

***Essentials of Investments 2024 Release 1st edition
Bodie Test Bank***

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Answers are located at the end of each chapter.

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

- 1) Which of the following is a money market security?
 - A) investment grade corporate bonds
 - B) U.S. Treasury Bonds
 - C) common stock
 - D) 9-month maturity certificate of deposit

- 2) _____ blank is (are) real assets.
 - A) U.S. Treasury Notes
 - B) Land
 - C) Preferred stock
 - D) 3-month maturity certificate of deposit

- 3) _____ blank represents an ownership share in a corporation.
 - A) A put option
 - B) Common Stock
 - C) High-yield corporate bonds
 - D) Senior Debt

- 4) An example of a derivative security is _____ blank.
 - A) a common share of General Motors
 - B) a call option on Intel stock
 - C) a U.S. Treasury bond
 - D) a Ford bond

- 5) Which of the following is *not* an example of a financial intermediary?
 - A) Bank of America
 - B) J.P. Morgan
 - C) General Motors
 - D) State Farm Insurance

Answer Key

Test name: Chapter 01-01

- 1) D
- 2) B
- 3) B
- 4) B
- 5) C

Answers are located at the end of each chapter.

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

- 1) Financial assets represent _____ of total assets of U.S. households in 2022.
 - A) about 65%
 - B) over 90%
 - C) under 10%
 - D) about 30%

- 2) Real assets in the economy include all but which one of the following?
 - A) Land
 - B) Buildings
 - C) Consumer durables
 - D) Common stock

- 3) In 2022, net worth represented _____ of the liabilities and net worth of commercial banks.
 - A) about 51%
 - B) about 91%
 - C) about 9%
 - D) about 31%

- 4) According to the *Flow of Funds Accounts of the United States*, the largest single asset of U.S. households is _____.
 - A) mutual fund shares
 - B) real estate
 - C) pension reserves
 - D) corporate equity

- 5) According to the *Flow of Funds Accounts of the United States*, the largest liability of U.S. households is _____.
- A) mortgages
 - B) consumer credit
 - C) bank loans
 - D) gambling debts
- 6) _____ is *not* a derivative security.
- A) A share of common stock
 - B) A call option
 - C) A futures contract
 - D) A put option
- 7) According to the *Flow of Funds Accounts of the United States*, the largest financial asset of U.S. households is _____.
- A) mutual fund shares
 - B) corporate equity
 - C) pension reserves
 - D) deposits
- 8) Active trading in markets and competition among securities analysts helps ensure that:
- 1. Security prices approach informational efficiency.
 - 2. Riskier securities are priced to offer higher potential returns.
 - 3. Investors are unlikely to be able to consistently find under- or overvalued securities.
- A) 1 only
 - B) 1 and 2 only
 - C) 2 and 3 only
 - D) 1, 2, and 3
- 9) The material wealth of society is determined by the economy's _____, which is a function of the economy's _____.
- A) investment bankers; financial assets
 - B) investment bankers; real assets
 - C) productive capacity; financial assets
 - D) productive capacity; real assets

- 10) Which of the following is *not* a money market security?
- A) U.S. Treasury bill
 - B) 6-month maturity certificate of deposit
 - C) Common stock
 - D) Mortgage-backed security
- 11) _____ assets generate net income to the economy, and _____ assets define allocation of income among investors.
- A) Financial; financial
 - B) Financial; real
 - C) Real; financial
 - D) Real; real
- 12) Which of the following are financial assets?
- 1. Debt securities
 - 2. Equity securities
 - 3. Derivative securities
- A) 1 only
 - B) 1 and 2 only
 - C) 2 and 3 only
 - D) 1, 2, and 3
- 13) _____ are examples of financial intermediaries.
- A) Commercial banks
 - B) Insurance companies
 - C) Investment companies
 - D) All of the choices are correct.
- 14) Asset allocation refers to _____.
- A) the allocation of the investment portfolio across broad asset classes
 - B) the analysis of the value of securities
 - C) the choice of specific assets within each asset class
 - D) None of the choices are correct.

