1) Stockholders' rights include

A) ownership of bonds.

B) the right to vote.

C) primary claims on all cash flows.

D) the right to manage.

E) all of the above.

2) Stockholders' rights include

A) the right to veto management's decisions.

B) the right to manage.

C) residual claim on all cash flows.

D) the right to change personnel policy.

E) primary claim on all of a company's assets.

3) Stockholders are residual claimants, meaning that they

A) receive the remaining cash flow after all other claims are paid.

B) have the first priority claim on all of a company's assets.

C) have a higher claim on cash flow than bond holders.

D) are liable for all of a company's debts.

E) will never share in a company's profits.

4) A stockholder's ownership of a company's stock gives her the right to

A) vote and assume responsibility for all liabilities.

B) vote and be the residual claimant of all cash flows.

C) manage and be the residual claimant of all cash flows.

D) vote and be the primary claimant of all cash flows.

E) manage and assume responsibility for all liabilities.

5) Periodic payments of net earnings to shareholders are known as

A) profits.

B) dividends.

C) capital gains.

D) all of the above.

E) both A and B of the above.

6) The value of any investment is found by

A) computing the present value of all future cash flows.

B) computing the future value of all sales.

C) computing the present value of all future sales.

D) computing the present value of all future liabilities.

E) computing the future value of all future expenses.

7) In the one-period valuation model, the value of an investment depends upon

A) the actual value of the dividends and expected sales price received in one year.

B) the present value of both dividends and the expected sales price.

C) only the present value of the future dividends.

D) the future value of dividends and the actual sales price.

E) only the present value of the expected sales price.

8) In the one-period valuation model, the current stock price increases if

A) the expected sales price falls.

B) the expected sales price increases.

C) the required return increases.

D) dividends are cut.

E) both A and C occur.

9) In the one-period valuation model, an increase in the required return

A) reduces the current price of a stock.

B) increases the current price of a stock.

C) reduces the dividend payment.

D) increases the expected sales price of a stock.

E) reduces the expected sales price of a stock.

10) Using the one-period valuation model, assuming a year-end dividend of $0.11, an expected sales price of $110, and a required rate of return of 10%, the current price of the stock would be

A) $110.11. B) $100.00. C) $121.12. D) $100.11 E) $100.10

11) Using the one-period valuation model, assuming a year-end dividend of $1.00, an expected sales price of $100, and a required rate of return of 10%, the current price of the stock would be

A) $90.91 B) $92.00 C) $91.00 D) $101.00 E) $91.82

12) Using the one–period valuation model, assuming a year–end dividend of $0.50, an expected sales price of $50, and a required rate of return of 10%, the current price of the stock would be

A) $45.91.

B) $45.00.

C) indeterminate.

D) $50.50.

E) $50.00.

13) Using the one–period valuation model, assuming a year–end dividend of $1.00, an expected sales price of $100, and a required rate of return of 5%, the current price of the stock would be

A) $95.23. B) $110.00. C) $100.00. D) $96.19. E) $101.00.

14) Using the one–period valuation model, assuming a year–end dividend of $11.00, an expected sales price of $110, and a required rate of return of 10%, the current price of the stock would be

A) $110. B) $121. C) $100 D) $99 E) $91

15) In the generalized dividend model, if the expected sales price is in the distant future

A) it is more important than dividends in determining a stock's price.

B) it is the most important determinant of the current stock price.

C) it is equally important with dividends in determining the stock's price.

D) it is less important than dividends but still affects a stock's price.

E) it does not affect the stock price.

16) In the generalized dividend model, a future sales price far in the future does not affect the current stock price because

A) the company may suffer bankruptcy.

B) the present value cannot be computed.

C) the stock may never be sold.

D) the sales price does not affect the current price.

E) the present value is almost zero.

17) In the generalized dividend model, the current stock price is the sum of

A) the present value of the future dividend stream plus the actual future sales price.

B) the present value of the future dividend stream.

C) the actual value of the future dividend stream.

D) the present value of the future sales price.

E) the future value of the dividend stream plus the sales price.

