

***Foundations of Investments 1st edition Adair Test
Bank***

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Name: _____ Class: _____ Date: _____

Chapter 2. Types and Attributes of Financial Instruments

1. All of the following are categories of financial instruments EXCEPT

- a. equity securities.
- b. debt securities.
- c. syndicates.
- d. money market securities.

ANSWER: c

2. Which of the following is an organization that regulates publicly traded securities?

- a. IPO
- b. SPAC
- c. SEC
- d. IRS

ANSWER: c

3. The investigation of a contract that a reasonable business makes before entering into an agreement is called

- a. a futures contract.
- b. due diligence.
- c. a preliminary prospectus.
- d. a private placement.

ANSWER: b

4. To determine who rightfully owns a security to ensure investors receive payments from the firm, what is necessary?

- a. Blockchain accounting practices
- b. An initial public offering
- c. Careful tracking of ownership
- d. Preliminary prospectus

ANSWER: c

5. In order to ensure that investors are allowed to exercise their right to control the firm's activities, what is necessary?

- a. Blockchain accounting practices
- b. An initial public offering
- c. Preliminary prospectus
- d. Careful tracking of ownership

ANSWER: d

6. For private equity and debt placements, where the buyer is not expected to resell the instrument, there is

- a. less commodity risk.
- b. greater commodity risk.
- c. no need for careful tracking by the SEC.
- d. a greater need for careful tracking by the SEC.

ANSWER: c

7. The Latin phrase *caveat emptor* that governs private transactions means

- a. "buyer has little risk."

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- b. "caves are empty."
- c. "let the seller beware."
- d. "let the buyer beware."

ANSWER: d

8. A direct sale of a security can be facilitated by the offering corporation or
- a. the IRS.
 - b. the U.S. government.
 - c. an investment bank.
 - d. the SEC.

ANSWER: c

9. The role of underwriting during the initial sale of stocks or bonds is generally fulfilled by
- a. an investment bank.
 - b. the U.S. government.
 - c. the SEC.
 - d. the IRS.

ANSWER: a

10. Sale or purchase of securities by the firm that issued them takes place in
- a. the primary market.
 - b. the secondary market.
 - c. an ETF.
 - d. the registration phase.

ANSWER: a

11. A firm that specializes in investing in securities of small, emerging companies is known as a(n)
- a. IPO.
 - b. venture capital firm.
 - c. SPAC.
 - d. market participant.

ANSWER: b

12. Venture capital firms generally invest in small firms with emerging technologies. They take on risks that public investors may not take to
- a. generate risk-free income.
 - b. experience exceptional growth.
 - c. hedge tax protections.
 - d. avoid due diligence.

ANSWER: b

13. The first sale of common stock to the general public is known as a(n)
- a. syndicate.
 - b. IPO.

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- c. SPAC.
- d. firm commitment.

ANSWER: b

14. All of the following are examples of what an investment bank may advise on EXCEPT

- a. mergers.
- b. privatization.
- c. restructuring.
- d. tax law.

