

Name \_\_\_\_\_

ID \_\_\_\_\_

Section Number \_\_\_\_\_

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

- 1) U.S. government bonds have no default risk because 1) \_\_\_\_\_  
A) the federal government can increase taxes to pay its obligations.  
B) they can be exchanged for silver at any time.  
C) they are backed by the full faith and credit of the federal government.  
D) they are backed with gold reserves.
- 2) The spread between interest rates on low quality corporate bonds and U.S. government bonds 2) \_\_\_\_\_  
A) did not change during the Great Depression.  
B) narrowed significantly during the Great Depression.  
C) widened significantly during the Great Depression.  
D) narrowed moderately during the Great Depression.
- 3) Suppose you are holding a 5 percent coupon bond maturing in one year with a yield to maturity of 15 percent. If the interest rate on one-year bonds rises from 15 percent to 20 percent over the course of the year, what is the yearly return on the bond you are holding? 3) \_\_\_\_\_  
A) 5 percent                      B) 10 percent                      C) 15 percent                      D) 20 percent
- 4) A monetary expansion \_\_\_\_\_ stock prices due to a decrease in the \_\_\_\_\_ and an increase in the \_\_\_\_\_, everything else held constant. 4) \_\_\_\_\_  
A) reduces; current dividend; expected rate of return  
B) increases; required rate of return; dividend growth rate  
C) reduces; future sales price; expected rate of return  
D) increases; required rate of return; future sales price
- 5) The expectations theory and the segmented markets theory do not explain the facts very well, but they provide the groundwork for the most widely accepted theory of the term structure of interest rates, 5) \_\_\_\_\_  
A) the Keynesian theory.                      B) liquidity premium theory.  
C) the asset market approach.                      D) separable markets theory.
- 6) When the yield curve is flat or downward-sloping, it suggest that the economy is more likely to enter 6) \_\_\_\_\_  
A) a recession.                      B) an expansion.  
C) a period of increasing output.                      D) a boom time.
- 7) A situation in which the quantity of bonds supplied exceeds the quantity of bonds demanded is called a condition of excess supply; because people want to sell \_\_\_\_\_ bonds than others want to buy, the price of bonds will \_\_\_\_\_. 7) \_\_\_\_\_  
A) more; rise                      B) more; fall                      C) fewer; rise                      D) fewer; fall
- 8) Everything else held constant, if income tax rates were lowered, then 8) \_\_\_\_\_  
A) the price of Treasury bonds would fall.  
B) the interest rate on Treasury bonds would rise.  
C) the interest rate on municipal bonds would fall.  
D) the interest rate on municipal bonds would rise.

- 9) Increased uncertainty resulting from the subprime crisis \_\_\_\_\_ the required return on investment in equity. 9) \_\_\_\_\_  
 A) had no impact on B) raised  
 C) decreased D) lowered
- 10) As their relative riskiness \_\_\_\_\_, the expected return on corporate bonds \_\_\_\_\_ relative to the expected return on default-free bonds, everything else held constant. 10) \_\_\_\_\_  
 A) decreases; decreases B) increases; increases  
 C) decreases; does not change D) increases; decreases
- 11) During a recession, the supply of bonds \_\_\_\_\_ and the supply curve shifts to the \_\_\_\_\_, everything else held constant. 11) \_\_\_\_\_  
 A) increases; left B) decreases; right C) increases; right D) decreases; left
- 12) If the expected path of 1-year interest rates over the next five years is 2 percent, 4 percent, 1 percent, 4 percent, and 3 percent, the expectations theory predicts that the bond with the lowest interest rate today is the one with a maturity of 12) \_\_\_\_\_  
 A) one year. B) two years. C) three years. D) four years.
- 13) Higher government deficits \_\_\_\_\_ the supply of bonds and shift the supply curve to the \_\_\_\_\_, everything else held constant. 13) \_\_\_\_\_  
 A) decrease; right B) increase; left C) increase; right D) decrease; left
- 14) If the amount payable in two years is \$2420 for a simple loan at 10 percent interest, the loan amount is 14) \_\_\_\_\_  
 A) \$1000. B) \$1210. C) \$2000. D) \$2200.
- 15) In asset markets, an asset's price is 15) \_\_\_\_\_  
 A) set equal to the highest price a seller will accept.  
 B) set equal to the lowest price a seller is willing to accept.  
 C) set equal to the highest price a buyer is willing to pay.  
 D) set by the buyer willing to pay the highest price.
- 16) Recently the Federal Reserve announced that they would keep short-term interest rates low until late 2014. According to the Expectations Theory of interest rates, which of the following could we expect to happen? 16) \_\_\_\_\_  
 A) a rising 3-year interest rate B) a flatter yield curve  
 C) a steeper yield curve D) a parallel shift in the yield curve
- 17) If market participants notice that a variable behaves differently now than in the past, then, according to rational expectations theory, we can expect market participants to 17) \_\_\_\_\_  
 A) give up trying to forecast this variable.  
 B) begin to make systematic mistakes.  
 C) no longer pay close attention to movements in this variable.  
 D) change the way they form expectations about future values of the variable.

