Finance Essentials 1st edition Kidwell Test Bank

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Testbank

to accompany

Finance essentials

1st edition

by

Kidwell et al.

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Module 2: The financial system

Multiple-choice questions

1. The functions of a financial system include:

A. facilitating the flow of funds.
B. providing means for the transfer and management of risks.
C. providing the mechanism for the settlement of transactions.
*D. all of the above.

Feedback: The flow of funds refers to the channelling of funds from the units with financial surplus to units with financial deficit, either directly or through financial intermediaries. The settlement function is fulfilled by the payment system, which is part of the financial system. The financial system, through general insurance companies or life insurance companies, provide ways to alleviate risks. In addition the financial system provides means for insuring against the risks created by some financial claims. The list of functions could be completed with the following ones: "generating and disseminating information that assists decision making" and "providing ways of dealing with the incentive problems that arise in financial contracting".
LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

2. A deficit spending unit is an economic unit:

A. who has negative income.
B. whose income is less than planned saving.
C. who can provide funds to the financial system.
*D. whose planned expenditure in a period exceeds current income.

Feedback: In order to provide funds to the financial system, the economic unit needs to be a surplus spending unit (SSU), i.e. its income exceeds planned expenditure so there are funds left (called savings). The SSU may also decide to repay existing debt instead of acquiring new financial assets. The deficit spending unit (DSU) is in the opposite situation as planned expenditure exceeds income (negative savings) and therefore he/she needs to find funds in the financial system to pay for the expenditure as an alternative to liquidate existing assets.
LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

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3. Which of the following statements best describes the concept of "two faces of debt"?

A. Government debt requires higher taxation in the future to repay the principal and interests of the debt.
B. Intermediaries issue financial claims to SSUs and own financial claims issued by DSUs.
*C. Every financial asset is someone else's liability/equity.
D. DSUs in one period can be SSUs in another one.

Feedback: Financial claims are liabilities (if debt) or equity (if shares) for recipients of funds and are assets to providers of funds. All the other statements are correct but are not related to the concept of "two faces of debt".
LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

4. It is important to be able to resell financial claims in a secondary market because it allows:

A. DSUs to finance a project with successive issues of financial claims.
B. DSUs to implement projects with horizon shorter than the SSUs' investment horizon.
*C. SSUs to purchase financial claims with maturities that are longer than their investment horizon.
D. SSUs to purchase financial claims with maturities that are shorter than their investment horizon.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

5. The functions of the financial system include:

A. providing ways of dealing with the incentive problems that arise in financial contracting.
B. generating and disseminating information that assists decision making.
C. facilitating the flow of funds.
*D. all of the above.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

6. Which of the following are NOT financial claims?

*A. commodities.
B. bonds.
C. shares.
D. loans.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

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7. During 2017, Michael and Jenny Jones expect total income of $215,000 and are budgeting total expenditure of $195,000. For this budget period, the Jones family is most specifically a:

A. deficit spending unit.
B. a recipient of funds from the financial system.
*C. surplus spending unit.
D. financial intermediary.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

8. Which of the following financial claims does NOT belong to the capital market?

A. Corporate bond.
*B. Bank bill.
C. Shares.
D. Government bond.

Feedback: Capital market refers to the market for financial claims with an original maturity larger than one year. Bonds issued by governments or corporations belong to that category as they are usually issued with an original maturity of 5 to 30 years. Shares have an unlimited maturity as they exist as long as the company operates. Shares therefore belong to capital market. Bank bills are issued by banks on behalf of a corporation and sold by banks to investors with an original maturity less than one year. They therefore belong to the money market.
LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

9. Corporate bonds:

*A. provide funding for capital expenditure.
B. have a very active secondary market.
C. have a maturity less than one year.
D. are issued by governments.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

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10. Which one of the following statements is **NOT** true?