15) Which one of the following best describes the purpose of derivatives markets?

- A) Transferring risk from one party to another.
- B) Investing for a short time period to earn a small rate of return.
- C) Investing for retirement
- D) Earning interest income

16) *Security selection* refers to the _____.

- A) allocation of the investment portfolio across broad asset classes
- B) analysis of the broad asset classes
- C) choice of specific securities within each asset class
- D) top-down method of investing

17) Which of the following is an example of an agency problem?

- A) Managers engage in empire building.
- B) Managers protect their jobs by avoiding risky projects.
- C) Managers overconsume luxuries such as corporate jets.
- D) All of the options are examples of agency problems.

18) _____ is (are) a mechanism for mitigating potential agency problems.

- A) Tying income of managers to success of the firm
- B) Directors defending top management
- C) Antitakeover strategies
- D) All of the choices are correct.

19) _____ is (are) real assets.

- A) Bonds
- B) Production equipment
- C) Stocks
- D) Life insurance

- 20) _____ portfolio construction starts with selecting attractively priced securities.
- A) Bottom-up
 - B) Top-down
 - C) Upside-down
 - D) Side-to-side
- 21) In a market economy, capital resources are primarily allocated by _____.
- A) governments
 - B) corporation CEOs
 - C) financial markets
 - D) investment bankers
- 22) _____ represents an ownership share in a corporation.
- A) A call option
 - B) Common stock
 - C) A fixed-income security
 - D) Preferred stock
- 23) The value of a derivative security _____.
- A) depends on the value of another related security
 - B) affects the value of a related security
 - C) is unrelated to the value of a related security
 - D) can be integrated only by calculus professors
- 24) Commodity and derivative markets allow firms to adjust their _____.
- A) management styles
 - B) focus from their main line of business to their investment portfolios
 - C) ways of doing business so that they'll always have positive returns
 - D) exposure to various business risks

- 25) _____ portfolio management calls for holding diversified portfolios without spending effort or resources attempting to improve investment performance through security analysis.
- A) Active
 - B) Momentum
 - C) Passive
 - D) Market-timing
- 26) Financial markets allow for all but which one of the following?
- A) Shift consumption through time from higher-income periods to lower.
 - B) Price securities according to their riskiness.
 - C) Channel funds from lenders of funds to borrowers of funds.
 - D) Allow most participants to routinely earn high returns with low risk.
- 27) Financial intermediaries exist because small investors cannot efficiently _____.
- A) diversify their portfolios
 - B) gather information
 - C) assess and monitor the credit risk of borrowers
 - D) All of the choices are correct.
- 28) Methods of encouraging managers to act in shareholders' best interest include:
- 1. Threat of takeover.
 - 2. Proxy fights for control of the board of directors.
 - 3. Tying managers' compensation to stock price performance.
- A) 1 only
 - B) 1 and 2 only
 - C) 2 and 3 only
 - D) 1, 2, and 3
- 29) Firms that specialize in helping companies raise capital by selling securities to the public are called _____.
- A) pension funds
 - B) investment banks
 - C) savings banks
 - D) REITs

- 30) In securities markets, there should be a risk-return trade-off with higher-risk assets having _____ expected returns than lower-risk assets.
- A) higher
 - B) lower
 - C) the same
 - D) The answer cannot be determined from the information given.
- 31) When the market is more optimistic about a firm, its share price will _____; as a result, it will need to issue _____ shares to raise funds that are needed.
- A) rise; fewer
 - B) fall; fewer
 - C) rise; more
 - D) fall; more
- 32) Security selection refers to _____.
- A) choosing specific securities within each asset class
 - B) deciding how much to invest in each asset class
 - C) deciding how much to invest in the market portfolio versus the riskless asset
 - D) deciding how much to hedge
- 33) An example of a derivative security is _____.
- A) a common share of General Motors
 - B) a call option on Intel stock
 - C) a Ford bond
 - D) a U.S. Treasury bond
- 34) _____ portfolio construction starts with asset allocation.
- A) Bottom-up
 - B) Top-down
 - C) Upside-down
 - D) Side-to-side

