BUS-123 Spring 2020 | Exam #4 | Name: _____________
Total Points: 45 | Chapters 9, 10, & 11 | Instr: F. Paiano

1. As an investment vehicle, bonds can provide investment returns in the form of ________________.
   a) current income only
   b) capital gains only
   c) both current income and capital gains
   d) neither current income nor capital gains

2. The single most important force affecting current bond prices in the bond market is ______________.
   a) the rate of corporate profits
   b) the movement of the stock market
   c) the real rate of return
   d) the behavior of interest rates

3. Which one of the following correctly describes the effect of a decline in interest rates on bond prices?
   a) The prices of existing bonds are not affected.
   b) The prices of existing bonds fall.
   c) The prices of existing bonds rise.
   d) The prices of newly issued bonds are lowered.

4. Which one of the following economic conditions helps create capital gains on outstanding bonds?
   a) falling interest rates
   b) rising inflation rates
   c) rising supply of bonds
   d) declining demand for bonds

5. How often do most bonds issued in the United States typically pay interest?
   a) monthly b) quarterly c) semi-annually d) annually

6. The major source of risk faced by investors who purchase ***high-quality, investment-grade, U.S.-based*** bonds (that should pay their interest and principal) is ____________, especially if the bond investor plans to sell their bonds before maturity.
   a) foreign risk b) interest rate risk c) liquidity risk d) default risk

7. The rate of interest that a bond pays throughout its lifetime is called the _________. It typically differs from the current rate and yield-to-maturity because the price of the bond changes over time as interest rates change.
   a) coupon rate b) nominal rate c) both (a) & (b) d) neither (a) nor (b)

8. The greatest value derived from adding some bonds to a stock portfolio is the __________.
   a) increased rate of return on the portfolio
   b) increased capital gains realized when interest rates rise
   c) additional stability gained from the lowered level of risk of bonds relative to stocks
   d) reduction in purchasing power risk during periods of high inflation

9. A 7%, $1,000 bond was issued five years ago. If the prevailing market rate for interest on comparable bonds is now 5%, then the bond pays it bondholders annual interest of _________________.
   a) $70, and the bond would sell for less than its par value (a.k.a. a discount bond)
   b) $70, and the bond would sell for more than its par value (a.k.a. a premium bond)
   c) $50, and the bond would sell for less than its par value (a.k.a. a discount bond)
   d) $50, and the bond would sell for more than its par value (a.k.a. a premium bond)

10. Two years ago, Juan Anatoo bought an 7% five-year bond. Today, the interest rate on newly issued comparable bonds is 9%. If Juan sells his bond today, he most likely __________.
    a) will realize a capital gain on the bond
    b) will realize a capital loss on the bond
    c) will sell the bond for an amount equal to the face value
    d) will receive an amount equal to the par value

11. If a bond is called away from a bond investor before its maturity date, _______________.
    a) it is in response to an action taken by the bond investor
    b) the result is often a reduced rate of return for the bond investor as interest rates have most likely fallen
    c) it is most likely in response to higher market interest rates
    d) it means the bond has matured and the principal needs to be repaid

12. At the time you purchase a bond, you know the investment return you will earn if _________.
a) the bond is called at any time prior to maturity
b) you resell the bond in exactly one year
c) interest rates decline within the next year
d) you hold the bond to maturity

13. A bond issue that has a single maturity date is called a ______________.
a) term bond
b) serial bond
c) convertible preferred bond
d) Treasury bill

14. Serial obligation bonds differ from most other bonds because ________________.
a) they are secured by the assets of the issuer
b) their par value is usually well below $1,000
c) their term-to-maturity is usually 30 years or more
d) they possess multiple maturity dates

15. The call provision of a bond stipulates ______________.
a) the coupon rate and the maturity date of the bond
b) the bond's degree of default risk and the collateral used to guarantee the issue
c) the terms under which the bond can be redeemed prior to maturity
d) whether the bond trades in a thin market or a broad market

