***Personal Finance, 6e* (Madura)**
Chapter 14 Investing Fundamentals

14.1 Types of Investments

1) Before you start an investment program, you should ensure liquidity by having money in financial institutions or in money market securities.
Answer: TRUE
Diff: 1
Question Status: Previous edition

2) Bonds are financial instruments representing partial ownership of a firm.
Answer: FALSE
Diff: 1
Question Status: Revised

3) The primary market is used by firms to raise funds and is a market where newly issued securities are traded.
Answer: TRUE
Diff: 1
Question Status: Previous edition

4) Many more shares of stock are traded daily on the primary market than on the secondary market.
Answer: FALSE
Diff: 2
Question Status: Previous edition

5) Most individual investors who buy and sell stock do so on the secondary market through brokers or investment companies.
Answer: TRUE
Diff: 1
Question Status: Previous edition

6) Institutional investors are professionals employed by a financial institution, who invest their own money earned from their jobs.
Answer: FALSE
Diff: 2
Question Status: Previous edition

7) A company has a choice of whether to distribute dividends to common shareholders or to keep its profits in the company as retained earnings.
Answer: TRUE
Diff: 2
Question Status: Revised

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8) The stocks of well-known companies are referred to as "preferred stock."
Answer: FALSE
Diff: 1
Question Status: Previous edition

9) Common stockholders usually have more dividend rights than preferred stockholders.
Answer: FALSE
Diff: 1
Question Status: Previous edition

10) One of the attractive features of mutual funds is that they offer small investors a diversified portfolio and professional management.
Answer: TRUE
Diff: 1
Question Status: Previous edition

11) It would be very difficult and expensive for an individual investor to benefit from holding all 500 stocks of the Standard and Poor's 500 Index.
Answer: FALSE
Diff: 2
Question Status: Previous edition

12) Real estate is a good investment option for individuals and it offers the same liquidity as stocks or bonds.
Answer: FALSE
Diff: 1
Question Status: Previous edition

13) Before you start to invest, you should ensure liquidity by owning
A) individual stocks.
B) money market securities.
C) options and puts.
D) corporate bonds.
Answer: B
Diff: 1
Question Status: Revised

14) Which of the following investments would you **not** consider if you have adequate liquidity and additional funds to invest?
A) Real estate
B) Preferred stock
C) Mutual funds
D) Money market securities
Answer: D
Diff: 1
Question Status: Previous edition

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15) The security that represents equity or ownership of a corporation is
A) common stock.
B) corporate bonds.
C) long-term loans.
D) commercial paper.
Answer: A
Diff: 1
Question Status: Previous edition

16) The market for newly issued securities and initial public offerings (IPOs) is the ________ market.
A) initial
B) original
C) primary
D) secondary
Answer: C
Diff: 1
Question Status: Previous edition

17) Which of the following is true of an initial public offering (IPO)?
A) Buying an IPO stock is less risky than purchasing established companies in the secondary market.
B) An IPO stock can be sold later in the primary market.
C) An IPO's stock price may rise or fall rapidly on the first day.
D) An IPO represents a company that was just created within the last month.
Answer: C
Diff: 1
Question Status: Revised

18) Investors who buy and sell stock, sometimes in the same day, are called
A) individual investors.
B) growth investors.
C) institutional investors.
D) day traders.
Answer: D
Diff: 2
Question Status: Previous edition

19) In the secondary market, stock prices are
A) determined by supply and demand.
B) stable.
C) easy to predict.
D) less expensive than on the primary market.
Answer: A
Diff: 1
Question Status: Previous edition

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20) The largest market where existing securities are sold is called the ________ market.
A) primary
B) secondary
C) third
D) fourth
Answer: B
Diff: 1
Question Status: Previous edition

21) ________ investors are professionals employed by a financial institution and are responsible for managing money.
A) Institutional
B) Professional
C) Managing
D) Security
Answer: A
Diff: 1
Question Status: Previous edition

22) Which of the following statements is **not** true regarding individual investors?
A) They commonly invest a portion of the money earned from their jobs.
B) They invest in stocks to earn a reasonable return on their investments.
C) They expect their money to grow by the time they wish to use it to make purchases.
D) The percentage of individual Americans who own stocks has increased since the financial crisis of 2008-2009.
Answer: D
Diff: 2
Question Status: Revised