- 18) The major criticism of the view that expectations are formed adaptively is that 18) \_\_\_\_\_  
 A) it is easier to model adaptive expectations than it is to model rational expectations.  
 B) adaptive expectations models have no predictive power.  
 C) people are irrational and therefore never learn from past mistakes.  
 D) this view ignores that people use more information than just past data to form their expectations.
- 19) Sara decides to lend Tom \$5,000 for 3 years at 2% interest rate with all interest and principal due 19) \_\_\_\_\_  
 at the end of the 3 years. What is the total amount Tom must pay Sara 3 years into the future?  
 A) 5222.02                      B) 5278.43                      C) 5306.04                      D) 5999.99
- 20) If 1-year interest rates for the next three years are expected to be 4, 2, and 3 percent, and the 20) \_\_\_\_\_  
 3-year term premium is 1 percent, than the 3-year bond rate will be  
 A) 1 percent.                      B) 2 percent.                      C) 3 percent.                      D) 4 percent.
- 21) In the one-period valuation model, the value of a share of stock today depends upon 21) \_\_\_\_\_  
 A) only the present value of the future dividends.  
 B) the present value of both dividends and the expected sales price.  
 C) the future value of dividends and the actual sales price.  
 D) the actual value of the dividends and expected sales price received in one year.
- 22) Sara decides to loan Tom \$750 at an 8% interest rate for 3 years. She wants Tom to pay her back 22) \_\_\_\_\_  
 in 3 equal annual payments. What will be Tom's annual payments?  
 A) \$291.02                      B) \$210.22                      C) \$245.25                      D) \$201.56
- 23) If investors expect interest rates to fall significantly in the future, the yield curve will be inverted. 23) \_\_\_\_\_  
 This means that the yield curve has a \_\_\_\_\_ slope.  
 A) steep upward                      B) slight upward                      C) downward                      D) flat
- 24) Everything else held constant, when the inflation rate is expected to rise, interest rates will 24) \_\_\_\_\_  
 \_\_\_\_\_; this result has been termed the \_\_\_\_\_.  
 A) rise; Keynes effect                      B) fall; Keynes effect  
 C) fall; Fisher effect                      D) rise; Fisher effect
- 25) If a \$5,000 coupon bond has a coupon rate of 13 percent, then the coupon payment every year is 25) \_\_\_\_\_  
 A) \$13.                      B) \$130.                      C) \$650.                      D) \$1,300.
- 26) Which of the following \$5,000 face-value securities has the highest to maturity? 26) \_\_\_\_\_  
 A) A 10 percent coupon bond selling for \$5,000  
 B) A 6 percent coupon bond selling for \$5,500  
 C) A 6 percent coupon bond selling for \$5,000  
 D) A 12 percent coupon bond selling for \$4,500
- 27) Rational expectations forecast errors will on average be \_\_\_\_\_ and therefore \_\_\_\_\_ be 27) \_\_\_\_\_  
 predicted ahead of time.  
 A) zero; cannot                      B) negative; can                      C) positive; can                      D) positive; cannot