16. A bond which has a deferred call (a.k.a. call protection period, call deferment period) _____________.
a) would not have to be redeemed when it reaches maturity
b) could be called at any time prior to maturity provided six months notice is given
c) could not be called for a specified period after the date of issue, but after that could be called any time
d) could be called at any time during the initial call period, but after that period, the bond becomes noncallable and can no longer be called

17. A bond whose coupon rate is greater than the prevailing market rate on new issues and is selling for more than its par value is called a ____________.
a) par bond
b) premium bond
c) discount bond
d) term bond

18. Treasury debt securities that mature in 2 to 10 years are technically called ________ although most everyone in the investment community also refers to them as Treasury bonds.
a) Strip-T's
b) Treasury notes
c) Treasury bills
d) Zero-coupon Treasuries

19. Rate the types of bonds according to their perceived levels of risk from the *least* to the *most* riskiest:
I. Treasury bonds
II. Agency bonds & those sponsored by the Federal government such as Fannie Mae or Freddie Mac
III. Municipal bonds
IV. Corporate bonds
a) II, III, IV, I
b) III, IV, I, II
c) IV, III, II, I
d) I, II, III, IV

20. Some bonds pay no interest. Instead, they are sold at a deep discount and are redeemed at their maturity value. The value of the bonds increase as the bonds approach maturity. These bonds are called __ bonds.
a) term
b) serial
c) discount
d) zero-coupon

21. Bonds that have received one of the top four ratings (Aaa through Baa, or AAA through BBB) are designated as _______________. These bonds (almost always) have a very, very small risk of default.
a) split bonds
b) investment grade bonds
c) illiquid bonds
d) high-yield bonds

22. Bonds that are rated below BBB (BB or below) are designated as ______________.
a) junk bonds
b) high-yield bonds
c) non-investment grade bonds
d) all of the above

23. The specific type of risk that is measured by bond ratings is _____________.
a) default risk
b) market risk
c) interest rate risk
d) purchasing power risk

24. Which one of the following statements correctly describes the major drawback of zero-coupon bonds?
a) Unless the bonds are held in tax-sheltered account, the investor must pay taxes on the annual accrued interest even though no interest is actually received by the bond investor.
b) The conversion feature that is found on most zero-coupon bonds generally requires the investor to switch to a coupon-bearing bond after a period of 5 years.
c) The lack of an annual coupon basically prohibits the investor from locking in a high rate of return.
d) Because there is no reinvestment of a coupon, large capital losses accrue when interest rates decline.

25. The yield curve depicts the relationship between a bond's yield to maturity and its ___________.
a) coupon rate b) time to call c) time to maturity d) volatility

26. Which of the following statements concerning the current yield (a.k.a. current rate) is correct?
a) It is of great interest to aggressive bond investors seeking capital gains with no regard to income.
b) It is equal to the coupon rate of bonds selling at a discount.
c) It shows the rate of return an investor will receive by selling the bond before its maturity date
d) It can be determined by dividing the annual interest income by the market price of a bond.

27. An inverted yield curve ___________________.
a) means that long-term bonds are yielding more than short-term bonds, a very unusual situation
b) exists when intermediate-term bonds have higher yields than either short-term or long-term bonds
c) rewards long-term investors for the additional risk they are assuming
d) often is an indicator that bond investors believe a recession is coming. An inverted yield curve is not normal as short-term bond yields are normally lower than long-term bond yields.