23) Of the following statements about a day trader, which is **not** correct?
A) They have a short-term focus.
B) They may buy and sell on the same day.
C) They are more risk averse than most investors.
D) Day trading may be their career.
Answer: C
Diff: 2
Question Status: Previous edition

24) Stock prices are characterized by all of the following **except** they
A) can plummet with poor economic conditions.
B) have a set lower limit.
C) can be affected by negative earnings.
D) can be affected by the quality of the company's management.
Answer: B
Diff: 1
Question Status: Revised

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25) Which of the following is not true of common stock?
A) Common stock represents partial ownership in the firm.
B) Common stock is riskier than preferred stock.
C) Investors in common stock are given voting rights.
D) Investors in common stock are guaranteed a dividend.
Answer: D
Diff: 1
Question Status: Revised

26) Which one thing do you always have with common stock?
A) Dividends
B) Voting rights
C) Capital appreciation
D) A guarantee of at least par value
Answer: B
Diff: 1
Question Status: Previous edition

27) If you believe that a firm will grow rapidly in the future, you should buy its
A) bonds.
B) notes.
C) common stock.
D) preferred stock.
Answer: C
Diff: 1
Question Status: Previous edition

28) If economic conditions deteriorate, stock prices are likely to
A) increase.
B) decrease.
C) stay the same.
D) not be directly affected by changes in economic conditions.
Answer: B
Diff: 2
Question Status: Revised

29) When a firm performs well, investors holding its shares are ________ willing to sell them and therefore, the demand for the stock ________.
A) more; increases
B) less; decreases
C) less; increases
D) more; decreases
Answer: C
Diff: 2
Question Status: Revised

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30) Which of the following is **not** true regarding preferred stock?
A) Preferred stockholders have rights to the assets of the corporation before common stockholders.
B) Preferred stockholders have priority over common stockholders in receiving dividends.
C) Preferred stock has greater potential for capital appreciation than common stock.
D) The price of preferred stock is less volatile than the price of common stock.
Answer: C
Diff: 2
Question Status: Revised

31) One difference between common and preferred stock is that preferred stock
A) does not pay dividends.
B) offers more predictable income and more safety.
C) has greater potential for capital appreciation.
D) is issued more frequently than common stock.
Answer: B
Diff: 2
Question Status: Revised

32) The best way to ensure that you will receive dividends is to
A) day trade.
B) purchase bonds.
C) purchase common stock.
D) purchase preferred stock.
Answer: D
Diff: 1
Question Status: Previous edition

33) If you wish to have a direct voice in the running of a company, you should purchase
A) bonds.
B) notes.
C) common stock.
D) preferred stock.
Answer: C
Diff: 1
Question Status: Previous edition

34) Publicly traded indexes are typically purchased by investors who expect an increase in
A) an inflation index.
B) an unemployment index.
C) an index representing the political approval rating of the president of the United States.
D) a particular stock index.
Answer: D
Diff: 2
Question Status: Revised

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35) Individuals who buy and sell stock on a very short-term basis as a career are called ________.
Answer: day traders
Diff: 1
Question Status: Previous edition

36) If you wish to have the power to vote on who will serve on the board of directors of a corporation you will need to purchase shares of ________ in the corporation.
Answer: common stock
Diff: 1
Question Status: Previous edition

37) When a corporation goes from being a private to a public firm it will sell stock in what is called a(n) ________.
Answer: initial public offering
Diff: 1
Question Status: Previous edition

38) Newly issued securities are traded in the ________.
Answer: primary market
Diff: 1
Question Status: Previous edition

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Use the following two columns of items to answer the matching questions below:

A) first offering of a firm's stock to the public
B) financial instruments that represent partial ownership of a firm
C) investors owning this type of stock have priority over common stockholders in receiving dividends
D) individual investors who buy and sell stocks within a day
E) market where existing securities are sold
F) professionals responsible for clients' funds
G) facilities that allow investors to purchase or sell existing stocks
H) debt instruments issued by the government or corporations to borrow money from investors

39) common stock
Diff: 1
Question Status: New

40) IPO
Diff: 1
Question Status: New

41) secondary market
Diff: 1
Question Status: New

42) day trader
Diff: 1
Question Status: New

43) bonds
Diff: 1
Question Status: New

44) institutional investors
Diff: 1
Question Status: New

45) stock exchanges
Diff: 1
Question Status: New

46) preferred stock
Diff: 1
Question Status: New

Answers: 39) B 40) A 41) E 42) D 43) H 44) F 45) G 46) C

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47) Day traders always trade
A) in the primary market.
B) in either the primary or secondary markets.
C) with an objective of buying and selling within two hours.
D) using margin funding.
Answer: B
Diff: 1
Question Status: New

