

Objective Type Questions

State whether the following statements are True (T) or False (F).

1. Investments are concerned with risk and return.
2. Investments involve long-term commitments.
3. Speculation brings about stable return for long-term period of time.
4. Speculation is considered with review and analysis and investments with capital gain.
5. Investments are based on portfolio construction, valuation, identification and analysis.
6. The variable investments consist of cash, bonds and savings certificates.
7. The investment objective is high risk and high return.
8. Arbitrage is a long-term investment.
9. The commodity investment is through saving bank.
10. Indirect securities consist of mutual fund and life insurance securities.

Ans: 1. (T), 2. (T), 3. (F), 4. (F), 5. (T), 6. (F), 7. (F), 8. (F), 9. (F), 10. (T).

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| (t) | 1 | The rate of exchange between certain future dollars and certain current dollars is known as the pure rate of interest. |
| (t) | 2 | An investment is the current commitment of dollars over time to derive future payments to compensate the investor for the time funds are committed, the expected rate of inflation and the uncertainty of future payments. |
| (f) | 3 | A dollar received to day is worth less than the same dollar received in the future. |
| (f) | 4 | Expected Return = $(1 + \text{nominal risk-free rate})(1 + \text{inflation rate})(1 + \text{risk premium}) - 1$ |
| (f) | 5 | The three components of the required rate of return are the nominal interest rate, an inflation premium, and a risk premium. |
| (t) | 6 | Risk is the uncertainty that an investment will earn its expected rate of return. |
| (f) | 7 | A manager with a passive asset allocation strategy will try to increase allocation of assets that he believes will outperform other classes in the next period. |
| (t) | 8 | People invest with one or more of the following three basic needs in mind: income, capital preservation, capital appreciation. |

- (t) 9 As the level of risk increases an investor will require an expected return that will compensate for this additional risk.
- (f) 10 An internally efficient market is one where stocks trade at low prices.
- (t) 11 The required rate of return is the minimum rate of return that will induce an investor to invest.
- (t) 12 Participants in primary capital markets that gather funds and channel them to borrowers are called financial intermediaries.
- (t) 13 A manager with an active security selection philosophy will try to identify securities that will do well over the coming period.

- (f) 1 An investor should expect to receive higher returns from taking on lower risks
- (f) 2 The sources of investment returns are dividends and interest.
- (f) 3 The holding period return (HPR) is equal to the return relative stated as a percentage.
- (t) 4 The geometric mean is the nth root of the product of the annual holding period returns for N years minus one.
- (f) 5 The geometric mean of a series of returns is always larger than the arithmetic mean and the difference increases with the volatility of the series.
- (t) 6 When rates of return are the same for all years, the geometric mean and the arithmetic mean will be the same.
- (f) 7 The coefficient of variation is the expected return divided by the standard deviation of the return.
- (f) 8 Historically return relatives are used to measure the risk for a series of historical rates of return.
- (t) 9 Widening interest rate spreads indicate a flight to quality.
- (f) 10 The risk premium is a function of sales volatility, financial leverage, and inflation.

- (f) 1 The U.S. equity and bond markets have grown in terms of their relative size of the world equity and bond market.
- (t) 2 Diversification with foreign securities can help reduce portfolio risk.
- (f) 3 The total domestic return on German bonds is the return that would be

experienced by a U.S. investor who owned German bonds.

- (t) 4 If the exchange rate effect for Japanese bonds is negative, it means that the domestic rate of return will be greater than the U.S. dollar return.
- (t) 5 Investors who limit themselves to the U.S. equity market experienced rates of return below those in many other countries.
- (f) 6 It is very important when diversifying that the correlation between rates of return for various countries be high and very stable over time.
- (t) 7 Municipal bonds are tax-exempt.
- (f) 8 A Eurobond is an international bond denominated in a currency other than that of the United States.
- (f) 9 Yields on money market funds are often lower than yields available to individuals investing in CD's because of the fees involved.
- (f) 10 Income bonds are considered as safe as debentures because they pay higher rates of interest.
- (t) 11 Warrants are options issued in connection with the sale of fixed income securities.
- (f) 12 A call option is issued by a firm in conjunction with a convertible bond.
- (f) 13 For a U.K. based investor with stock investments in the U.S. a weakening dollar will enhance returns in terms of pounds.
- (t) 14 For a U.S. based investor with stock investments in the U.K. a weakening dollar will enhance returns in dollar terms.