ANSWER: d

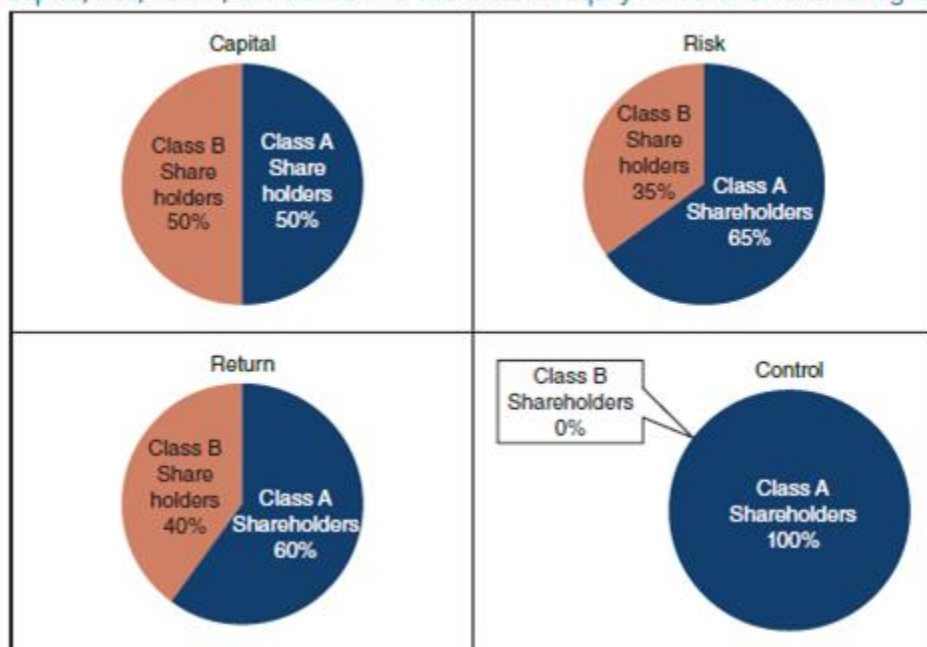
15. A selling group assembled to market an issue of securities is called a

- a. syndicate.
- b. venture capital firm.
- c. money market fund.
- d. participating bond.

ANSWER: a

16. The following diagram shows that when there are two different classes of stock shares, one class of shares

Capital, Risk, Return, and Control in a Two-Class All-Equity Firm with Differential Rights



- a. gets less control in exchange for less risk or more return.
- b. gets more control in exchange for less risk or more return.
- c. maintains all the decision-making power.
- d. takes all the risk.

ANSWER: a

17. The following diagram is indicative of what type of stakeholder relationship?

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Capital, Risk, Return, and Control in a Firm



- a. All equity
- b. All debt
- c. Some equity and debt
- d. Government owned

ANSWER: a

18. The term *residual claimant* refers to
- a. leftover payments after promised payments.
 - b. primary payments.
 - c. primary debt.
 - d. leftover debt resolutions.

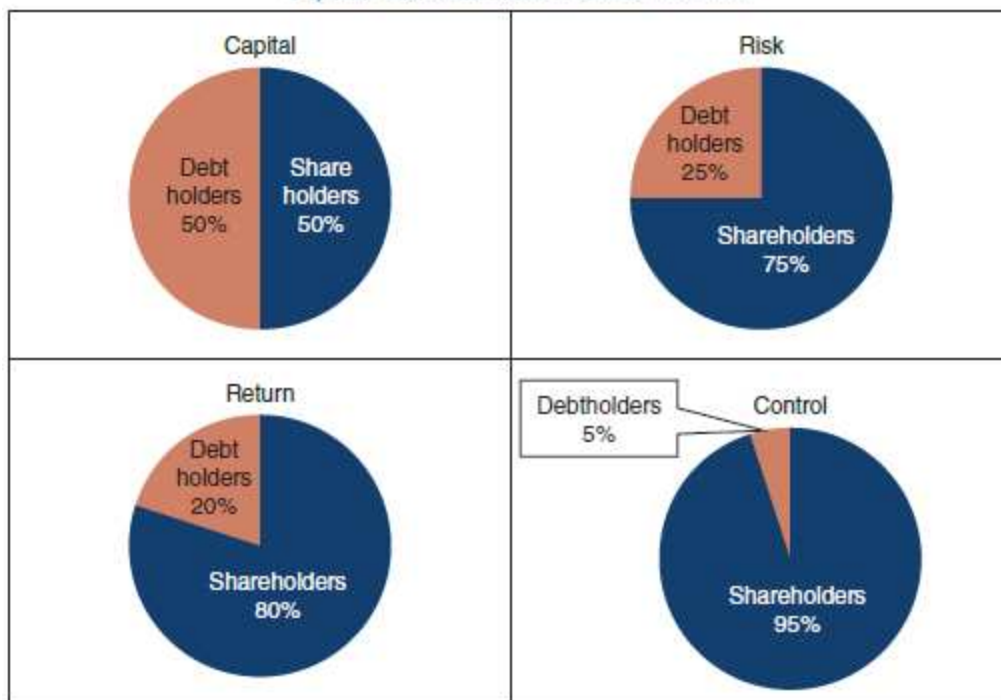
ANSWER: a

19. The following diagram is indicative of what type of stakeholder relationship?

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Capital, Risk, Return, and Control in a Firm