48) Which of the following is an accurate statement?
A) Owning common stock is less risky than owning real estate.
B) In times of rising inflation, it is safer to own bonds than common stock.
C) Owning common stock provides the investor with a share of the firm's earnings and potential dividends.
D) Owning preferred stock is more risky than owning common stock since the investor has voting rights with common stock and it stands before preferred stock in the event of bankruptcy.
Answer: C
Diff: 2
Question Status: New

49) Describe common stock.
Answer: Common stock has no guaranteed value and may not even pay dividends. If dividends are paid, the amount can change from one distribution to the next. Common stockholders have the lowest priority of claims to the assets and profits of a corporation. The one thing common stockholders have are voting rights on certain key issues. Common stockholders also get to share in the eventual profits of a corporation. Since these profits may increase over time, the value of the common stock can increase substantially.
Diff: 2
Question Status: Revised

50) You have been given an overview of stocks, bonds, and mutual funds. Give one advantage and one disadvantage of investing in each of these.
Answer: Stocks—advantage: You may get a dividend and also capital appreciation if you pick a good stock. Disadvantage of stock is that its price may decline. If you have all of your investment in one company you would lose everything.
Bonds—advantage: You have a predictable return that is lower risk with a highly rated bond. Disadvantage is that the bond price may actually drop before you want to sell it.
Mutual funds—advantage is that you have a diversified investment with professional management. Disadvantage is that you have no personal control of your investment.
Diff: 2
Question Status: Revised

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51) All of the following are true about IPO's, **except**
A) an IPO is the first time a firm's shares are listed on a stock exchange and publically traded.
B) an IPO is the first time a firm sells shares to investors.
C) after the IPO, shares begin trading on the secondary market.
D) All of the statements are true about IPO's.
Answer: A
Diff: 2
Question Status: New

14.2 Investment Return

1) Since the gain received from the sale of stock is always taxed as ordinary income, you might want to time your sale to shift your profit from one year to another.
Answer: FALSE
Diff: 2
Question Status: Previous edition

2) The timing on the sale of a stock could make a big difference in the amount of taxes that are due on the profits.
Answer: TRUE
Diff: 1
Question Status: Previous edition

3) Present and future value concepts are used to determine the wealth provided by an investment.
Answer: TRUE
Diff: 1
Question Status: Previous edition

4) Growth stocks are likely to pay high dividends.
Answer: FALSE
Diff: 1
Question Status: Previous edition

5) The higher the dividend paid by a firm, the lower its potential stock price appreciation.
Answer: TRUE
Diff: 2
Question Status: Previous edition

6) Common stockholders have the right to vote on key corporate issues, but also have the last right to the assets or profits of a company.
Answer: TRUE
Diff: 1
Question Status: Previous edition

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7) Because dividends are fixed, the prices of preferred stock are not as volatile as those of common stock.
Answer: TRUE
Diff: 2
Question Status: Previous edition

8) An advantage of investing in corporate bonds is that they hold their value and pay predictable interest (coupon) payments periodically.
Answer: FALSE
Diff: 2
Question Status: Previous edition

9) In addition to the interest earned on a bond, it is also possible that the actual bond will increase in value over time.
Answer: TRUE
Diff: 1
Question Status: Previous edition

10) Mutual fund gains can be in the form of dividends or capital gains, which are passed on to the individual investors.
Answer: TRUE
Diff: 1
Question Status: Previous edition

11) Dividends are a portion of
A) earnings returned to the investor.
B) the equity returned to the investor.
C) liabilities returned to the company.
D) assets returned to the company.
Answer: A
Diff: 2
Question Status: Previous edition

12) All of the following are true statements about common stock dividends **except**
A) dividends are based upon earnings.
B) no dividends may be paid.
C) dividends are usually between 1% and 3% of the stock's price.
D) dividends are contractually guaranteed to common stockholders.
Answer: D
Diff: 1
Question Status: Revised

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13) Regarding dividends paid on common stock,
A) older, established firms tend to pay lower dividends.
B) newer firms in growth industries tend to pay higher dividends.
C) some firms don't pay any dividends at all.
D) a firm with high dividends is likely to have high stock price appreciation.
Answer: C
Diff: 2
Question Status: Previous edition