A. Prices in the corporate bond market tend to be more volatile than the market for shares.
*B. Corporate bonds are more marketable than the securities that have higher daily trading volumes.
C. The market for corporate bonds is thin.
D. Life insurance companies and superannuation funds are the largest investors in corporate bonds.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

11. An economy with a large flow of funds requires:

A. a tightly controlled central bank.
*B. an efficient financial system.
C. a lot of gold reserves.
D. all of the above.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

12. The financial system's primary concern is funnelling money from _____ to _____.

*A. SSUs, DSUs.
B. DSUs, SSUs.
C. wealthy individuals, individuals.
D. the government, wealthy individuals.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

13. An important function of the financial system is:

*A. to direct money to the best investment opportunities in the economy.
B. to allow the federal government to view all financial transactions.
C. to help state governments to coordinate state tax levies.
D. all of the above.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

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14. A surplus budget position means that an entity's:

A. income and expenditures are the same.
*B. income for the period exceeds expenses.
C. expenditures for the period exceed revenues.
D. none of the above.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

15. The major players in the direct financial markets are:

A. regional banks.
B. commercial banks.
C. investment banks.
*D. both B and C.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

16. Which of the following would most likely be involved in underwriting public securities?

A. A broker.
*B. A dealer.
C. A regional commercial banker.
D. None of the above are involved in underwriting.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

17. The ASX is an example of:

A. an over-the-counter market exchange.
*B. an electronic organised exchange.
C. a physical exchange.
D. all of the above.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

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18. Which of the following is not a role of financial markets:

A. matching borrowers and lenders.
B. facilitation of business and trade.
*C. to increase the poverty gap.
D. facilitation of savings by individuals to allow for future consumption.

LO 2.1: Discuss the primary role of the financial system in the economy, and how fund transfers take place.

19. A sale of an entire security issue to a small group of surplus spending units is:

A. a dealer arrangement.
*B. a private placement.
C. an underwriting.
D. indirect finance.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

20. An over-the-counter market:

A. is a primary market.
B. is regulated by the RBA.
*C. has no central location.
D. allows investors in financial claims to trade directly among themselves.

Feedback: An organised security exchange has a central location whereas an over-the-counter market operates through a network of dealers located at various locations. Organised security exchanges and over-the-counter markets are secondary markets as their purpose is to assist in the change of ownership among investors over financial claims. Trade in the secondary market does not involve the issuer, except in the rare case of buybacks. All markets are regulated by ASIC, while the RBA focuses on the general stability of the financial system. Investors in an over-the-counter market trade with a dealer not with each other.
LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

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21. Which of the following transactions occurs in the primary market?

A. A managed fund sells some Optus shares it owns.
B. Mr Grey buys Commonwealth Bank shares listed on the ASX.
*C. The Federal government sells Treasury bonds to finance road infrastructure.
D. Mrs Thompson sells government bonds to a dealer.

Feedback: A primary market is the market in which financial claims are sold for the first time in order to provide funds to the issuer of the claim. When the government puts in circulation new Treasury bonds with the aim of raising funds, this transaction takes place in the primary market. The later transactions among investors who want to rearrange their portfolios will take place in the secondary market. When an investor sells an asset it had previously bought the transaction is necessarily in the secondary market and the transaction brings funds to the selling investor not the issuer of the financial claim. The managed funds selling Optus shares and Mrs Thompson selling the government bonds are good examples of investors trading in the secondary market. ASX, where shares trade among investors, is a famous example of a secondary market. New shares issued by corporations to raise funds are not put in circulation through the ASX but through an investment bank.
LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

22. A futures market is:

A. a dealer market in which securities that are not sold on one of the organised exchanges are traded.
B. an over-the-counter market in which people trade contracts for future delivery of securities, commodities or the value of securities sold in the spot market.
*C. an organised market in which people trade contracts for future delivery of securities, commodities or the value of securities sold in the spot market.
D. a dealer market for contracts to buy (or sell) a particular type of security or commodity from (or to) the futures exchange during a predetermined future time period.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

23. Which of the following statements is NOT correct?

*A. Owners of financial claims can sell them in the primary market.
B. Deficit spending units raise funds by issuing financial claims in the primary market.
C. Owners of financial claims can sell them in the secondary market before maturity date.
D. A financial claim has one issuer but possibly successive owners through the secondary market.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

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24. An organised security exchange:

A. is a primary market.
B. relies on dealers for trading.
C. has no central location.
*D. is accessible by authorised traders only.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

25. Which of the following statements is NOT correct?

A. Money markets are operated by dealers.
B. Money market securities have short-term maturities.
C. Money market transactions are seldom below $1 million.
*D. Money markets securities are issued to finance long-term projects.

