

Chapter 2 - Practice Questions

1. The interest rate charged by banks with excess reserves at a Federal Reserve Bank to banks needing overnight loans to meet reserve requirements is called the_____.
 - A) prime rate
 - B) discount rate
 - C) federal funds rate
 - D) call money rate
 - E) money market rate

2. Which one of the following is **not** a money market instrument?
 - A) a Treasury bill
 - B) a negotiable certificate of deposit
 - C) commercial paper
 - D) a Treasury bond
 - E) a Eurodollar account

3. Commercial paper is a short-term security issued by _____ to raise funds.
 - A) the Federal Reserve Bank
 - B) commercial banks
 - C) large, well-known companies
 - D) the New York Stock Exchange
 - E) state and local governments

4. Which of the following is **true** regarding a firm's securities?
 - A) Common dividends are paid before preferred dividends.
 - B) Preferred stockholders have voting rights.
 - C) Preferred dividends are usually cumulative.
 - D) Preferred dividends are contractual obligations.
 - E) Common dividends usually can be paid if preferred dividends have been skipped.

Use the following to answer question 5:

Consider the following three stocks:

| <u>Stock</u> | <u>Price</u> | <u>Number of shares outstanding</u> |
|--------------|--------------|-------------------------------------|
| Stock A | \$40 | 200 |
| Stock B | \$70 | 500 |
| Stock C | \$10 | 600 |

5. The value-weighted index constructed with the three stocks using a divisor of 100 is
- A) 1.2
 - B) 1200
 - C) 490
 - D) 4900
 - E) 49
6. If the market prices of each of the 30 stocks in the Dow Jones Industrial Average (DJIA) all change by the same percentage amount during a given day, which stock will have the greatest impact on the DJIA?
- A) The stock trading at the highest dollar price per share.
 - B) The stock with total equity has the higher market value.
 - C) The stock having the greatest amount of equity in its capital structure.
 - D) The stock having the lowest volatility.
 - E) All will have an equal impact.
7. A form of short-term borrowing by dealers in government securities is
- A) reserve requirements.
 - B) repurchase agreements.
 - C) banker's acceptances.
 - D) commercial paper.
 - E) brokers' calls.
8. Which of the following is **not** a mortgage-related government or government sponsored agency?
- A) The Federal Home Loan Bank
 - B) The Federal National Mortgage Association
 - C) The U.S. Treasury
 - D) Freddie Mac
 - E) Ginnie Mae
9. In order for you to be indifferent between the after tax returns on a corporate bond paying 8.5% and a tax-exempt municipal bond paying 6.12%, what would your tax bracket need to be?
- A) 33%
 - B) 72%
 - C) 15%
 - D) 28%
 - E) Cannot tell from the information given

10. Suppose an investor is considering a corporate bond with a 7.17% before-tax yield and a municipal bond with a 5.93% before-tax yield. At what marginal tax rate would the investor be indifferent between investing in the corporate and investing in the muni?
- A) 15.4%
 - B) 23.7%
 - C) 39.5%
 - D) 17.3%
 - E) 12.4%
11. In order for you to be indifferent between the after tax returns on a corporate bond paying 9% and a tax-exempt municipal bond paying 7%, what would your tax bracket need to be?
- A) 17.6%
 - B) 27%
 - C) 22.2%
 - D) 19.8%
 - E) Cannot tell from the information given
12. For a taxpayer in the 15% marginal tax bracket, a 15-year municipal bond currently yielding 6.2% would offer an equivalent taxable yield of:
- A) 6.2%.
 - B) 5.27%.
 - C) 8.32%.
 - D) 7.29%.
 - E) none of the above.

Answer Key

1. C
2. D
3. C
4. C
5. C
6. A
7. B
8. C
9. D
10. D
11. C
12. D