18) Using the Gordon growth model, a stock's price will increase if

A) the expected sales price rises.

B) dividends are reduced.

C) the growth rate of dividends falls.

D) the required rate of return rises.

E) the dividend growth rate increases.

19) Using the Gordon growth model, a stock's price will increase if

A) the future sales price increases.

B) the dividend growth rate increases.

C) the required rate of return increases.

D) all of the above occur.

E) both A and B of the above.

20) Using the Gordon growth model, a stock's price will increase if

A) the future sales price falls.

B) the required rate of return falls.

C) the current dividend falls.

D) the dividend growth rate falls.

E) none of the above.

21) New information about an asset can result in a decrease in the asset's price due to

A) an expected increase in the dividend growth rate.

B) an expected decrease in the level of future dividends.

C) an expected increase in the future sales price.

D) a decrease in the required rate of return.

E) none of the above.

22) A change in perceived risk of a stock changes

A) the current dividend.

B) the expected sales price.

C) the required rate of return.

D) the expected dividend growth rate.

E) all of the above.

23) A stock's price will fall if there is

A) an increase in perceived risk.

B) an increase in the required rate of return.

C) an increase in the future sales price.

D) all of the above.

E) both A and B of the above.

24) A monetary expansion _____ stock prices due to a decrease in the _____ and an increase in the ____.

A) increases; dividend growth rate; future sales price

B) reduces; future sales price; expected rate of return

C) reduces; current dividend; expected rate of return

D) increases; required rate of return; future sales price

E) increases; required rate of return; dividend growth rate

25) A monetary contraction _____ stock prices due to a decrease in the _____ and an increase in the _____.

A) reduces; dividend growth rate; future sales price

B) increases; current dividend; future sales price

C) increases; dividend growth rate; required rate of return

D) reduces; dividend growth rate; required rate of return

E) reduces; required rate of return; dividend growth rate

26) Terrorist attacks on the United States caused a(n)

A) decrease in stock prices due to lower expected dividend growth and reduced uncertainty.

B) increase in stock prices due to an increased required return.

C) decrease in stock prices due to lower future sales prices.

D) increase in stock prices due to higher expected dividend growth.

E) decrease in stock prices due to lower expected growth and greater risk.

27) An increase in uncertainty due to threat of war will

A) increase stock prices due to a higher required return.

B) not affect stock prices.

C) depress stock prices due to a lower required return.

D) increase stock prices due to a lower required return.

E) depress stock prices due to a higher required return.

28) Dishonest corporate accounting procedures caused stock prices to

A) decrease due to lower expected dividend growth and higher required return.

B) remain unchanged.

C) increase due to higher expected dividend growth and higher future sales price.

D) increase due to higher expected dividend growth and lower required return.

E) decrease due to lower expected dividend growth and lower required return.

29) If expectations of the future inflation rate are formed solely on the basis of a weighted average of past inflation rates, then economics would say that expectation formation is

A) irrational.

B) adaptive.

C) rational.

D) the result of none of the above.

30) According to adaptive expectations,

A) expectations of inflation are viewed as being an average of past inflation rates.

B) expectations of inflation are viewed as being an average of expected future inflation rates.

C) expectations formation indicates that changes in expectations occur slowly over time as past data change.

D) only A and B of the above.

E) only A and C of the above.

31) The adaptive expectations view

A) regards expectations of inflation as being an average of past inflation rates.

B) has been criticized on the grounds that people will use more information than just past data on a single variable to form their expectations of that variable.

C) holds that expectations change relatively quickly.

D) only A and B of the above.

E) only A and C of the above.

32) The major criticism of the view that expectations are formed adaptively is that

A) adaptive expectations models have no predictive power.

B) this view ignores that people use more information than just past data to form their expectations.

C) it is easier to model adaptive expectations than it is to model rational expectations.

D) people are irrational and therefore never learn from past mistakes.

33) If expectations are formed adaptively, then people

A) often change their expectations quickly when faced with new information.

B) use more information than just past data on a single variable to form their expectations of that variable.

C) use only the information from past data on a single variable to form their expectations of that variable.

D) do none of the above.