Feedback: Money markets are markets for managing liquidity. Governments and companies borrow short term to finance current operations, not long term investments, or lent to avoid holding idle cash in the short term. Money markets tend to be wholesale (i.e. large denominations) OTC markets made by dealers.
LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

26. Which of the following financial claims does NOT belong to the money market?

A. Bank bill.
B. Treasury note.
*C. Corporate bond.
D. Commercial paper.

Feedback: Money markets refer to the markets for financial claims with an original maturity less than one year. Bonds are usually issued with an original maturity of 5 to 30 years and therefore do not belong to the money market.
LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

27. Which of the following is NOT a characteristic of money market instruments?

A. Low default risk.
B. High marketability.
*C. Small denomination.
D. Short term to maturity.

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28. The financial market where new securities are sold for the first time is:

A. an indirect market.
B. a secondary market.
*C. a primary market.
D. none of the above.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

29. Secondary financial markets are similar to:

A. new-car markets.
*B. used-car markets.
C. direct auction markets.
D. all of the above.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

30. The ease with which a security can be sold and converted into cash is referred to as:

A. book value.
*B. marketability.
C. convertibility.
D. none of the above.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

31. Highly liquid financial instruments with a maturities of 90 days would be traded in:

A. the bond market.
B. the share market.
*C. the money market.
D. all of the above.

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32. Which market would a company participate in if it needs to adjust its liquidity position?

*A. The money market.
B. The bond market.
C. The share market.
D. All of the above.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

33. If a company needs to finance a new corporate headquarters building, then it would most likely seek the funds in the:

A. money market.
*B. capital market.
C. futures market.
D. foreign exchange market.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

34. The most common reason that corporate companies use the futures and options markets is to:

A. take risk.
*B. hedge risk.
C. make deposits.
D. none of the above.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

35. Which of the following is not a way in which secondary markets support primary markets?

A. Facilitating risk management.
*B. Underwriting new issues of securities.
C. Providing liquidity for holders of issued securities.
D. Providing a price-discovery mechanism for primary markets when new issues are contemplated.

Feedback: Secondary markets do not underwrite new issues of securities (underwriters do that).
LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

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36. Private placements are:

A. issues of securities to the public.
B. issues of securities directly onto the ASX.
C. issues of securities made only by the government.
*D. issues of securities made by negotiation directly with purchasers.

LO 2.2: Describe the primary, secondary and money markets, and explain why these markets are so important to businesses.

37. Which of the following is NOT a comparative advantage of financial intermediaries over surplus spending units in providing funds to deficit spending units?

A. Economies of scale.
B. Lower transactions costs.
C. Better management of credit risk.
*D. Higher searching costs for credit information.

Feedback: Financial intermediaries transform claims: the claims that link them to SSUs are different to the claims that link them to DSUs. Thanks to that differentiation financial intermediaries can reach a better outcome than what SSUs could do directly. Financial intermediaries are able to generate a profit out of this transformation because: (a) of economies of scale of production, (b) they reduce search costs for both DSUs and SSUs, and (c) they are able to obtain sensitive information, which allows them to manage credit risk better.
LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

38. Denomination transformation refers to the ability of financial institutions to:

A. spread risk.
B. raise short-term funds to lend for longer periods.
*C. raise many small amounts to lend larger amounts.
D. raise funds in one currency to lend in another currency.

Feedback: The denomination is the amount of money lent associated to a given financial claim. Surplus spending units usually can provide only small amounts of funds while deficit spending units have often very large needs. Financial intermediaries can reconcile these opposite preferences. The other answers are related to other services provided by financial institutions. Raising short-term funds to lend for longer periods is called maturity transformation. Raising funds in one currency to lend funds in another currency is currency transformation. Spreading risks refers to risk diversification.
LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

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39. Most financial intermediaries issue _____financial claims and purchase _____financial claims.

A. direct; direct.
*B. indirect; direct.
C. direct; indirect.
D. indirect; indirect.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

40. Credit risk diversification of a loan portfolio occurs when:

A. loans from similar borrowers are combined in a portfolio.
B. loans with similar payment patterns are combined in a single portfolio.
*C. adding loans to the portfolio decreases the variability of the loan portfolio.
D. adding loans to the portfolio increases the variability of the loan portfolio.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

41. Which of the following is NOT a comparative advantage of financial intermediaries over surplus spending funds in providing funds to deficit spending units?

*A. Ability to increase credit risk.
B. Ability to reduce transaction costs.
C. Ability to achieve economies of scale.
D. Ability to find confidential information.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

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42. Which of the following financial institutions accepts deposits as liabilities?

*A. Credit unions.
B. Managed funds.
C. Finance companies.
D. Superannuation funds.