- 35) Which one of the following firms falsely claimed to have a \$4.8 billion bank account, eventually resulting in the firm's bankruptcy?
- A) WorldCom
 - B) Enron
 - C) Parmalat
 - D) Global Crossing
- 36) Debt securities promise:
- 1. A fixed stream of income.
 - 2. A stream of income that is determined according to a specific formula.
 - 3. A share in the profits of the issuing entity.
- A) 1 only
 - B) 1 or 2 only
 - C) 1 and 3 only
 - D) 2 or 3 only
- 37) The Sarbanes-Oxley Act tightened corporate governance rules by requiring all but which one of the following?
- A) Required that corporations have more independent directors.
 - B) Required that the CFO personally vouch for the corporation's financial statements.
 - C) Required that firms could no longer employ investment bankers to sell securities to the public.
 - D) Required the creation of a new board to oversee the auditing of public companies.
- 38) The success of common stock investments depends on the success of _____.
- A) derivative securities
 - B) fixed-income securities
 - C) the firm and its real assets
 - D) government methods of allocating capital

- 39) The highest historical annual rate of return on U.S. stocks was in _____ and the worst was in _____.
- A) 2008; 1929
 - B) 1930; 1929
 - C) 1933; 1931
 - D) 1997; 2001
- 40) The average rate of return on U.S. Treasury bills since 1926 was _____.
- A) less than 0%
 - B) less than 4%
 - C) over 4%
 - D) over 12%
- 41) An example of a real asset is:
- 1. A college education
 - 2. Customer goodwill
 - 3. A patent
- A) 1 only
 - B) 2 only
 - C) 1 and 3 only
 - D) 1, 2, and 3
- 42) The 2002 law designed to improve corporate governance is titled the _____.
- A) Pension Reform Act
 - B) ERISA
 - C) Financial Services Modernization Act
 - D) Sarbanes-Oxley Act
- 43) Which of the following is *not* a financial intermediary?
- A) A mutual fund
 - B) An insurance company
 - C) A real estate brokerage firm
 - D) A credit union

- 44) The combined liabilities of American households in 2022 represent approximately _____ of combined assets.
- A) 7%
 - B) 12%
 - C) 25%
 - D) 33%
- 45) In 2022 real assets represented approximately _____ of the total asset holdings of American households.
- A) 33%
 - B) 42%
 - C) 48%
 - D) 55%
- 46) In 2022, mortgages represented approximately _____ of total liabilities and net worth of American households.
- A) 7.5%
 - B) 14.5%
 - C) 28.0%
 - D) 42.5%
- 47) Liabilities equal approximately _____ of total assets for nonfinancial U.S. businesses in 2022.
- A) 14%
 - B) 24%
 - C) 45%
 - D) 56%
- 48) Which of the following is *not* an example of a financial intermediary?
- A) Goldman Sachs
 - B) Allstate Insurance
 - C) First Interstate Bank
 - D) IBM

- 49) Real assets represent about _____ of total assets for commercial banks and savings institutions in 2022.
- A) 1%
 - B) 15%
 - C) 25%
 - D) 40%
- 50) Money market securities are characterized by:
- 1. Maturity less than 1 year
 - 2. Safety of the principal investment
 - 3. Low rates of return
- A) 1 only
 - B) 1 and 2 only
 - C) 1 and 3 only
 - D) 1, 2, and 3
- 51) After much investigation, an investor finds that Intel stock is currently underpriced. This is an example of _____.
- A) asset allocation
 - B) security analysis
 - C) top-down portfolio management
 - D) passive management
- 52) After considering current market conditions, an investor decides to place 60% of her funds in equities and the rest in bonds. This is an example of _____.
- A) asset allocation
 - B) security analysis
 - C) top-down portfolio management
 - D) passive management