- a. All equity
- b. All debt
- c. Some equity and debt
- d. Government owned

ANSWER: c

20. A market where securities trade after issuance by the firm is called a
- a. primary market.
 - b. secondary market.
 - c. money market.
 - d. syndicate.

ANSWER: b

21. When a syndicate of investment bank brokers an IPO, the firm that manages the sale is known as the
- a. underwriter.
 - b. lead underwriter.
 - c. derivative instrument.
 - d. participating organization.

ANSWER: b

22. An agreement with an investment banker who does not guarantee the sale of the security is called a
- a. venture capitalist agreement.
 - b. repurchase agreement.
 - c. firm commitment.

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d. best-efforts agreement.

ANSWER: d

23. An investment banker guaranteeing the sale of securities by agreeing to purchase the entire issue at a specified price is a

- a. venture capitalist agreement.
- b. repurchase agreement.
- c. firm commitment.
- d. best-efforts agreement.

ANSWER: c

24. The initial document detailing the financial condition of a firm that is filed with the SEC to register a new issue of securities is called a

- a. registration.
- b. preliminary prospectus.
- c. repurchase agreement.
- d. futures contract.

ANSWER: b

25. The process of filing information with the SEC concerning a proposed sale of securities to the public is called a

- a. registration.
- b. preliminary prospectus.
- c. repurchase agreement.
- d. futures contract.

ANSWER: a

26. A series of sales presentations to potential investors by an underwriting firm is called a(n)

- a. road show.
- b. preliminary prospectus.
- c. IPO.
- d. futures contract.

ANSWER: a

27. Lockup agreements prevent

- a. the sale of stock by insiders following an IPO.
- b. tax benefits due to public sale of assets.
- c. tax benefits due to public trading of common stock.
- d. government intervention in an IPO.

ANSWER: a

28. When existing outstanding shares are sold to the public for the first time in a secondary market with no underwriter involvement, this is called

- a. an indirect transfer.
- b. a direct listing.

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- c. commercial paper.
- d. SPAC.

ANSWER: b

29. An investment vehicle that raises capital in its IPO and then looks for a private company to purchase is called a
- a. SPAC.
 - b. venture capital firm.
 - c. derivative instrument.
 - d. repurchase agreement.

ANSWER: a

30. Which type of investment receives dividends first?
- a. Common stock
 - b. Debt securities
 - c. Preferred stock
 - d. Money market bonds

ANSWER: c

31. What type of equity security receives dividend payments and has debt features?
- a. Preferred stock
 - b. Common stock
 - c. Corporate bonds
 - d. Government bonds

ANSWER: a

32. The maximum amount that an equity investor can lose should a public corporation default on its obligations is the
- a. amount of the investment.
 - b. assets held by the investor.
 - c. amount of the investment plus taxes.
 - d. amount of the debt held.

ANSWER: a

33. The maximum amount that an investor can lose who pledged personal assets to secure a loan should the corporation default on its obligations is the
- a. amount of the investment the personal assets pledged.
 - b. assets held by the investor.
 - c. amount of the investment plus taxes.
 - d. amount of the debt held.

ANSWER: a

34. The legal status where an investor's liability is limited to their investment in a firm is called
- a. due diligence.
 - b. repurchase agreement.
 - c. liability minimization.

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d. limited liability.