Feedback: Credit unions and building societies are not commercial banks but accept deposits in their liabilities, like commercial banks. Finance companies do not take deposits and resort to the issue of short term debt to finance their loans. Superannuation funds collect funds through the contributions of employees and employers while managed funds raise funds through the issue of shares.
LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

43. Superannuation funds tend to invest in:

A. government securities exclusively.
*B. predominantly long-term securities.
C. money market securities exclusively.
D. predominantly lower-yielding securities.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

44. Which of the following activities is NOT performed by money-market corporations?

A. Underwriting securities.
*B. Offering insurance services.
C. Marketing new issues of securities.
D. Advising on mergers and acquisitions.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

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45. Which of the following statements is NOT correct? Australian commercial banks:

A. are highly regulated.
B. take deposits and make loans.
C. have various sources of funds.
*D. have fewer assets than superannuation funds.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

46. _____ risk is the risk that a company will not generate sufficient cash inflows to meet required cash outflows.

*A. liquidity.
B. credit.
C. operational.
D. political.

Feedback: Credit risk is the risk that the borrower does not repay the principal or the interests. Operational risk refers to any dys-functioning in the organisation of the company. Political risk occurs when government changes regulation/policies or changes the terms of a financial contract by which it borrowed funds.
LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

47. The risk that a borrower may not repay the principal or the interest is called:

*A. credit risk.
B. political risk.
C. liquidity risk.
D. operational risk.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

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48. _____ risk is the risk that a government decides to change the terms of a financial contract by which it borrowed funds.

A. credit.
*B. political.
C. liquidity.
D. operational.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

49. The process of converting financial securities with one set of characteristics into securities with another set of characteristics is called:

A. financial disintermediation.
*B. financial intermediation.
C. financial bundling.
D. none of the above.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

50. A _____ to a business is like a credit card to an individual.

A. a bond.
B. a term loan.
*C. line of credit.
D. none of the above.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

51. A superannuation fund would not include _____ as a major proportion of their investment portfolio.

*A. commercial papers.
B. long-term corporate bonds.
C. shares.
D. none of the above.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

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52. If a small business opts not to borrow from a commercial bank, then what is probably its next best alternative?

*A. A finance company.
B. An investment fund.
C. An insurance company.
D. A superannuation fund.

LO 2.3: Explain how financial institutions serve consumers and small businesses that are unable to participate in the direct financial markets, and describe how companies use the financial system.

53. Which international institution sets capital adequacy guidelines for banks that have been adopted by Australian regulatory authorities?

A. The World Bank.
B. The International Monetary Fund (IMF).
*C. The Bank for International Settlements (BIS).
D. The United Nations Organisation for Economic Cooperation and Development (OECD).

Feedback: The BIS sets capital adequacy guidelines for banks that are adopted by many countries, including Australia.
LO 2.4: Discuss the internationalisation of financial markets and the role played by the BIS in ensuring the global financial markets remain stable.

54. Which of the following is an important international financial market for Australian firms?

A. The eurocurrency market.
B. The short-term US market.
C. The long-term Eurobond market.
*D. All of the above.

LO 2.4: Discuss the internationalisation of financial markets and the role played by the BIS in ensuring the global financial markets remain stable.

55. Which of the following conduct daily transactions between the Australian domestic markets and the international markets?

A. Large financial institutions.
B. Institutional investors.
C. Business firms.
*D. All of the above.

LO 2.4: Discuss the internationalisation of financial markets and the role played by the BIS in ensuring the global financial markets remain stable.

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56. Which international institution aims to reduce poverty and improve living conditions and quality of life in the Asia-Pacific region?

A. The World Bank.
*B. The Asian Development Bank (ADB).
C. The International Monetary Fund (IMF).
D. The Bank for International Settlements (BIS).

LO 2.4: Discuss the internationalisation of financial markets and the role played by the BIS in ensuring the global financial markets remain stable.

57. Which international institution facilitates the expansion and balanced growth of international trade?

A. The World Bank.
B. The Asian Development Bank (ADB).
*C. The International Monetary Fund (IMF).
D. The Bank for International Settlements (BIS).

LO 2.4: Discuss the internationalisation of financial markets and the role played by the BIS in ensuring the global financial markets remain stable.