34) The assumption that people use only the information from past data on a single variable to form their expectations of that variable is called the

A) Lucas critique.
B) adaptive expectations hypothesis.
C) rational expectations hypothesis.
D) Ricardian equivalence theorem.

35) In rational expectations theory, the term "optimal forecast" is essentially synonymous with

A) the correct guess.
B) the best guess.
C) the actual outcome.
D) correct forecast.

36) If additional information is not used when forming an optimal forecast because it is not available at that time, then expectations are

A) formed adaptively.
B) still considered to be formed rationally.
C) obviously formed irrationally.
D) the result of none of the above.

37) According to rational expectations theory, forecast errors of expectations

A) tend to be persistently high or low.
B) are more likely to be positive than negative.
C) are unpredictable.
D) are more likely to be negative than positive.

38) Rational expectations forecast errors will on average be _____ and therefore _____ be predicted ahead of time.

A) zero; can
B) positive; can
C) negative; can
D) zero; cannot
E) positive; cannot

39) If market participants notice that a variable behaves differently now than in the past, then, according to rational expectations theory, we can expect market participants to

A) no longer pay close attention to movements in this variable.
B) begin to make systematic mistakes.
C) change the way they form expectations about future values of the variable.
D) give up trying to forecast this variable.

40) According to rational expectations,

A) expectations formation indicates that changes in expectations occur slowly over time as past data change.
B) expectations of inflation are viewed as being an average of past inflation rates.
C) expectations will not differ from optimal forecasts using all available information.
D) expectations of inflation are viewed as being an average of expected future inflation rates.

41) According to rational expectations,

A) people will use more information than just past data on a single variable to form their expectations of that variable.

B) people often change their expectations quickly when faced with new information.

C) expectations will not differ from optimal forecasts (the best guess of the future) using all available information.

D) all of the above are true.

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

42) According to rational expectations,

A) people will use more information than just past data on a single variable to form their expectations of that variable.

B) expectations will not differ from optimal forecasts (the best guess of the future) using all available information.

C) because people use all available information, the prediction represented by the expectation will always be perfectly accurate.

D) all of the above are true.

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

43) According to rational expectations,

A) expectations will not differ from optimal forecasts using all available information.

B) because people use all available information, the prediction represented by the expectation will always be perfectly accurate.

C) the forecast using all available information must be correct on average.

D) only A and B of the above are true.

E) only A and C of the above are true.

44) Announcements of money supply increases in countries experiencing rapid rates of inflation are often followed by immediate interest rate increases. This behavior is consistent with which of the following?

A) Expectations of higher inflation in the near future

B) A tight current monetary policy

C) Rational expectations

D) Both A and B of the above

E) Both A and C of the above

45) You observe that interest rates fall after an announcement by the Federal Reserve that the money supply has expanded over the past week. You might speculate that

A) the efficient markets hypothesis has been refuted.

B) market participants expect a surge in inflation in the next few months.

C) market participants don't expect inflation to surge any time soon.

D) both A and C of the above are true.

46) You observe that interest rates rise after an announcement by the Federal Reserve that the money supply has expanded over the past week. You might speculate that

A) the efficient markets hypothesis has been refuted.

B) market participants expect a surge in inflation in the next few months.

C) market participants do not expect inflation to surge anytime soon.

D) none of the above are true.

47) You observe that both short-term and long-term interest rates fall after an announcement by the Federal Reserve that the money supply has expanded over the past week. You might speculate that

A) market participants expect a surge in inflation in the next few months.

B) market participants do not expect a surge in inflation in the next few months.

C) the efficient markets hypothesis has been refuted.

D) both A and B of the above are true.

48) You observe that both short-term and long-term interest rates rise after an announcement by the Federal Reserve that the economy appears to be growing rapidly. You might speculate that

A) market participants do not expect a surge in inflation in the next few months.

B) the efficient markets hypothesis has been refuted.

C) market participants expect a surge in inflation in the next few months.

D) both B and C of the above are true.

49) You observe that both short-term and long-term interest rates rise after an announcement by the Federal Reserve that the economy appears to be growing rapidly. You might speculate that

A) the efficient markets hypothesis has been refuted.