14) Growth stocks tend to
A) be those of more established companies.
B) offer great opportunities for capital appreciation.
C) pay high dividends.
D) be favored by more conservative investors.
Answer: B
Diff: 2
Question Status: Previous edition

15) Growth stocks tend to pay ________ dividends and have ________ appreciation of stock prices.
A) lower; higher
B) higher; lower
C) lower; lower
D) higher; higher
Answer: A
Diff: 2
Question Status: Previous edition

16) Income stocks tend to pay ________ dividends and have ________ appreciation of stock prices.
A) lower; higher
B) higher; lower
C) lower; lower
D) higher; higher
Answer: B
Diff: 2
Question Status: Previous edition

17) All of the following are true regarding stock prices **except** they
A) are influenced by supply and demand.
B) are regulated by the Federal Reserve Board.
C) have no set limit.
D) generally increase with good financial news.
Answer: B
Diff: 1
Question Status: Previous edition

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18) Of the following, which is **not** used in measuring a stock's return?
A) Price of the stock at the time of purchase
B) Average price of the stock during the period owned
C) Price of the stock at the time of sale
D) Dividends earned during the period owned
Answer: B
Diff: 2
Question Status: Revised

19) If you invest $1,000 in stock that pays no dividends and sell the stock one year later for $1,100, what will be your return? (Ignore commissions and trading fees.)
A) 1%
B) 5%
C) 10%
D) 100%
Answer: C
Diff: 1
Question Status: Previous edition

20) If you purchase 100 shares of Ajax Corporation for $15 a share and one year later sell it for $20 a share, what was your return if the stock paid $2 per share dividends? (Ignore commissions and trading fees. Round to the nearest whole percent.)
A) 10%
B) 33%
C) 47%
D) 40%
Answer: C
Explanation: C) (($20 - $15) + $2)/$15 = 47%
Diff: 2
Question Status: Previous edition

21) If you bought stock for $3,000 a year ago, received no dividends, and sold it for $1,000, what is the return on your investment?
A) -67%
B) 0%
C) 67%
D) -33%
Answer: A
Explanation: A) ($1,000 - $3,000)/$3,000 = -67%
Diff: 2
Question Status: Revised

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22) John decides to take his annual Christmas bonus of $2,000 and invest it each year for the next five years, in stock he believes can earn an 8% annual return. How much will John's investment be worth at the end of the five years?
A) $11,972
B) $19,098
C) $11,734
D) $15,600
Answer: C
Explanation: C) $2,000 × 5.867 (FVIFA) = $11,734
Diff: 2
Question Status: Previous edition

23) Jane has $3,200 she wants to invest in stocks. She has found an investment that she believes will earn a 9% annual return. What will be the value of Jane's investment in 20 years if she is correct?
A) $17,933
B) $16,512
C) $14,915
D) $21,526
Answer: A
Explanation: A) $3,200 × 5.604 (FVIF) = $17,933
Diff: 2
Question Status: Revised

24) If you purchase 100 shares of XYZ Corporation for $50 per share, receive a dividend check for $200, and then sell the stock for $62 per share, what will your return on the stock be?
A) 4%
B) 424%
C) 24%
D) 28%
Answer: D
Explanation: D) Dividend rate = $200/100 shares = $2 per share; ($62 - $50 + $2)/$50 = 28%
Diff: 2
Question Status: Previous edition

25) All of the following gains from investments are taxed as ordinary income **except**
A) coupon payments.
B) interest.
C) short-term capital gains.
D) long-term capital gains.
Answer: D
Diff: 1
Question Status: Revised

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26) For minimal tax consequences, when your stock increases in value it should be held for
A) four months or longer.
B) over a year.
C) under a year.
D) five years or longer.
Answer: B
Diff: 1
Question Status: Previous edition

27) It is December 30th and you have stock in Zero Corporation that you bought on March 1st that has increased $2,000 in value. You are thinking of selling the stock. From a tax standpoint, what should you do with the Zero stock?
A) Sell it today.
B) Sell it on January 2nd of next year.
C) Wait until after March 1st of next year and sell it then.
D) Sell half the stock today and the rest on January 2.
Answer: C
Diff: 3
Question Status: Revised

