***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.

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

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.

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.

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

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.

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.

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

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

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

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

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

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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A) NASDAQ

B) Euronext

C) American Exchange

D) Chicago Mercantile Exchange

E) London Stock Exchange

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.

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.

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.

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.

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

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

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

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

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

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.

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.

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

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.

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

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

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

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

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.

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

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

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.

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.

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

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

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.

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

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

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

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?

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

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

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 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?

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

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

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

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

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

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?

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?

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

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?