B) market participants expect the Fed to increase the money supply more rapidly to lower interest rates.

C) market participants expect a surge in inflation in the next few months.

D) both A and C of the above are true.

50) Expectations play a key role in the theory of asset demand and the determination of interest rates. According to the _____ effect interest rates _____ when money growth _____.

A) Pigou; fall; decreases

B) Fisher; fall; increases

C) Pigou; rise; increases

D) Fisher; rise; decreases

E) Fisher; rise; increases

51) The theory of rational expectations, when applied to financial markets, is known as

A) the theory of strict liability.

B) monetarism.

C) the theory of impossibility.

D) the efficient markets hypothesis.

52) The efficient markets hypothesis

A) is an application of rational expectations to the pricing of financial securities.

B) holds that the expected return on a security equals the equilibrium return.

C) is based on the assumption that prices of securities fully reflect all available information.

D) holds that all of the above are true.

E) holds that only A and B of the above are true.

53) Another way to state the efficient markets condition is: in an efficient market,

A) unexploited profit opportunities will never exist.

B) unexploited profit opportunities will be quickly eliminated.

C) arbitrageurs guarantee that unexploited profit opportunities never exist.

D) both A and C of the above occur.

54) The efficient markets hypothesis suggests that if an unexploited profit opportunity arises in an efficient market,

A) financial analysts are your best source of this information.

B) it will be quickly eliminated.

C) it will tend to go unnoticed for some time.

D) prices will reflect the unexploited profit opportunity.

55) Another way to state the efficient markets condition is: in an efficient market,

A) every financial market participant must be well informed about securities.

B) unexploited profit opportunities will not exist for long, as market participants will act quickly to eliminate them.

C) unexploited profit opportunities will never exist as market participants ensure that they are instantaneously dissipated.

D) only A and C of the above.

56) Financial markets quickly eliminate unexploited profit opportunities through

A) changes in tax laws.

B) changes in dividend payments.

C) changes in asset prices.

D) changes in monetary policy.

E) accounting conventions.

57) Since the efficient market hypothesis assumes that all relevant, publicly available information is discounted in asset price as soon as it is released

A) investors cannot construct systematically profitable trading rules based only on this information.

B) investors have no incentive to buy stock based on favorable information, since the market will have already discounted it.

C) investors have an incentive to buy stock based on favorable information, since the market takes time to discount it.

D) both A and B of the above.

E) both A and C of the above

58) The number and availability of discount brokers has grown rapidly since the mid–1970s. The efficient markets hypothesis predicts that people who use discount brokers

A) are going against evidence suggesting that full–service brokers can help outperform the market.

B) will likely earn lower returns than those who use full–service brokers.

C) are likely to outperform the market by a wide margin.

D) will likely earn about the same as those who use full–service brokers, but will net more after brokerage commissions.

E) are likely to be poor.

59) If a mutual fund outperforms the market in one period, evidence suggests that this fund is

A) likely to under–perform the market in subsequent periods to average its overall returns.

B) not likely to consistently outperform the market in subsequent periods.

C) not likely to under–perform the market in any subsequent period.

D) highly likely to consistently outperform the market in subsequent periods due to its superior investment strategy.

E) not likely to outperform the market in any subsequent period.

60) Sometimes one observes that the price of a company's stock falls after the announcement of favorable earnings. This phenomenon is

A) clearly inconsistent with the efficient markets hypothesis.

B) consistent with the efficient markets hypothesis if the earnings were not as low as anticipated.

C) consistent with the efficient markets hypothesis if the favorable earnings were expected.

D) consistent with the efficient markets hypothesis if the earnings were not as high as anticipated.

61) According to the efficient markets hypothesis

A) one cannot expect to earn an abnormally high return by purchasing a security.

B) information in newspapers and in the published reports of financial analysts is already reflected in market prices.

C) unexploited profit opportunities abound, thereby explaining why so many people get rich by trading securities.

D) all of the above are true.