28) It is December 10th and you have a stock that you purchased last January 5th, which has increased in value by more than $3,000. You think the stock will not significantly increase or decrease in value over the next month or so, and you would like to take your gain. What should you do?
A) Sell the stock today and take the gain.
B) Wait until December 30th and sell the stock then.
C) Sell the stock on January 6th of next year or later.
D) Do not sell the stock until it starts to go down in value.
Answer: C
Diff: 2
Question Status: Revised

29) You can estimate the amount by which your wealth will increase from an investment using
A) standard deviation.
B) discounted range of returns.
C) time value of money.
D) analysis of past returns.
Answer: C
Diff: 2
Question Status: Previous edition

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30) The time value of money concepts do not include
A) interest or the cost of money.
B) payments of principal and interest.
C) present and future values.
D) the risks associated with various investments.
Answer: D
Diff: 1
Question Status: Previous edition

31) Corporate bonds
A) offer a predictable return to investors in the form of interest or coupon payments.
B) maintain their value even in periods of changing interest rates.
C) appreciate in value as the maturity date nears.
D) lose value at the maturity date nears.
Answer: A
Diff: 2
Question Status: Previous edition

32) Which of the following is **not** true regarding mutual funds?
A) There are thousands of funds with many different investing objectives.
B) They offer small investors diversification and professional management.
C) Dividends received from their investments are used to pay operational expenses, and capital gains are passed on to the mutual fund shareowners.
D) Both dividends and gains are distributed to mutual fund shareowners.
Answer: C
Diff: 1
Question Status: Previous edition

33) One advantage of investing in commercial real estate compared to stock, bonds, and mutual funds is that real estate
A) is more likely to go up in value.
B) is more marketable.
C) may yield income and tax advantages not available with the other investments.
D) is less risky than the other investments.
Answer: C
Diff: 2
Question Status: Previous edition

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34) What would be the return on 200 shares of stock purchased on January 1, 2016 for $60 per share and sold on December 31, 2016 at $80 per share? Also assume that the company paid dividends of $2 per share over the year. The prices include all brokerage fees. Round to the nearest whole percent.
A) 37%
B) 25%
C) 33%
D) 40%
Answer: A
Explanation: A) [(80 - 60) + 2]/60 = 36.60 or 37%
Diff: 2
Question Status: Revised

35) If a stock is purchased for $30 a share and pays $5 per share in dividends a year, what selling price at the end of the year would result in a return of 50%?
A) $60
B) $40
C) $35
D) $15
Answer: B
Explanation: B) [(x - 30) + 5]/30 = 0.5 or 50%
x = $40
Diff: 1
Question Status: Previous edition

36) What would be the annual compound return on a stock purchased at $20 per share, held for 5 years, and sold for $32.22? Ignore brokerage commissions and tax implications and assume the stock paid no dividends during the holding period. Round to the nearest whole percent if necessary.
A) 3%
B) 10%
C) 15%
D) 16%
Answer: B
Explanation: B) $32.22/$20 = 1.611
Referring to the future value of $1 table, A-1, on the 5 period line 1.611 is the factor for a 10% return.
Diff: 2
Question Status: Revised

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37) What would you pay for a stock whose price you estimate will be $50 in 10 years and you wish to earn a return on the investment of 9% per year? Ignore brokerage commissions and tax implications and assume the stock pays no dividends during the holding period.
A) $45
B) $41
C) $21.10
D) $15
Answer: C
Explanation: C) $50 × 0.422 (PV of $1, 10 periods, 9%) = $21.10
Diff: 2
Question Status: Revised

38) Assuming a tax rate on ordinary income of 25% and a long-term capital gain rate of 10%, how much would you pay in taxes if you sold stock "A" for a $200 capital gain after holding it for 5 months, stock "B" for a $300 capital gain after holding it for 8 months, and stock "C" for a $500 capital gain after holding it for 14 months?
A) $250
B) $100
C) $130
D) $175
Answer: D
Explanation: D)
Short-term capital gains ($200 + $300) × 0.25 = $125
Long-term capital gains ($500 × 0.10 = $50
Total taxes due $175
Diff: 2
Question Status: Previous edition

39) Name three applications of present and future value concepts to stocks.
Answer: Present value could be used to estimate the current price that could be paid for a stock using projected dividends and price estimates. Future value could be used in estimating what dividends and market appreciation would have to occur to yield a particular rate of return. A third application using future value could be the determination of a selling price necessary to achieve a desired rate of return.
Diff: 1
Question Status: Previous edition