- 28) If Greece defaults on their sovereign debt sometime in the near future, we should expect the interest rate on Irish government bonds to \_\_\_\_\_, and the interest rate on U.S. government bonds to \_\_\_\_\_.  
 A) rise, fall                      B) fall, fall                      C) rise, rise                      D) fall, rise                      28) \_\_\_\_\_
- 29) The yield to maturity for a discount bond is \_\_\_\_\_ related to the current bond price.  
 A) not                      B) directly                      C) negatively                      D) positively                      29) \_\_\_\_\_
- 30) During business cycle expansions when income and wealth are rising, the demand for bonds \_\_\_\_\_ and the demand curve shifts to the \_\_\_\_\_, everything else held constant.  
 A) falls; right                      B) rises; left                      C) rises; right                      D) falls; left                      30) \_\_\_\_\_
- 31) What is the return on a 5 percent coupon bond that initially sells for \$1,000 and sells for \$1,200 next year?  
 A) 10 percent                      B) 5 percent                      C) 25 percent                      D) -5 percent                      31) \_\_\_\_\_
- 32) Municipal bonds have default risk, yet their interest rates are lower than the rates on default-free Treasury bonds. This suggests that  
 A) Treasury bonds are not default-free.  
 B) the benefit from the tax-exempt status of municipal bonds is less than their default risk.  
 C) the benefit from the tax-exempt status of municipal bonds equals their default risk.  
 D) the benefit from the tax-exempt status of municipal bonds exceeds their default risk.                      32) \_\_\_\_\_
- 33) Tom would like to borrow \$450 from Sara today. In return, Tom has agreed to pay Sara \$76.5 forever, but will never pay back the \$450. (Assume they both live forever). What is Sara's yield to maturity?  
 A) 14%                      B) 12%                      C) 17%                      D) 20%                      33) \_\_\_\_\_
- 34) Corporate bonds are not as liquid as government bonds because  
 A) the corporate bond rating must be calculated each time they are traded.  
 B) corporate bonds cannot be resold.  
 C) fewer corporate bonds for any one corporation are traded, making them more costly to sell.  
 D) corporate bonds are not callable.                      34) \_\_\_\_\_
- 35) In September 2011, the Federal Reserve announced they would undertake "operation twist" whereby they would buy long-term bonds and sell short-term bonds. According to the Bond Market model, we should expect  
 A) a steepening yield curve  
 B) rising short-term and falling long-term interest rates.  
 C) falling short-term and rising long-term interest rates  
 D) an upward shift of the yield curve.                      35) \_\_\_\_\_
- 36) A consol paying \$20 annually when the interest rate is 5 percent has a price of  
 A) \$100.                      B) \$200.                      C) \$400.                      D) \$800.                      36) \_\_\_\_\_
- 37) The value of any investment is found by computing the  
 A) present value of all future liabilities.                      B) future value of all future expenses.  
 C) present value of all future sales.                      D) present value of all future cash flows.                      37) \_\_\_\_\_





- 1) A
- 2) C
- 3) C
- 4) B
- 5) B
- 6) A
- 7) B
- 8) D
- 9) B
- 10) D
- 11) D
- 12) A
- 13) C
- 14) C
- 15) D
- 16) B
- 17) D
- 18) D
- 19) C
- 20) D
- 21) B
- 22) A
- 23) C
- 24) D
- 25) C
- 26) D
- 27) A
- 28) A
- 29) C
- 30) C
- 31) C
- 32) D
- 33) C
- 34) C
- 35) B
- 36) C
- 37) D
- 38) A
- 39) D
- 40) B
- 41) B
- 42) D
- 43) B
- 44) B
- 45) C
- 46) B
- 47) D
- 48) B
- 49) B
- 50) D