- 53) Suppose an investor is considering one of two investments that are identical in all respects except for risk. If the investor anticipates a fair return for the risk of the security he invests in, he can expect to _____.
- A) earn no more than the Treasury-bill rate on either security
 - B) pay less for the security that has higher risk
 - C) pay less for the security that has lower risk
 - D) earn more if interest rates are lower
- 54) The efficient market hypothesis suggests that _____.
- A) active portfolio management strategies are the most appropriate investment strategies
 - B) passive portfolio management strategies are the most appropriate investment strategies
 - C) either active or passive strategies may be appropriate, depending on the expected direction of the market
 - D) a bottom-up approach is the most appropriate investment strategy
- 55) In a perfectly efficient market the best investment strategy is probably _____.
- A) an active strategy
 - B) a passive strategy
 - C) asset allocation
 - D) market timing
- 56) Market signals will help to allocate capital efficiently only if investors are acting _____.
- A) on the basis of their individual hunches
 - B) as directed by financial experts
 - C) as dominant forces in the economy
 - D) on accurate information

- 57) Which of the following is (are) true about hedge funds?
1. They are open to institutional investors.
 2. They are open to wealthy individuals.
 3. They are more likely than mutual funds to pursue simple strategies.
- A) 1 and 2 only
B) 1 and 3 only
C) 2 and 3 only
D) 1, 2, and 3
- 58) Venture capital is _____.
- A) frequently used to expand the businesses of well-established companies
B) supplied by venture capital funds and individuals to start-up companies
C) illegal under current U.S. laws
D) most frequently issued with the help of investment bankers
- 59) Individuals may find it more advantageous to purchase claims from a financial intermediary rather than directly purchasing claims in capital markets because:
1. Intermediaries are better diversified than most individuals.
 2. Intermediaries can exploit economies of scale in investing that individual investors cannot.
 3. Intermediated investments usually offer higher rates of return than direct capital market claims.
- A) 1 only
B) 1 and 2 only
C) 2 and 3 only
D) 1, 2, and 3
- 60) Surf City Software Company develops new surf forecasting software. It sells the software to Microsoft in exchange for 1,000 shares of Microsoft common stock. Surf City Software has exchanged a _____ asset for a _____ asset in this transaction.
- A) real; real
B) financial; financial
C) real; financial
D) financial; real

- 61) Stone Harbor Products takes out a bank loan. It receives \$100,000 and signs a promissory note to pay back the loan over 5 years. In this transaction, _____.
- A) a new financial asset was created
 - B) a financial asset was traded for a real asset
 - C) a financial asset was destroyed
 - D) a real asset was created
- 62) Which of the following firms was *not* engaged in a major accounting scandal between 2000 and 2005?
- A) General Electric
 - B) Parmalat
 - C) Enron
 - D) WorldCom
- 63) Accounting scandals can often be attributed to a concept in the study of finance known as the _____.
- A) agency problem
 - B) risk-return trade-off
 - C) allocation of risk
 - D) securitization
- 64) An intermediary that pools and manages funds for many investors is called _____.
- A) an investment company
 - B) an insurance company
 - C) an investment banker
 - D) a commercial bank
- 65) Financial institutions that specialize in assisting corporations in primary market transactions are called _____.
- A) mutual funds
 - B) investment bankers
 - C) pension funds
 - D) globalization specialists