ANSWER: d

35. Shareholders of an organization have the right to

- a. vote the shares and participate in hiring the firm's management.
- b. vote the shares and elect a board of directors.
- c. participate in hiring the firm's management and elect a board of directors.
- d. participate in hiring the firm's management and comply with government regulations.

ANSWER: b

36. Which of the following is entitled to a firm's earnings?

- a. Investment banks
- b. Creditors
- c. Stockholders
- d. Debtholders

ANSWER: c

37. Which of the following gets paid last if a firm goes bankrupt?

- a. Bondholders
- b. Stockholders
- c. Creditors
- d. Debtholders

ANSWER: b

38. Fixed-income bonds are least likely to be issued by

- a. large corporations.
- b. federal governments.
- c. municipal governments.
- d. smaller corporations.

ANSWER: d

39. Risk assumed by the lender in which the borrower might fail to pay interest or principal repayments is called

- a. inherent risk.
- b. interest rate risk.
- c. purchasing power risk.
- d. default risk.

ANSWER: d

40. The potential return on a bond is known as

- a. maturity.
- b. coupon.
- c. yield.
- d. interest.

ANSWER: c

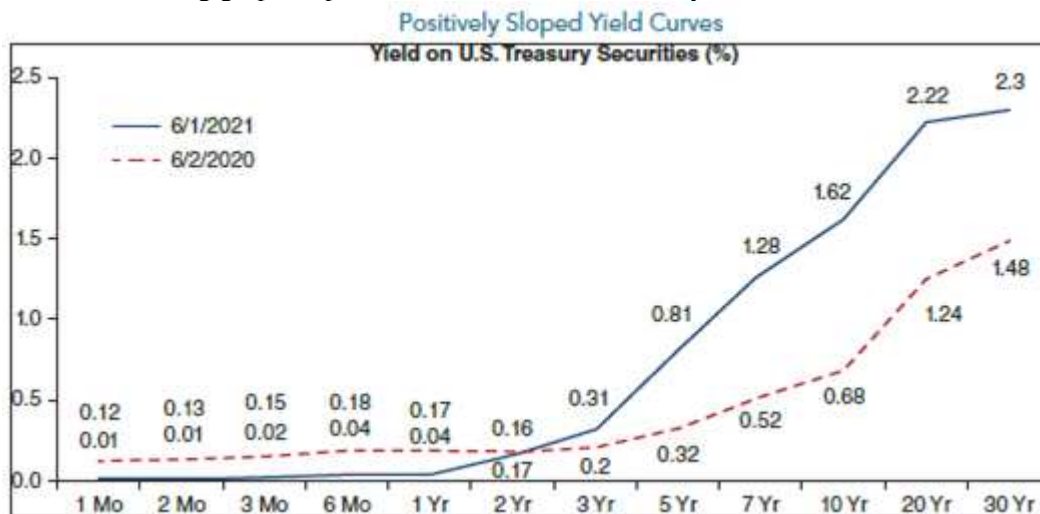
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41. The estimated annual rate of return for a bond, assuming the investor holds the asset to its maturity date, is known as
- coupon yield.
 - interest yield.
 - yield to maturity.
 - yield.

ANSWER: c

42. The following graph implies that as the term to maturity of a bond increases, the investors



- require additional compensation.
- require less compensation.
- can tolerate less risk.
- can tolerate more risk.