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Exam 1

V-1



Name \_\_\_\_\_

ID \_\_\_\_\_

Section Number \_\_\_\_\_

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

- 1) Corporate bonds are not as liquid as government bonds because 1) \_\_\_\_\_  
A) fewer corporate bonds for any one corporation are traded, making them more costly to sell.  
B) corporate bonds are not callable.  
C) corporate bonds cannot be resold.  
D) the corporate bond rating must be calculated each time they are traded.
- 2) If market participants notice that a variable behaves differently now than in the past, then, 2) \_\_\_\_\_  
according to rational expectations theory, we can expect market participants to  
A) give up trying to forecast this variable.  
B) change the way they form expectations about future values of the variable.  
C) no longer pay close attention to movements in this variable.  
D) begin to make systematic mistakes.
- 3) According to the segmented markets theory of the term structure 3) \_\_\_\_\_  
A) buyers require an additional incentive to hold long-term bonds.  
B) buyers of bonds do not prefer bonds of one maturity over another.  
C) the interest rate on long-term bonds will equal an average of short-term interest rates that  
people expect to occur over the life of the long-term bonds.  
D) interest rates on bonds of different maturities do not move together over time.
- 4) If investors expect interest rates to fall significantly in the future, the yield curve will be inverted. 4) \_\_\_\_\_  
This means that the yield curve has a \_\_\_\_\_ slope.  
A) downward                      B) flat                      C) slight upward                      D) steep upward
- 5) A monetary expansion \_\_\_\_\_ stock prices due to a decrease in the \_\_\_\_\_ and an increase in 5) \_\_\_\_\_  
the \_\_\_\_\_, everything else held constant.  
A) increases; required rate of return; dividend growth rate  
B) reduces; current dividend; expected rate of return  
C) increases; required rate of return; future sales price  
D) reduces; future sales price; expected rate of return
- 6) Which of the following is not a factor pushing down the 10-year interest rate in 2011? 6) \_\_\_\_\_  
A) A slowing economy                      B) A \$1.3 trillion federal deficit  
C) Euro-Zone debt crisis                      D) QE-2
- 7) The sum of the current yield and the rate of capital gain is called the 7) \_\_\_\_\_  
A) par value.                      B) discount yield.                      C) rate of return.                      D) perpetuity yield.
- 8) The risk premium on corporate bonds reflects the fact that corporate bonds have a higher default 8) \_\_\_\_\_  
risk and are \_\_\_\_\_ U.S. Treasury bonds.  
A) less speculative than                      B) tax-exempt unlike  
C) lower-yielding than                      D) less liquid than

- 9) The major criticism of the view that expectations are formed adaptively is that \_\_\_\_\_  
 A) it is easier to model adaptive expectations than it is to model rational expectations.  
 B) adaptive expectations models have no predictive power.  
 C) this view ignores that people use more information than just past data to form their expectations.  
 D) people are irrational and therefore never learn from past mistakes.
- 10) If the expected path of 1-year interest rates over the next five years is 2 percent, 4 percent, 1 percent, 4 percent, and 3 percent, the expectations theory predicts that the bond with the lowest interest rate today is the one with a maturity of \_\_\_\_\_  
 A) one year.                      B) two years.                      C) three years.                      D) four years.
- 11) In the bond market, the market equilibrium shows the market-clearing \_\_\_\_\_ and market-clearing \_\_\_\_\_  
 A) price; interest rate                      B) interest rate; deposit  
 C) price; deposit                      D) interest rate; premium
- 12) During a recession, the supply of bonds \_\_\_\_\_ and the supply curve shifts to the \_\_\_\_\_, everything else held constant.                      12) \_\_\_\_\_  
 A) increases; left                      B) decreases; right                      C) decreases; left                      D) increases; right
- 13) Suppose you are holding a 5 percent coupon bond maturing in one year with a yield to maturity of 15 percent. If the interest rate on one-year bonds rises from 15 percent to 20 percent over the course of the year, what is the yearly return on the bond you are holding?                      13) \_\_\_\_\_  
 A) 5 percent                      B) 10 percent                      C) 15 percent                      D) 20 percent
- 14) Everything else held constant, when bonds become less widely traded, and as a consequence the market becomes less liquid, the demand curve for bonds shifts to the \_\_\_\_\_ and the interest rate \_\_\_\_\_.                      14) \_\_\_\_\_  
 A) left; falls                      B) right; rises                      C) left; rises                      D) right; falls
- 15) Everything else held constant, if income tax rates were lowered, then \_\_\_\_\_                      15) \_\_\_\_\_  
 A) the price of Treasury bonds would fall.  
 B) the interest rate on municipal bonds would fall.  
 C) the interest rate on Treasury bonds would rise.  
 D) the interest rate on municipal bonds would rise.
- 16) The yield to maturity for a discount bond is \_\_\_\_\_ related to the current bond price.                      16) \_\_\_\_\_  
 A) negatively                      B) not                      C) positively                      D) directly
- 17) Rational expectations forecast errors will on average be \_\_\_\_\_ and therefore \_\_\_\_\_ be predicted ahead of time.                      17) \_\_\_\_\_  
 A) positive; cannot                      B) positive; can                      C) zero; cannot                      D) negative; can
- 18) In the one-period valuation model, the value of a share of stock today depends upon \_\_\_\_\_                      18) \_\_\_\_\_  
 A) the present value of both dividends and the expected sales price.  
 B) the actual value of the dividends and expected sales price received in one year.  
 C) the future value of dividends and the actual sales price.  
 D) only the present value of the future dividends.