- 66) When a pass-through mortgage security is issued, what does the issuing agency expect to receive?
- A) The amount of the original loan plus a servicing fee.
 - B) The principal and interest that are paid by the homeowner.
 - C) The principal and interest that are paid by the homeowner, minus a servicing fee.
 - D) The interest paid by the homeowner, plus a servicing fee.
- 67) In 2008, the largest corporate bankruptcy in U.S. history involved the investment banking firm of _____.
- A) Goldman Sachs
 - B) Lehman Brothers
 - C) Morgan Stanley
 - D) Merrill Lynch
- 68) The inability of shareholders to influence the decisions of managers, despite overwhelming shareholder support, is a breakdown in what process or mechanism?
- A) Auditing
 - B) Public finance
 - C) Corporate governance
 - D) Public reporting
- 69) Real assets are _____.
- A) assets used to produce goods and services
 - B) always the same as financial assets
 - C) always equal to liabilities
 - D) claims on a company's income
- 70) A major cause of the mortgage market meltdown in 2007 and 2008 was linked to _____.
- A) private equity investments
 - B) securitization
 - C) negative analyst recommendations
 - D) online trading

- 71) In recent years the greatest dollar amount of securitization occurred for which type of loan?
- A) Home mortgages
 - B) Credit card debt
 - C) Automobile loans
 - D) Equipment leasing
- 72) Which of the following is (are) true about nonconforming mortgage loans?
- A) They are also known as subprime loans.
 - B) They have higher default risk than conforming loans.
 - C) They were able to be offered without due diligence.
 - D) All of the choices are correct.
- 73) The systemic risk that led to the financial crisis of 2008 was increased by _____.
- A) collateralized debt obligations
 - B) subprime mortgages
 - C) credit default swaps
 - D) All of the choices are correct.
- 74) An investment adviser has decided to purchase gold, real estate, stocks, and bonds in equal amounts. This decision reflects which part of the investment process?
- A) Asset allocation
 - B) Investment analysis
 - C) Portfolio analysis
 - D) Security selection
- 75) The Volcker Rule
- A) prohibits banks from proprietary trading.
 - B) restricts banks' investments in hedge funds.
 - C) restricts banks' investments in private equity funds.
 - D) All of the choices are correct.

- 76) Until 1999, the _____ Act separated commercial banking and investment banking activities.
- A) Dodd-Frank Wall Street Reform and Consumer Protection
 - B) Sarbanes-Oxley
 - C) Glass-Steagall
 - D) Volcker Rule
- 77) The difference between LIBOR and the Treasury-bill rate
- A) is called the TED spread.
 - B) measures credit risk in the banking sector.
 - C) was very low just before the 2008 financial crisis.
 - D) All of the choices are correct.
- 78) The Dodd-Frank Reform Act does all of the following except
- A) reduces capital requirements for banks.
 - B) limits the risk-taking in which banks can engage.
 - C) requires public companies to set "claw-back" provisions.
 - D) creates an office within the SEC to oversee credit rating agencies.
- 79) Which insurance company sold more than \$400 billion of CDS contracts on subprime mortgages prior to the 2008 market crash?
- A) Metlife
 - B) AIG
 - C) Northwestern Mutual
 - D) New York Life

Answer Key

Test name: Chapter 01-02

- 1) A
- 2) D
- 3) C
- 4) B
- 5) A
- 6) A
- 7) C
- 8) D
- 9) D
- 10) C
- 11) C
- 12) D
- 13) D
- 14) A
- 15) A
- 16) C
- 17) D
- 18) A
- 19) B
- 20) A
- 21) C
- 22) B
- 23) A
- 24) D
- 25) C
- 26) D
- 27) D
- 28) D
- 29) B
- 30) A
- 31) A
- 32) A
- 33) B
- 34) B
- 35) C
- 36) B
- 37) C

- 38) C
- 39) C
- 40) B
- 41) D
- 42) D
- 43) C
- 44) B
- 45) A
- 46) A
- 47) C
- 48) D
- 49) A
- 50) D
- 51) B
- 52) A
- 53) B
- 54) B
- 55) B
- 56) D
- 57) A
- 58) B
- 59) B
- 60) C
- 61) A
- 62) A
- 63) A
- 64) A
- 65) B
- 66) C
- 67) B
- 68) C
- 69) A
- 70) B
- 71) A
- 72) D
- 73) D
- 74) A
- 75) D
- 76) C
- 77) D

- 78) A
- 79) B