40) Stocks that provide investors with steady income in the form of large dividends are classified as ________.
Answer: income stocks
Diff: 1
Question Status: Previous edition

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41) What would be the market price of a stock that paid a constant $2.00 per year in dividends in perpetuity, if the expected market return for a risk of this type was 7.5%?
A) $25
B) $100
C) $26.67
D) $27.50
Answer: C
Diff: 2
Question Status: New

42) What return on investment would you earn if you bought a stock on 1/1/16 for $100, received a 1% per quarter dividend and sold the stock on 1/2/2017 for $107?
A) 9%
B) 11.2%
C) 12.07%
D) 11%
Answer: D
Diff: 2
Question Status: New

43) The main difference(s) between a preferred stock in Company A that pays a $2.50 per share annual dividend and a common stock in Company A that also pays a $2.50 per share current annual dividend is (are)
A) the common stock has potential for price appreciation due to company earning s growth.
B) the common stock dividend may increase but the preferred dividend is fixed in perpetuity.
C) the common stock could lose value if the company performance were to suffer.
D) all of the above are real differences between preferred and common stock in the same company.
Answer: D
Diff: 2
Question Status: New

14.3   Risk from Investing

1) The return you will earn on certain stocks and bonds is uncertain because specific prices are not guaranteed.
Answer: TRUE
Diff: 2
Question Status: Revised

2) Most investors are fully aware of the risk involved when pursuing investments that have the potential for very large returns.
Answer: FALSE
Diff: 2
Question Status: Previous edition

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3) A key reason for uncertainty surrounding the return on investment is the uncertainty surrounding the current economic conditions.
Answer: TRUE
Diff: 2
Question Status: Previous edition

4) When economic conditions are strong, the demand for most types of investments is low.
Answer: FALSE
Diff: 2
Question Status: Previous edition

5) It is easy to predict the level of demand for certain investments since future economic conditions are fairly measurable.
Answer: FALSE
Diff: 2
Question Status: Previous edition

6) Individual risk is
A) objective.
B) a fixed percentage.
C) an individual's comfort with the risk-return relationship.
D) pretty much the same for everyone.
Answer: C
Diff: 1
Question Status: Previous edition

7) To measure an investment's risk, you may use all of the following **except**
A) time value of money.
B) range of returns.
C) standard deviation of returns.
D) subjective measures of risk.
Answer: A
Diff: 1
Question Status: Previous edition

8) Which of the following ranges of returns would indicate a less risky, more stable investment?
A) -3.0% to 4.0%
B) 1.5% to 5.75%
C) .4% to 1.4%
D) -1.7% to 3.75%
Answer: C
Diff: 1
Question Status: Revised

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9) Which of the following statements regarding an investment's risk is **not** true?
A) Investors measure risk to determine the degree of uncertainty surrounding their future returns.
B) Risky stock will have a smaller range of returns and a smaller standard deviation of returns.
C) Investments with a wide range of returns have more risk.
D) Standard deviation measures the degree of volatility in the stock's return over time.
Answer: B
Diff: 1
Question Status: Revised

10) A stock's ________ is a measure of the degree of volatility in a stock's returns over time.
A) range of returns
B) standard deviation
C) beta
D) value
Answer: B
Diff: 1
Question Status: Previous edition

11) Which of the following are not factors that may impact the return on stock or bond investments?
A) An individual investor's comfort with the level of risk of an investment.
B) Recent weakness in China's economy.
C) Increasing interest rates in the U.S. economy.
D) Increasing inflation in the U.S. and Europe.
Answer: A
Diff: 2
Question Status: New

12) If investors were risk averse they would want to
A) maximize the return they are receiving compared to the standard deviation of the returns on the particular security.
B) invest in technology stocks.
C) minimize risk, i.e., standard deviation, for the amount of return they are receiving on an investment.
D) seek the highest return they could find.
Answer: C
Diff: 2
Question Status: New

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14.4 Tradeoff between Return and Risk

1) Smart investors can find investments that generate high rates of returns with small amounts of risk.
Answer: FALSE
Diff: 1
Question Status: Previous edition

2) One of the factors impacting the risks of investments is the time period you have available to keep your money invested.
Answer: TRUE
Diff: 1
Question Status: Revised