ANSWER: a

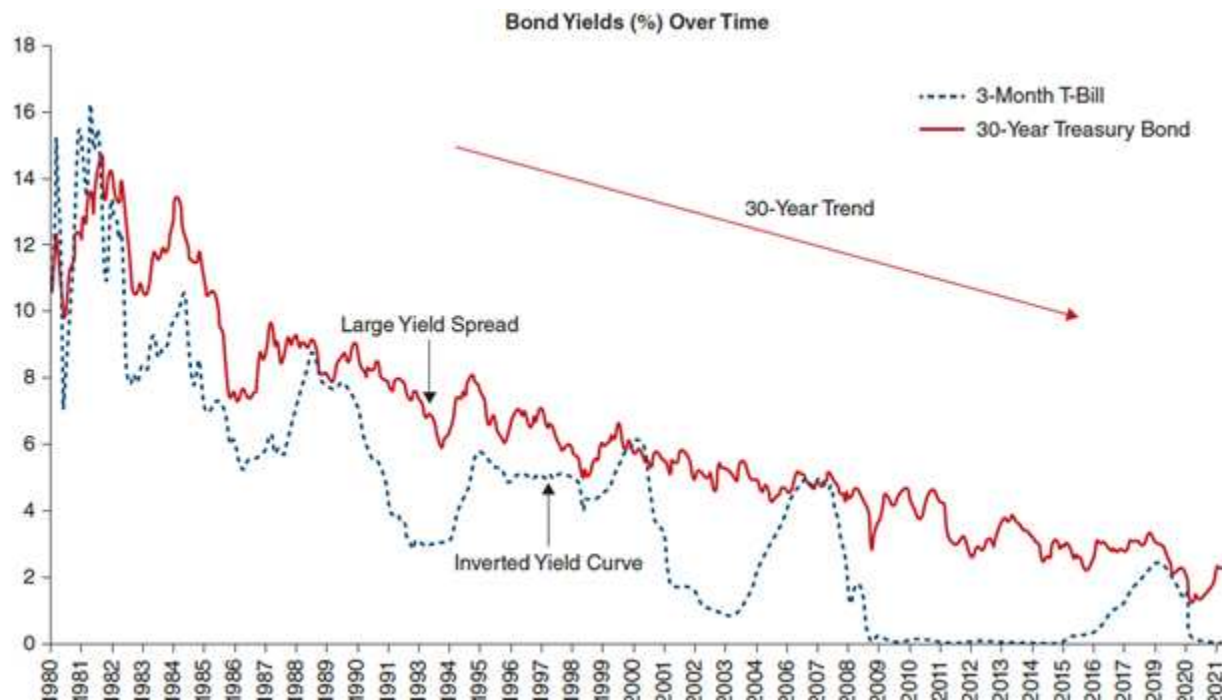
43. The stated legal document for a debt agreement is known as the
- indenture.
 - debenture.
 - yield spread.
 - registration.

ANSWER: a

44. According to the following graph, the large yield spread of Treasury Bills and Treasury Bonds appears over time to

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- a. increase.
- b. remain relatively stable.
- c. decrease.
- d. decrease in risk.

ANSWER: c

45. All of the following are debt agreement terms that debtors must meet included in the indenture EXCEPT

- a. coupon rate.
- b. yield.
- c. date of maturity.
- d. date of issuance.

ANSWER: b

46. Property that a borrower must offer to secure a loan is known as

- a. the yield.
- b. an asset.
- c. a T-bill.
- d. collateral.

ANSWER: d

47. An agent appointed to act in the interest of the bondholders is known as

- a. a fiduciary.
- b. an investment bank.
- c. a trustee.
- d. the SEC.

ANSWER: c

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48. Out of the bonds in the following table, which is the least risky?

Ratings for Selected Bonds Maturing in 2025

Issuer	Coupon Rate of Interest	S&P Rating	Moody's Rating
Apple	2.500%	AA+	A2
Bank of America	4.000	BBB+	Baa3
FedEx	3.200	BBB	Baa1
General Motors Financing	4.000	BBB	Ba1
Merck	2.750	AA	A2
Waste Management	3.125	A	Baa2

- a. Waste Management
- b. Merck
- c. Apple
- d. Bank of America

ANSWER: c

49. A diversified bond portfolio can protect an investor against

- a. interest rate risk.
- b. reinvestment risk.
- c. purchasing power risk.
- d. default risk.

ANSWER: d

50. A factor of debt that partially compensates for the risk of price fluctuations is

- a. that the debt ultimately matures.
- b. risk tends to lessen over time.
- c. the bond market evens out over the life of the loan.
- d. bonds have less risk than stocks.

