

SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT

An introduction to investment alternatives, security analysis, and portfolio construction. Topics include: the environment in which investment decisions are made: (1) markets for the purchase and sales of securities, (2) risk and return--their measurement and use in the construction of the individual's portfolio, (3) taxation, and (4) the efficiency of financial markets; as well as specific investments: (1) debt instruments—corporate bonds, federal government securities, and municipal bonds; (2) equity investments, (3) put and call options, (4) investment companies, and (5) nonfinancial assets such as real estate, gold, and collectibles. (3 s.h.)

FIN-321-TE

This is a two-hour examination in which you must answer 100 multiple-choice questions (worth 1 point each). A passing score is **60** out of 100 points.

Here are the topics covered and their approximate importance on the test:

- I. THE ENVIRONMENT AND TOOLS OF INVESTING (30%)
 - A. Mechanics of buying and selling securities
 - B. Investment banking
 - C. Taxation and tax shelters
 - D. Risk and its measurement
 - E. Diversification
 - F. Time value of money
 - G. Efficient markets
 - H. Regulation
- II. INVESTING IN FIXED INCOME SECURITIES (20%)
 - A. Variety of corporate debt
 - B. Federal government bonds
 - C. Municipal bonds
 - D. Preferred stock
 - E. Valuation of fixed income securities
 - F. Yields: current yield, yield to maturity
- III. INVESTING IN COMMON STOCK (20%)
 - A. Aggregate measures of stock prices
 - B. Historical rates of return
 - C. Valuation of common stock
 - D. Analysis of financial statements
 - E. Fundamentals and technical analysis
- IV. INVESTING IN OPTIONS, FUTURES, AND NONFINANCIAL ASSETS (20%)
 - A. Puts and calls
 - B. Warrants
 - C. Commodities
 - D. Real estate
 - E. Collectibles
 - F. Precious metals

V. INVESTMENT COMPANIES AND THE CONSTRUCTION OF DIVERSIFIED PORTFOLIOS (10%)

- A. Closed-end investment companies
- B. Mutual funds
- C. Returns earned by investment companies

Textbooks to help you prepare:

Gup, Benton. *The Basics of Investing*. Current edition. New York: John Wiley

Mayo, Herbert B. *Investments: An Introduction*. Current edition. Ft. Worth, TX: South-Western/Cengage

Reilly, Frank K. and Edgar A. Norton. *Investments*. Current edition. Ft. Worth, TX: South-Western/Cengage

SAMPLE QUESTIONS

1. A liquid asset may
 - a. be converted into cash
 - b. be converted into cash with little chance of loss
 - c. not be converted into cash
 - d. not be converted without loss
2. A negatively sloped yield curve suggests that
 - a. short-term rates exceed long-term rates, and the Federal Reserve is following a tight monetary policy
 - b. short-term rates exceed long-term rates, and the Federal Reserve is following an easy monetary policy
 - c. long-term rates exceed short-term rates, and the Federal Reserve is following a tight monetary policy
 - d. long-term rates exceed short-term rates, and the Federal Reserve is following an easy monetary policy
3. The market price of a bond depends on the
 - a. coupon rate, and terms of the indenture
 - b. coupon rate, and maturity date
 - c. terms of the indenture, and maturity date
 - d. coupon rate, terms of the indenture, and maturity date
4. While bond prices fluctuate,
 - a. yields are constant
 - b. coupons are constant
 - c. the spread between yields is constant
 - d. short-term bond prices fluctuate even more

5. If interest rates rise, the price of preferred stock
 - a. is not affected
 - b. rises
 - c. falls
 - d. may rise or fall

6. Municipal government debt
 - a. pays more interest than corporate debt
 - b. is often purchased by individuals with high incomes
 - c. is exempt from estate taxation
 - d. is not subject to interest rate risk

7. The use of financial leverage by a firm may be measured by the
 - a. ratio of debt to total assets
 - b. firm's beta coefficient
 - c. firm's retention of earnings
 - d. ratio of the price of the firm's stock price to its earnings

8. An example of a depreciable asset is
 - a. land
 - b. cash
 - c. accounts receivable
 - d. equipment

9. As the debt ratio increases,
 - a. fewer assets are debt-financed, and the ratio of debt-to-equity increases
 - b. fewer assets are debt-financed, and the ratio of debt-to-equity decreases
 - c. more assets are debt-financed, and the ratio of debt-to-equity increases
 - d. more assets are debt-financed, and the ratio of debt-to-equity decreases

10. The net asset value of a mutual fund investing in stock rises with
 - a. higher stock prices
 - b. lower equity values
 - c. an increased number of shares
 - d. increased liabilities

11. Which of the following helps determine the relationship between the expected return and risk for individual securities?
 - a. Security market line
 - b. Capital market line
 - c. Markowitz model
 - d. (a) and (b)

12. A call is an option to
- sell stock at a specified price
 - buy stock at a specified price
 - sell stock on a specified date
 - buy stock on a specified date
13. Which of the following is on the horizontal axis of the Security Market Line?
- Standard deviation
 - Beta
 - Expected return
 - Required return
14. You own a large orange grove and will be harvesting from November through April. To hedge against price risks you should
- sell orange juice contracts with a November delivery
 - buy orange juice contracts with a November delivery
 - sell orange juice contracts with delivery dates between November and April
 - buy orange juice contracts with delivery dates between November and April
15. Financial leverage may increase a corporation's risk because
- operating income may stabilize
 - the firm has fixed obligations to meet
 - more common stock is outstanding
 - dividends must be paid
16. What is the value of a call on the expiration date, if on that date the price of the stock is \$25 and the exercise price is \$26?
- \$1
 - \$0
 - \$1
 - \$25
17. Equity does NOT include
- cash and paid-in capital
 - common stock and paid-in capital
 - paid-in capital and retained earnings
 - common stock, paid-in capital and retained earnings
18. What is the price of a stock estimated to pay a dividend of \$.60 next year, if the dividend growth rate is 5% and the appropriate discount rate is 8%?
- \$18
 - \$19
 - \$20
 - \$21

19. Corporate bond indenture agreements often specify each of the following EXCEPT
- a. bond call provisions
 - b. sinking fund requirements
 - c. restrictions on the corporation's dividend payments
 - d. assets on which debenture issues are collateralized
20. If you were confident that the price of stock X would drop dramatically within two months, which of the following investment transactions would yield the highest return on your investment?
- a. Purchase stock X
 - b. Sell stock X short
 - c. Purchase a call on stock X
 - d. Purchase a put on stock X

ANSWERS TO SAMPLE QUESTIONS

1. **b** 2. **a** 3. **d** 4. **b** 5. **c** 6. **b** 7. **a** 8. **d** 9. **c** 10. **a**
11. **a** 12. **b** 13. **b** 14. **c** 15. **b** 16. **b** 17. **a** 18. **c** 19. **d** 20. **d**