- 39) What is the return on a 5 percent coupon bond that initially sells for \$1,000 and sells for \$1,200 next year? 39) \_\_\_\_\_  
 A) 5 percent                      B) 25 percent                      C) 10 percent                      D) -5 percent
- 40) As their relative riskiness \_\_\_\_\_, the expected return on corporate bonds \_\_\_\_\_ relative to the expected return on default-free bonds, everything else held constant. 40) \_\_\_\_\_  
 A) decreases; decreases                      B) increases; decreases  
 C) decreases; does not change                      D) increases; increases
- 41) In September 2011, the Federal Reserve announced they would undertake "operation twist" whereby they would buy long-term bonds and sell short-term bonds. According to the Bond Market model, we should expect 41) \_\_\_\_\_  
 A) falling short-term and rising long-term interest rates  
 B) rising short-term and falling long-term interest rates.  
 C) an upward shift of the yield curve.  
 D) a steepening yield curve
- 42) When the interest rate on a bond is \_\_\_\_\_ the equilibrium interest rate, in the bond market there is excess \_\_\_\_\_ and the interest rate will \_\_\_\_\_. 42) \_\_\_\_\_  
 A) below; supply; fall                      B) above; demand; rise  
 C) above; supply; rise                      D) above; demand; fall
- 43) If a security pays \$110 next year and \$121 the year after that, what is its yield to maturity if it sells for \$200? 43) \_\_\_\_\_  
 A) 9 percent                      B) 10 percent                      C) 11 percent                      D) 12 percent
- 44) The value of any investment is found by computing the 44) \_\_\_\_\_  
 A) present value of all future sales.                      B) present value of all future cash flows.  
 C) present value of all future liabilities.                      D) future value of all future expenses.
- 45) Municipal bonds have default risk, yet their interest rates are lower than the rates on default-free Treasury bonds. This suggests that 45) \_\_\_\_\_  
 A) the benefit from the tax-exempt status of municipal bonds equals their default risk.  
 B) the benefit from the tax-exempt status of municipal bonds exceeds their default risk.  
 C) Treasury bonds are not default-free.  
 D) the benefit from the tax-exempt status of municipal bonds is less than their default risk.
- 46) Higher government deficits \_\_\_\_\_ the supply of bonds and shift the supply curve to the \_\_\_\_\_, everything else held constant. 46) \_\_\_\_\_  
 A) decrease; right                      B) increase; right                      C) increase; left                      D) decrease; left
- 47) Sara decides to lend Tom \$5,000 for 3 years at 2% interest rate with all interest and principal due at the end of the 3 years. What is the total amount Tom must pay Sara 3 years into the future? 47) \_\_\_\_\_  
 A) 5222.02                      B) 5999.99                      C) 5278.43                      D) 5306.04
- 48) Assume Tom would like to borrow money from Sara for 3 years but can only afford \$100 annual loan payments. If Sara agrees to lend money to Tom at an interest rate of 8%, how much money can Tom afford to borrow today? 48) \_\_\_\_\_  
 A) 301.60                      B) 295.18                      C) 273.61                      D) 257.70

- 49) Assume today's one-year interest rate is 0.10%, the three-year interest rate is 0.50%, and the three-year liquidity premium is 0.10%. According to the Liquidity Premium Theory, which of the following is a possible combination of future one-year interest rates? 49) \_\_\_\_\_
- A) 0.50%,0.60%      B) 0.10%, 0.10%      C) 0.60%, 0.60%      D) 0.20%, 0.30%
- 50) During business cycle expansions when income and wealth are rising, the demand for bonds \_\_\_\_\_ and the demand curve shifts to the \_\_\_\_\_, everything else held constant. 50) \_\_\_\_\_
- A) rises; left      B) falls; right      C) falls; left      D) rises; right

- 1) A
- 2) B
- 3) D
- 4) A
- 5) A
- 6) B
- 7) C
- 8) D
- 9) C
- 10) A
- 11) A
- 12) C
- 13) C
- 14) C
- 15) D
- 16) A
- 17) C
- 18) A
- 19) D
- 20) C
- 21) C
- 22) C
- 23) B
- 24) D
- 25) D
- 26) D
- 27) A
- 28) D
- 29) A
- 30) C
- 31) D
- 32) C
- 33) B
- 34) C
- 35) C
- 36) D
- 37) A
- 38) C
- 39) B
- 40) B
- 41) B
- 42) D
- 43) B
- 44) B
- 45) B
- 46) B
- 47) D
- 48) D
- 49) A
- 50) D