58. In an efficient capital market:

A. prices of securities adjust as new information becomes available to the market.
B. security prices fully reflect the knowledge and expectations of all investors at a particular point in time.
C. investors and financial managers have no reason to believe the securities are not priced at or near their true value.
*D. All of the above are true.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

59. Which one of the following statements is **NOT** true?

A. Operational efficiency focuses on bringing buyers and sellers together at the lowest possible cost.
*B. If market prices reflect all relevant information about securities at a particular point in time, the market is operationally efficient.
C. The overall efficiency of a capital market depends on its operational efficiency and its informational efficiency.
D. All of the above are true.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

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60. With strong-form market efficiency:

*A. it would not be possible to earn abnormally high returns by trading on private information.
B. investors who have access to inside or private information will be able to earn abnormal returns.
C. the price of a security in the market reflects all public information only.
D. None of the above.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

61. With semi-strong form market efficiency:

*A. the price of a security in the market reflects all public information only.
B. it would be possible to earn abnormally high returns by trading on public information.
C. investors who have access to inside or private information will be unable to earn abnormal returns.
D. None of the above.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

62. Which one of the following statements is **NOT** true?

*A. Strong-form market efficiency implies that investors who have access to private information will be able to earn abnormal returns.
B. Semi-strong form market efficiency implies that investors who have access to private information will be able to earn abnormal returns.
C. Weak-form market efficiency implies that investors who have access private information will be able to earn abnormal returns.
D. None of the above.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

63. What does operational efficiency refer to?

A. Prices that quickly reflect important information.
B. Sufficient securities to efficiently allocate risk.
*C. Low transaction costs.
D. Both B and C are correct.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

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64. If markets were strong form efficient, which of the following situations would yield abnormal returns?

A. Obtaining insider information.
B. Analysing a company's earnings report.
C. Identifying a pattern in a company's stock price.
*D. None of the above would yield abnormal returns.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

65. Which of the following are forms of market efficiency?

A. Weak form.
B. Strong form.
C. Semi-strong form.
*D. All of the above.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

66. If markets were semi-strong form efficient, which of the following situations would yield abnormal returns?

*A. Obtaining insider information.
B. Analysing a company's earnings report.
C. Identifying a pattern in a company's stock price.
D. None of the above would yield abnormal returns.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

67. How are abnormal returns defined?

A. Positive return.
B. Returns in excess of the risk-free rate.
C. Returns in excess of the market return.
*D. Returns in excess of the risk-adjusted expected return.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

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68. If markets were weak form efficient, which of the following situations would NOT yield abnormal returns?

A. Obtaining insider information.
B. Analysing a company's earnings report.
*C. Identifying a pattern in a company's stock price.
D. None of the above would yield abnormal returns.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

69. If a senior manager can consistently earn excess profits by trading her company's stock, which form of efficiency is contradicted?

A. Weak form.
B. Semi-strong form.
*C. Strong form.
D. No form of efficiency is contradicted.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

70. If an investor consistently makes excess profits by following the advice provided on the Financial Guru public website, which form of efficiency is contradicted?

A. Strong form.
*B. Semi-strong form.
C. Weak form.
D. No form of efficiency is contradicted.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

71. A stock's price rises 8 percent two days before the announcement of a large long-term project takes place. Which form of efficiency is contradicted?

*A. Strong form.
B. Weak form.
C. Semi-strong form.
D. No form of efficiency is contradicted.

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72. The announcement of the sudden accidental death of the CEO and principal scientist of a public company is associated with a 10% decrease in the company's share price. Which form of market efficiency is contradicted?

A. Weak form.
B. Semi-strong form.
C. Strong form.
*D. No form of efficiency is contradicted.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

73. Technical analysis, which is defined as the analysis of historical trends of prices, is an important field in finance. Which form of efficiency is this field based on?

A. Strong form inefficiency.
*B. Weak form inefficiency.
C. Semi-strong form inefficiency.
D. It has nothing to do with efficiency.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

74. You purchased shares of a company in the automotive industry a year ago. Over the course of the past year, the economy began to slow down and the company faced declining sales. As a result, the stock price declined over your holding period. Which of the following is true?

A. This is a violation of weak form market efficiency.
B. This is a violation of strong form market efficiency.
*C. This is not a violation of the efficient market hypothesis.
D. This is a violation of semi-strong form market efficiency.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

75. If security markets are efficient, then:

*A. the net present value of all securities should be zero.
B. the net present value of all securities should be negative.
C. the net present value of all securities should be positive.
D. there are no implications on the net present value of securities.

LO 2.5: Explain what an efficient capital market is and why market efficiency is important to financial managers.

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