3) The standard deviation of a stock's monthly returns measures the degree of volatility of a stock's returns over time and can be a method of evaluating a stock's future risk.
Answer: TRUE
Diff: 1
Question Status: Previous edition

4) An investment that has the potential to rise substantially in value also has the potential to decline substantially in value. If you cannot afford the possible loss, you should not make that investment.
Answer: TRUE
Diff: 1
Question Status: Previous edition

5) An initial public offering (IPO) is characterized by all of the following **except** that
A) it is the first time offering of stock by a corporation.
B) it has the potential to be sold later for a profit in the secondary market.
C) it can result in losing the investment.
D) it is available to individual investors before institutional investors.
Answer: D
Diff: 2
Question Status: Revised

6) You can reduce your risk by
A) diversifying your investments.
B) having a shorter time horizon.
C) putting all of your investment in one successful company.
D) Both A and B are correct.
Answer: A
Diff: 1
Question Status: Previous edition

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7) To earn the highest possible return in the stock market, you will need to
A) invest in the most well known stocks.
B) diversify your portfolio.
C) accept a high level of risk.
D) buy only the stocks of large, international firms.
Answer: C
Diff: 2
Question Status: Previous edition

8) If you have $1,000 to invest, but will need the money in one month to pay bills, you should
A) put the money in a money market savings account.
B) buy a one-year CD.
C) buy stocks of relatively stable firms that have low risk.
D) invest in a diversified stock mutual fund.
Answer: A
Diff: 1
Question Status: Previous edition

9) If you have $5,000 to invest but will need to use the funds in three years to buy a home, you should
A) invest in a diversified stock mutual fund.
B) buy stocks of relatively stable firms that have low risk.
C) buy a three-year CD.
D) put the money in a money market savings account.
Answer: C
Diff: 1
Question Status: Revised

10) Which of the following statements is true with regard to the risk of investments?
A) There is very little risk in an IPO since returns often exceed 20% in the first day.
B) Mutual funds containing mostly large stocks are more risky than mutual funds containing smaller stocks.
C) If you prefer less risk, purchase a bond issued by a successful and established firm.
D) There is little risk in purchasing land as an investment since the value of land always appreciates over time.
Answer: C
Diff: 1
Question Status: Revised

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11) You have $3,000 to invest, but will need the funds in a year to make a tuition payment. You should
A) put the money in a corporate bond.
B) buy a one-year CD.
C) buy stocks of relatively stable firms that have low risk.
D) invest in a diversified stock mutual fund.
Answer: B
Diff: 1
Question Status: Revised

12) You have $10,000 to invest and would like to set these funds aside for retirement in 20 years. You should
A) put the money in a money market savings account.
B) buy a one-year CD.
C) buy stocks of relatively stable firms that have low risk.
D) invest in a diversified stock mutual fund.
Answer: D
Diff: 1
Question Status: Previous edition

13) The risk-return relationship means
A) the lower the risk, the higher the return.
B) the higher the risk, the lower the return.
C) the higher the risk, the higher the return.
D) risk and return have little or no correlation.
Answer: C
Diff: 1
Question Status: Previous edition

14) Money you set aside for a "rainy day fund" should be invested in ________, while money you are saving for retirement in 20 years should be invested in ________.
A) mutual funds; bond funds
B) money market funds; growth oriented stock mutual funds
C) three year bank CD's; 20 year bank CD's
D) preferred stock; common stock
Answer: B
Diff: 2
Question Status: New

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14.5 Learning from Investment Mistakes

1) Examples of common investment mistakes covered in the text include all of the following **except**
A) following the advice of a stockbroker.
B) making decisions based on unrealistic goals.
C) borrowing to invest.
D) taking risks to recover losses from previous investments.
Answer: A
Diff: 2
Question Status: Previous edition

2) The Internet should be used for all of the following **except**
A) company financial statements.
B) specific recommendation on which stocks to buy.
C) stock prices.
D) analysis of stocks and industries.
Answer: B
Diff: 1
Question Status: Previous edition

14.6 How Investments Fit Within Your Financial Plan

1) Describe how the decision to invest in stocks affects financial planning, liquidity management, financing, and protecting your wealth.
Answer: Stocks are part of the investment plan and the overall financial plan. Purchasing stocks requires liquidity or financing/borrowing. In considering purchasing individual stocks, it should be done to increase your wealth either in the short term or the long term.
Diff: 1
Question Status: Revised

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