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Exam 1

V-2



Name \_\_\_\_\_

ID \_\_\_\_\_

Section Number \_\_\_\_\_

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

- 1) When the interest rate on a bond is \_\_\_\_\_ the equilibrium interest rate, in the bond market there is excess \_\_\_\_\_ and the interest rate will \_\_\_\_\_. 1) \_\_\_\_\_  
 A) above; demand; fall B) below; supply; fall  
 C) above; demand; rise D) above; supply; rise
- 2) The major criticism of the view that expectations are formed adaptively is that 2) \_\_\_\_\_  
 A) adaptive expectations models have no predictive power.  
 B) it is easier to model adaptive expectations than it is to model rational expectations.  
 C) this view ignores that people use more information than just past data to form their expectations.  
 D) people are irrational and therefore never learn from past mistakes.
- 3) The value of any investment is found by computing the 3) \_\_\_\_\_  
 A) present value of all future liabilities. B) future value of all future expenses.  
 C) present value of all future cash flows. D) present value of all future sales.
- 4) If a security pays \$55 in one year and \$133 in three years, its present value is \$150 if the interest rate is 4) \_\_\_\_\_  
 A) 5 percent. B) 10 percent. C) 12.5 percent. D) 15 percent.
- 5) If 1-year interest rates for the next three years are expected to be 4, 2, and 3 percent, and the 3-year term premium is 1 percent, then the 3-year bond rate will be 5) \_\_\_\_\_  
 A) 1 percent. B) 2 percent. C) 3 percent. D) 4 percent.
- 6) If investors expect interest rates to fall significantly in the future, the yield curve will be inverted. This means that the yield curve has a \_\_\_\_\_ slope. 6) \_\_\_\_\_  
 A) flat B) slight upward C) steep upward D) downward
- 7) Increased uncertainty resulting from the subprime crisis \_\_\_\_\_ the required return on investment in equity. 7) \_\_\_\_\_  
 A) lowered B) had no impact on  
 C) decreased D) raised
- 8) According to the segmented markets theory of the term structure 8) \_\_\_\_\_  
 A) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.  
 B) buyers require an additional incentive to hold long-term bonds.  
 C) buyers of bonds do not prefer bonds of one maturity over another.  
 D) interest rates on bonds of different maturities do not move together over time.

- 9) Recently the Federal Reserve announced that they would keep short-term interest rates low until late 2014. According to the Expectations Theory of interest rates, which of the following could we expect to happen? 9) \_\_\_\_\_
- A) a steeper yield curve  
B) a rising 3-year interest rate  
C) a parallel shift in the yield curve  
D) a flatter yield curve
- 10) Assume today's one-year interest rate is 0.10%, the three-year interest rate is 0.50%, and the three-year liquidity premium is 0.10%. According to the Liquidity Premium Theory, which of the following is a possible combination of future one-year interest rates? 10) \_\_\_\_\_
- A) 0.50%, 0.60%      B) 0.60%, 0.60%      C) 0.20%, 0.30%      D) 0.10%, 0.10%
- 11) In asset markets, an asset's price is 11) \_\_\_\_\_
- A) set equal to the lowest price a seller is willing to accept.  
B) set equal to the highest price a seller will accept.  
C) set equal to the highest price a buyer is willing to pay.  
D) set by the buyer willing to pay the highest price.
- 12) The risk premium on corporate bonds reflects the fact that corporate bonds have a higher default risk and are \_\_\_\_\_ U.S. Treasury bonds. 12) \_\_\_\_\_
- A) less speculative than      B) less liquid than  
C) lower-yielding than      D) tax-exempt unlike
- 13) Which of the following is not a factor pushing down the 10-year interest rate in 2011? 13) \_\_\_\_\_
- A) QE-2      B) A \$1.3 trillion federal deficit  
C) Euro-Zone debt crisis      D) A slowing economy
- 14) Suppose you are holding a 5 percent coupon bond maturing in one year with a yield to maturity of 15 percent. If the interest rate on one-year bonds rises from 15 percent to 20 percent over the course of the year, what is the yearly return on the bond you are holding? 14) \_\_\_\_\_
- A) 5 percent      B) 10 percent      C) 15 percent      D) 20 percent
- 15) In the bond market, the market equilibrium shows the market-clearing \_\_\_\_\_ and market-clearing \_\_\_\_\_. 15) \_\_\_\_\_
- A) interest rate; premium      B) price; interest rate  
C) price; deposit      D) interest rate; deposit
- 16) Sara decides to loan Tom \$750 at an 8% interest rate for 3 years. She wants Tom to pay her back in 3 equal annual payments. What will be Tom's annual payments? 16) \_\_\_\_\_
- A) \$291.02      B) \$210.22      C) \$245.25      D) \$201.56
- 17) A monetary expansion \_\_\_\_\_ stock prices due to a decrease in the \_\_\_\_\_ and an increase in the \_\_\_\_\_, everything else held constant. 17) \_\_\_\_\_
- A) increases; required rate of return; future sales price  
B) reduces; future sales price; expected rate of return  
C) increases; required rate of return; dividend growth rate  
D) reduces; current dividend; expected rate of return