28. Preferred stock _________________.
a) shareholders get paid after bond investors but before common stock investors in case of default
b) shareholders are last in line for repayment of principal after common shareholders
c) pays variable dividends
d) earns dividends which are fully tax-exempt to shareholders

29. Preferred stock or bonds that can be exchanged for shares of common stock are called ______ securities.
a) putable b) exchangeable c) convertible d) callable

30. The type of preferred stock that specifies that any dividends in arrears must be paid to the preferred stockholders before dividends can be restored to common stockholders is known as __________.
a) cumulative preferred stock c) convertible preferred stock
b) non-cumulative preferred stock d) participating preferred stock

31. The chance that the value or actual return on an investment will differ unfavorably from its expected return is called _________.
a) probability b) risk c) correlation d) liquidity

32. Spreading your investments across a number of assets and asset classes to eliminate some, but not all, of the risk is called ______________.
a) risk attenuation b) correlation c) diversification d) dollar cost averaging

33. One popular measure of risk is ______. The greater it is, the riskier the investment has been in the past.
a) total dollar return b) total percentage return c) standard deviation d) net asset value

34. The tendency of the returns of two investments to move together (or not move together) is called _____.
a) risk attenuation b) correlation c) diversification d) dollar cost averaging

35. Two investments are ____________ correlated if they generally move up and down together.
a) positively b) negatively c) neutrally d) imperfectly

36. __________ correlation is the reason diversification works. No two investments are exactly alike.
a) Positive b) Neutral c) Perfect d) Imperfect

37. The measure of how closely the returns of two (or more) investments move together is called the __________.
a) standard deviation b) variance c) risk factor d) correlation coefficient

38. All other factors being equal, which portfolio, over the long-term, has actually exhibited the *least* risk as measured by standard deviation?
a) 100% stocks b) 100% bonds c) A mix of 50% stocks and 50% bonds

39. Choosing the appropriate mix of investments for an investor is called __________.
a) asset allocation b) blending investments c) rebalancing d) dollar cost averaging

40. For many years, one popular method of asset allocation is to subtract your age from 100 (or 110 or 120). The resulting number is the amount of investments you should have in stocks. The rest should be in bonds. Not all investors and their advisors think it is the best strategy since people are living far longer these days. (A=True, B=False)

41. Many financial advisers advocate that investors realign their portfolio mix every year and reset the percentages they set for themselves the previous year. This technique is known as ___________.
a) rebalancing b) blending investments c) diversification d) dollar cost averaging

42. A system of buying an investment at regular intervals with a fixed dollar amount is called _________. It is most likely the most practical method of investing for the vast majority of working class investors.
a) rebalancing b) blending investments c) diversification d) dollar cost averaging

43. Manny Haddett-Cumming is 25 years old and is saving for retirement. Which one of the following portfolio allocations might best suit his situation if he is willing to accept a *large amount of risk* in anticipation of potential *significant long-term capital appreciation*?
a) 25% stocks, 60% bonds, 15% money market
b) 85% stocks, 15% bonds
c) 10% stocks, 80% bonds, 10% CDs
d) 30% stocks, 70% bonds

44. Sam and Janette Evening are in their early-sixties, retired, and both are in excellent health and are expected to live a long time. Which one of the following portfolios would best allow them to generate income and growth over longer periods of time while at the same time reducing the risks of losing a substantial amount of their investment?
a) 100% bonds
b) 100% stocks
c) 40% stocks, 40% bonds, 20% money market
d) 100% money market

45. ***Although not guaranteed***, a system of buying an investment at regular intervals (usually monthly) with a fixed dollar amount (such as $50 or $100 per month or more if you afford it) will usually result in the following:
a) An investor’s average cost per share should be higher than their average price per share.
(*Well, that does not make any sense. If that were true, why would we do it?!*)
b) An investor’s average cost per share should be the same as their average price per share.
(*No, they can’t be true. Prices changes every day.*)
c) An investor’s average cost per share and average price per share will have no correlation whatsoever.
(*Wait a minute. This could only be true if we did not stick to our plan and instead bought & sold randomly.*)
d) ***An investor’s average cost per share should be lower than their average price per share.***
(*Ah, this makes sense. But did we say that there are no guarantees? We did? Good. Just wanted to be sure...*)