ANSWER: a

51. The likelihood that future cash flows won't be worth as much because of inflation is known as

- a. purchasing power risk.
- b. inflation rate risk.
- c. interest rate risk.
- d. default risk.

ANSWER: a

52. When an investor acquires bonds in a foreign currency, there is a type of risk known as

- a. purchasing power risk.
- b. interest rate risk.
- c. default risk.
- d. foreign exchange risk.

ANSWER: d

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53. The safest short-term security that typically has a maturity of less than one year is known as

- a. commercial paper.
- b. a CD.
- c. a T-bill.
- d. a repurchase agreement.

ANSWER: c

54. The sale of a security where a seller agrees to buy back the security at a specified price at a specified date is called

- a. commercial paper.
- b. a CD.
- c. a T-bill.
- d. a repurchase agreement.

ANSWER: d

55. Short-term debt issued by a corporation that matures in 270 days or less is known as

- a. commercial paper.
- b. a CD.
- c. a T-bill.
- d. a repurchase agreement.

ANSWER: a

56. In which type of instrument does an investor know precisely how much will be made on the investment?

- a. Commercial paper
- b. CD
- c. T-bill
- d. Repurchase agreement

ANSWER: d

57. What instrument is a short-term promissory note that a bank guarantees?

- a. Tax anticipation note
- b. CD
- c. Banker's acceptance
- d. Repurchase agreement

ANSWER: c

58. A debt issued by a state and to be repaid from future tax revenues is called a

- a. CD.
- b. T-bill.
- c. tax anticipation note.
- d. repurchase agreement.

ANSWER: c

59. Yield on money market funds compared to other mutual funds tends to be

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- a. much higher.
- b. much lower.
- c. much riskier.
- d. more likely to follow the S&P 500.

ANSWER: b

60. Risk associated with money market funds compared to other mutual funds tends to be
- a. much lower.
 - b. much higher.
 - c. more likely to improve with time.
 - d. more likely to follow the S&P 500.

ANSWER: a

61. A contract that derives its value from an underlying asset or factor is known as a
- a. financial instrument.
 - b. registration.
 - c. derivative instrument.
 - d. commodity.

ANSWER: c

62. A form of insurance that investors take against risk is known as a
- a. muni.
 - b. T-bill.
 - c. hedge.
 - d. commodity.

ANSWER: c

63. A basic good used in commerce that is interchangeable with other goods of a similar type is known as a
- a. commodity.
 - b. T-bill.
 - c. hedge.
 - d. muni.

ANSWER: a

64. A formal agreement to buy or sell a commodity at a specified price is known as a(n)
- a. option.
 - b. futures contract.
 - c. hedge.
 - d. muni.

ANSWER: b

65. A transaction where an individual does not purchase but rather enters into a contract to buy or sell is known as a(n)
- a. option.
 - b. T-bill.

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- c. hedge.
- d. futures contract.

ANSWER: d

66. The primary appeal of commodity contracts to speculators is the potential
- a. to diversify a portfolio.
 - b. to hedge against upside risk.
 - c. to hedge against downside risk.
 - d. for a large return on the investment.

ANSWER: d

67. An investment defined as the non-binding right to buy or sell a stock at a specified price for a specified length of time is a(n)
- a. hedge.
 - b. futures contract.
 - c. commodity.
 - d. option.

ANSWER: d

68. Leverage exists in futures contracts because the
- a. contract may become null and void if conditions are not met.
 - b. contract controls a large amount of the underlying asset and costs little money.
 - c. value is inherent in the underlying asset.
 - d. value of the underlying asset changes predictably.

ANSWER: b

69. Which investing market is the largest in the world?
- a. Stock market
 - b. Bond market
 - c. Foreign exchange market
 - d. Primary market

ANSWER: c

70. Speculating in foreign markets is thought to be
- a. risk averse.
 - b. not very risky.
 - c. level in terms of risk.
 - d. very risky.

ANSWER: d