- 18) Assume Tom would like to borrow money from Sara for 3 years but can only afford \$100 annual loan payments. If Sara agrees to lend money to Tom at an interest rate of 8%, how much money can Tom afford to borrow today? 18) \_\_\_\_\_  
 A) 257.70                      B) 273.61                      C) 301.60                      D) 295.18
- 19) Everything else held constant, when bonds become less widely traded, and as a consequence the market becomes less liquid, the demand curve for bonds shifts to the \_\_\_\_\_ and the interest rate \_\_\_\_\_. 19) \_\_\_\_\_  
 A) right; rises                      B) left; rises                      C) left; falls                      D) right; falls
- 20) If a \$5,000 coupon bond has a coupon rate of 13 percent, then the coupon payment every year is 20) \_\_\_\_\_  
 A) \$13.                      B) \$1,300.                      C) \$130.                      D) \$650.
- 21) During business cycle expansions when income and wealth are rising, the demand for bonds \_\_\_\_\_ and the demand curve shifts to the \_\_\_\_\_, everything else held constant. 21) \_\_\_\_\_  
 A) falls; right                      B) rises; right                      C) rises; left                      D) falls; left
- 22) Higher government deficits \_\_\_\_\_ the supply of bonds and shift the supply curve to the \_\_\_\_\_, everything else held constant. 22) \_\_\_\_\_  
 A) decrease; left                      B) increase; right                      C) decrease; right                      D) increase; left
- 23) Which of the following \$5,000 face-value securities has the highest to maturity? 23) \_\_\_\_\_  
 A) A 6 percent coupon bond selling for \$5,500  
 B) A 6 percent coupon bond selling for \$5,000  
 C) A 12 percent coupon bond selling for \$4,500  
 D) A 10 percent coupon bond selling for \$5,000
- 24) A situation in which the quantity of bonds supplied exceeds the quantity of bonds demanded is called a condition of excess supply; because people want to sell \_\_\_\_\_ bonds than others want to buy, the price of bonds will \_\_\_\_\_. 24) \_\_\_\_\_  
 A) fewer; rise                      B) more; rise                      C) more; fall                      D) fewer; fall
- 25) If during the past decade the average rate of monetary growth has been 5% and the average inflation rate has been 5%, everything else held constant, when the Federal Reserve announces that the new rate of monetary growth will be 10%, the adaptive expectation forecast of the inflation rate is 25) \_\_\_\_\_  
 A) between 5 and 10%.                      B) more than 10%.  
 C) 10%.                      D) 5%.
- 26) If the expected path of 1-year interest rates over the next five years is 2 percent, 4 percent, 1 percent, 4 percent, and 3 percent, the expectations theory predicts that the bond with the lowest interest rate today is the one with a maturity of 26) \_\_\_\_\_  
 A) one year.                      B) two years.                      C) three years.                      D) four years.
- 27) Everything else held constant, when the inflation rate is expected to rise, interest rates will \_\_\_\_\_; this result has been termed the \_\_\_\_\_. 27) \_\_\_\_\_  
 A) rise; Keynes effect                      B) fall; Fisher effect  
 C) rise; Fisher effect                      D) fall; Keynes effect
- 28) During a recession, the supply of bonds \_\_\_\_\_ and the supply curve shifts to the \_\_\_\_\_, everything else held constant. 28) \_\_\_\_\_  
 A) decreases; left                      B) increases; left                      C) decreases; right                      D) increases; right