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

62) Important implications of the efficient markets hypothesis include:

A) stock prices will respond to announcements only when the information in these announcements is new.

B) future changes in stock prices should, for all practical purposes, be unpredictable.

C) sometimes a stock price declines when good news is announced.

D) all of the above.

E) only A and B of the above.

63) You read a story in the newspaper announcing the proposed merger of Dell Computer and Gateway. The merger is expected to greatly increase Gateway's profitability. If you decide to invest in Gateway stock, you can expect to earn

A) above average returns since your stock price will definitely appreciate as higher profits are earned.

B) below average returns since computer makers have low profit rates.

C) a normal return since stock prices adjust to reflect expected changes in profitability almost immediately.

D) above average returns since you will share in the higher profits.

E) none of the above.

64) That favorable earning reports do not always result in increases in stock prices suggests that

A) people trading stocks sometimes incorrectly estimate companies' earnings.

B) stock prices tend to be biased measures of future corporate earnings.

C) the stock market is not efficient.

D) all of the above are true.

E) both A and C of the above are true.

65) To say that stock prices follow a "random walk" is to argue that

A) stock prices cannot be predicted based on past trends.

B) stock prices rise, then fall, then rise again.

C) stock prices rise, then fall in a predictable fashion.

D) stock prices tend to follow trends.

66) To say that stock prices follow a "random walk" is to argue that

A) stock prices are, for all practical purposes, unpredictable.

B) stock prices rise, then fall in a predictable fashion.

C) stock prices rise, then fall.

D) stock prices tend to follow trends.

67) The efficient markets hypothesis predicts that stock prices follow a "random walk." The implication of this hypothesis for investing in stocks is

A) following the advice of technical analysts.

B) turning over your stock portfolio each month, selecting stocks by throwing darts at the stock page.

C) a "buy and hold strategy" of holding stocks to avoid brokerage commissions.

D) a "churning strategy" of buying and selling often to catch market swings.

E) to do none of the above.

68) Rules used to predict movements in stock prices based on past patterns are, according to the efficient markets hypothesis,

A) a waste of time.

B) consistent with the random walk hypothesis.

C) the most efficient rules to employ.

D) profitably employed by all financial analysts.

69) Which of the following accurately summarize the empirical evidence about technical analysis?

A) Technical analysts fare no better than other financial analysis—on average they do not outperform the market.

B) Technical analysts tend to outperform other financial analysis, but on average they nevertheless under-perform the market.

C) Technical analysts fare no better than other financial analysis, and like other financial analysts they under-perform the market.

D) Technical analysts fare no better than other financial analysis, and like other financial analysts they outperform the market.

70) The small-firm effect refers to the

A) fact that small firms earn low returns after adjusting for risk.

B) fact that small firms generally earn negative returns.

C) lower than average returns earned by small firms.

D) abnormally high returns earned by small firms.

E) fact that small firms earn returns equal to large firms.

71) The January effect refers to

A) the fact that stock prices tend to fall in January.

B) the fact that most stock market crashes have occurred in January.

C) the fact that stock prices have historically experienced abnormal price increases in January.

D) the fact that stock prices are excessively volatile only in the month of January.

E) the fact the football team winning the Super Bowl accurately predicts the behavior of the stock market for the next year.

72) A phenomenon closely related to market overreaction is

A) mean reversion.

B) the January effect.

C) the small–firm effect.

D) excessive volatility.

E) the random walk.

73) Excessive volatility refers to the fact that

A) stock price tend to rise in the month of January.

B) stock prices can be slow to react to new information.

C) stock prices fluctuate more than is justified by dividend fluctuations.

D) stock returns display mean reversion.

E) all of the above.

74) Evidence in support of the efficient markets hypothesis includes

A) the small–firm effect.

B) the January effect.

C) excessive volatility.

D) the failure of technical analysis to outperform the market.

E) all of the above.

75) Evidence against market efficiency includes

A) the inability of mutual fund managers to consistently beat the market.

B) the January effect.

C) failure of technical analysis to outperform the market.

D) the random walk behavior of stock prices.

E) all of the above.

76) Evidence against market efficiency includes

A) the January effect.

