benefits. These benefits have been small lately because the United States has dominated the rest of the world in economic performance, but this is not likely to continue indefinitely. International investing also introduces foreign exchange risk, information risk, and sovereign risk, as well as trading and tax complexities. The ADRs limit foreign exchange risk and other trading complexities. Foreign firms are also required to meet U.S. disclosure requirements when ADRs are issued, although the amount of disclosure varies with the level of the ADR.

Difficulty: 2 Medium

Topic: International Aspects of Stock Markets

Bloom's: Remember; Understand

AACSB: Reflective Thinking

Learning Goal: 08-09 Describe the major characteristics of international stock markets.

Accessibility: Keyboard Navigation

60) As a small (minority) stockholder would you prefer to have cumulative voting or straight voting shares? As a majority shareholder?

Answer: Cumulative voting gives a small shareholder a better chance of electing a given board member because the shareholder doesn't have to own (or control by proxy) a majority of shares. As a controlling stockholder, you can ensure that you will always be able to elect the entire board of your choice if you have straight voting.

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

61) When would preferred stock be a better investment choice than common stock or bonds?

Answer: Preferred stocks have higher yields than bonds and much higher dividend yields than stocks. One will not get capital gains with preferred stock, however. Thus, if steady high pretax yields are desired, with little or no chance of capital gains, and a tax-sheltered investment vehicle such as an IRA is available, preferred may be an ideal choice.

Difficulty: 2 Medium

Topic: Stock Market Securities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-02 Identify the major characteristics of preferred stock.

Accessibility: Keyboard Navigation

62) What are ECNs? How are they changing trading in the traditional markets?

Answer: ECNs are electronic communication networks. These computerized trading systems automatically match buy and sell orders. Since they are electronic, ECNs allow for extended trading hours. As fewer humans and physical overheads are required, ECNs provide a potentially cheaper trading platform than the exchanges. Institutions use ECNs to solicit trading interest on large blocks of shares. The rule changes requiring publishing all quotes from different markets mean that ECN market share is likely to grow at the expense of the NYSE and NASDAQ (hence, a rationale for the mergers between NYSE and Archipelago, and NASDAQ and Instinet).

Difficulty: 2 Medium

Topic: Primary and Secondary Stock Markets

Bloom's: Remember; Understand

AACSB: Reflective Thinking

Learning Goal: 08-05 Examine the process by which a trade takes place in the stock markets.

Accessibility: Keyboard Navigation

63) In what major ways do stocks differ from bonds?

Answer: Stocks have the following characteristics:

1. Discretionary cash flows (dividend payments). The board of directors may choose to pay or not to pay a dividend.

2. Residual claim in the event of bankruptcy.

3. No maturity date; thus there is no guarantee of a return of your principal.

4. Voting rights. As a stockholder you are part owner of the company and typically have a voice in company decisions.

5. Stock markets are deeper and more actively traded than bond markets.

Difficulty: 3 Hard

Topic: The Stock Markets: Chapter Overview

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-01 Identify the major characteristics of common stock.

Accessibility: Keyboard Navigation

64) A firm desires to sell stock to the public. The underwriter charges $0.45 million in fees and offers to buy six million shares from the firm at a price of $35 per share. In addition, registration and audit fees total $130,000, and marketing and miscellaneous fees add up to another $75,000. The underwriter expects to earn gross proceeds per share of $38. What is the issuing firm's out-of-pocket dollar transaction cost to issue the stock? Immediately after the stock was issued, the stock price rose to $40. What is the issuing firm's opportunity cost? What is the total issuance cost, including opportunity costs, as a percentage of the total funds available to the issuing firm?

Answer: Out-of-pocket cost = $450,000 + $130,000 + $75,000 = $655,000

Opportunity cost = 6 million shares × ($40 − $35) = $30,000,000

Actual funds available to firm: (6 million × $35) − $655,000 = $209,345,000

Percentage cost = ($30,000,000 + $655,000)/$209,345,000 = 14.64%

Difficulty: 3 Hard

Topic: Primary and Secondary Stock Markets

Bloom's: Analyze; Apply

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation

65) What are the major effects of the Sarbanes-Oxley Act (SOX) of 2002 on the stock markets? What else has the NYSE done to improve corporate governance?

Answer: The SOX Act

* created an independent auditing oversight board under the SEC.
* increased penalties for corporate wrongdoing.
* required more extensive accounting disclosure.
* increased ability of aggrieved shareholders to seek recourse from management.

The NYSE changed listing requirements to ensure

* that listed firms have a majority of independent directors.
* that boards institute and implement codes of ethics for the board and top management.
* that shareholder approval of equity-based compensation plans is implemented.
* that CEOs annually certify the information given to stockholders.

Difficulty: 3 Hard

Topic: Other Issues Pertaining to Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-08 Explain the three forms of market efficiency.

Accessibility: Keyboard Navigation

66) Why have international stock prices fallen as a result of the subprime crisis in the United States?

Answer: U.S. economic growth slowed as a result of the subprime crisis and the resulting credit crunch. Slower U.S. growth often results in poorer economic performance overseas. This is one reason why foreign stock prices have not performed well even though most overseas countries with the exception of Great Britain have not had similar mortgage problems. Problems in the United States also engendered a flight to quality until the extent of the crisis could be known. As money moved out of equity markets to safer securities, stock prices fell. Another way to say the same thing is to note that risk premia increased, resulting in stock price declines.

Difficulty: 2 Medium

Topic: International Aspects of Stock Markets

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 08-09 Describe the major characteristics of international stock markets.

Accessibility: Keyboard Navigation

67) You own 500 shares of common stock in a firm that has two million shares outstanding. The firm announces a plan to sell an additional 500,000 shares through a rights offering.

a. How many rights to purchase new shares will you receive?

b. Suppose that the market price per share is $30, but each right allows you to purchase a share of stock for $27. What should be the value of one right?

c. If you sold your rights, how much money should you make?

Answer:

a. (500,000/2,000,000) × 500 = 125 rights

b. [(500 × 30) + (125 × 27)]/(500 + 125) = 18,375/625 = 29.40; 29.40 − 27 = $2.40

c. $2.40 × 125 = $300

Difficulty: 3 Hard

Topic: Primary and Secondary Stock Markets

Bloom's: Analyze; Apply

AACSB: Reflective Thinking

Learning Goal: 08-03 Examine the process by which common stock is issued in primary stock markets.

Accessibility: Keyboard Navigation