- 29) If a security pays \$110 next year and \$121 the year after that, what is its yield to maturity if it sells for \$200? 29) \_\_\_\_\_  
 A) 9 percent                      B) 10 percent                      C) 11 percent                      D) 12 percent
- 30) Corporate bonds are not as liquid as government bonds because 30) \_\_\_\_\_  
 A) the corporate bond rating must be calculated each time they are traded.  
 B) corporate bonds cannot be resold.  
 C) corporate bonds are not callable.  
 D) fewer corporate bonds for any one corporation are traded, making them more costly to sell.
- 31) If Greece defaults on their sovereign debt sometime in the near future, we should expect the interest rate on Irish government bonds to \_\_\_\_\_, and the interest rate on U.S. government bonds to \_\_\_\_\_. 31) \_\_\_\_\_  
 A) fall, rise                      B) rise, fall                      C) fall, fall                      D) rise, rise
- 32) Assume UW Credit Union has a current capital-to-asset ratio of 9% and would like to maintain that ratio over the next year. Also assume the credit union's assets are expected to grow 10% over the next year. What is the credit union's required return on assets? 32) \_\_\_\_\_  
 A) 0.55%                      B) 0.90%                      C) 15.0%                      D) 22.2%
- 33) Everything else held constant, if income tax rates were lowered, then 33) \_\_\_\_\_  
 A) the price of Treasury bonds would fall.  
 B) the interest rate on Treasury bonds would rise.  
 C) the interest rate on municipal bonds would rise.  
 D) the interest rate on municipal bonds would fall.
- 34) A consol paying \$20 annually when the interest rate is 5 percent has a price of 34) \_\_\_\_\_  
 A) \$100.                      B) \$200.                      C) \$400.                      D) \$800.
- 35) In September 2011, the Federal Reserve announced they would undertake "operation twist" whereby they would buy long-term bonds and sell short-term bonds. According to the Bond Market model, we should expect 35) \_\_\_\_\_  
 A) an upward shift of the yield curve.  
 B) a steepening yield curve  
 C) falling short-term and rising long-term interest rates  
 D) rising short-term and falling long-term interest rates.
- 36) The expectations theory and the segmented markets theory do not explain the facts very well, but they provide the groundwork for the most widely accepted theory of the term structure of interest rates, 36) \_\_\_\_\_  
 A) separable markets theory.                      B) the asset market approach.  
 C) the Keynesian theory.                      D) liquidity premium theory.
- 37) The yield to maturity for a discount bond is \_\_\_\_\_ related to the current bond price. 37) \_\_\_\_\_  
 A) positively                      B) negatively                      C) directly                      D) not



- 48) U.S. government bonds have no default risk because 48) \_\_\_\_\_  
A) they can be exchanged for silver at any time.  
B) they are backed by the full faith and credit of the federal government.  
C) they are backed with gold reserves.  
D) the federal government can increase taxes to pay its obligations.
- 49) As their relative riskiness \_\_\_\_\_, the expected return on corporate bonds \_\_\_\_\_ relative to 49) \_\_\_\_\_  
the expected return on default-free bonds, everything else held constant.  
A) decreases; decreases B) decreases; does not change  
C) increases; increases D) increases; decreases
- 50) Tom would like to borrow \$450 from Sara today. In return, Tom has agreed to pay Sara \$76.5 50) \_\_\_\_\_  
forever, but will never pay back the \$450. (Assume they both live forever). What is Sara's  
yield to maturity?  
A) 12% B) 14% C) 20% D) 17%

- 1) A
- 2) C
- 3) C
- 4) B
- 5) D
- 6) D
- 7) D
- 8) D
- 9) D
- 10) A
- 11) D
- 12) B
- 13) B
- 14) C
- 15) B
- 16) A
- 17) C
- 18) A
- 19) B
- 20) D
- 21) B
- 22) B
- 23) C
- 24) C
- 25) D
- 26) A
- 27) C
- 28) A
- 29) B
- 30) D
- 31) B
- 32) B
- 33) C
- 34) C
- 35) D
- 36) D
- 37) B
- 38) A
- 39) C
- 40) A
- 41) B
- 42) D
- 43) D
- 44) C
- 45) C
- 46) A
- 47) D
- 48) D
- 49) D
- 50) D

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Exam 1  
V-3