B) the excessive volatility of stock prices.

C) the random walk behavior of stock prices.

D) all of the above.

E) both A and B of the above.

77) Evidence against market efficiency includes

A) the excessive volatility of stock prices.

B) the small–firm effect.

C) the January effect.

D) all of the above.

E) both A and C of the above.

78) The efficient markets hypothesis suggests that allocating your funds in the financial markets on the advice of a financial analyst

A) will certainly mean higher returns than if you had made selections by throwing darts at the financial page.

B) is good for the economy.

C) will always mean lower returns than if you had made selections by throwing darts at the financial page.

D) is not likely to prove superior to a strategy of making selections by throwing darts at the financial page.

79) According to the efficient markets hypothesis, purchasing the reports of financial analysts

A) is likely to increase one's returns by an average of 10%.

B) is likely to increase one's returns by an average of about 2 to 3%.

C) is likely to increase one's returns by about 3 to 5%.

D) is not likely to be an effective strategy for increasing financial returns.

E) guarantees negative returns.

80) Which of the following types of information most likely allows the exploitation of a profit opportunity?

A) Insider information

B) Technical analysis

C) Hot tips from a stockbroker

D) Financial analysts' published recommendations

81) Which of the following types of information most likely allows the exploitation of a profit opportunity?

A) Newspaper articles

B) Hot tips from a stockbroker

C) Financial analysts' published recommendations

D) Technical analysis

E) None of the above

82) The advantage of a "buy–and–hold strategy" is that

A) the longer a stock is held, the higher will be its price.

B) losses will eventually be eliminated.

C) net profits will tend to be higher because there will be fewer brokerage commissions.

D) only B and C of the above are true.

83) The efficient markets hypothesis indicates that

A) investors can use the advice of technical analysts to outperform the market.

B) investors do better if they purchase loaded mutual funds.

C) investors do better on average if they adopt a "buy and hold" strategy.

D) investors let too many unexploited profit opportunities go by if they adopt a "buy and hold" strategy.

84) The efficient markets hypothesis suggests that

A) investors let too many unexploited profit opportunities go by if they adopt a "buy and hold" strategy.

B) investors should purchase no–load mutual funds which have low management fees.

C) investors can use the advice of technical analysts to outperform the market.

D) only A and B of the above are sensible strategies.

85) The efficient markets hypothesis suggests that

A) "buy and hold" a well–diversified portfolio of securities is the best strategy for most investors.

B) incorrectly valued assets are quickly discovered and traded until their prices reflect their correct underlying value.

C) most investors will not earn excess returns from paying for technical market analysis.

D) all of the above are true.

E) both A and C of the above are true.

86) ________ occurs when people are more unhappy when they suffer losses than they are happy when they achieve gains.

A) Loss fundamentals B) Loss aversion C) Loss leader D) Loss cycle

87) Psychologists have found that people tend to be ________ in their own judgments.

A) underconfident B) overconfident C) indecisive D) insecure

88) ________ and ________ may provide an explanation for stock market bubbles.

A) Overconfidence; social contagion B) Underconfidence; social contagion

C) Overconfidence; social isolationism D) Underconfidence; social isolationism

Answer Key
Testname: CH7

1) B
2) C
3) A
4) B
5) B
6) A
7) B
8) B
9) A
10) E
11) E
12) A
13) D
14) A
15) E
16) E
17) B
18) E
19) B
20) B
21) B
22) C
23) E
24) E
25) D
26) E
27) E
28) A
29) B
30) E
31) D
32) B
33) C
34) B
35) B
36) B
37) C
38) D
39) C
40) C
41) D
42) E
43) E
44) E
45) C
46) B
47) B
48) C
49) C
50) E
51) D

52) D
53) B
54) B
55) B
56) C
57) D
58) D
59) B
60) D
61) E
62) D
63) C
64) A
65) A
66) A
67) C
68) A
69) A
70) D
71) C
72) D
73) C
74) D
75) B
76) E
77) D
78) D
79) D
80) A
81) E
82) C
83) C
84) B
85) D
86) B
87) B
88) A