

## Chapter 11 Investing Basics and Evaluating Bonds

### True / False Questions

1. Investment goals are always oriented to the future.

True False

2. Short term goals should be completed in 30 days or less.

True False

3. Intermediate goals should be accomplished in two to five years.

True False

4. Long term goals should be completed in two to five years.

True False

5. It isn't important to know how much you owe in order to survive a financial crisis.

True False

6. To help survive a financial crisis, it is important to establish a larger than usual emergency fund.

True False

7. If you are unable to make your credit card payments, you should not contact your credit card company.

True False

8. To survive a financial crisis, one should track the value of his/her stock, mutual fund and retirement accounts.

True False

9. A bankruptcy can stay on your credit report for up to 12 years.

True False

10. For many people, the easiest way to begin an investment program is to participate in an employer-sponsored 401(k) or 403(b) retirement account.

True False

11. Investments that earn a lower rate of interest will have a higher total dollar return than those that earn a high rate of interest.

True False

12. An example of an investment with high risk is a government bond.

True False

13. The potential return of any investment should be directly related to the risk that the investor assumes.

True False

14. Investors choose safe investments because they know there is a moderate chance that these investments will become worthless.

True False

15. The prices of some investments may fluctuate because of periods of economic expansion followed by periods of recession.

True False

16. Patrick Guitman wants to protect himself against losses in his investments. To do this, he should evaluate the companies he wants to purchase and continue to evaluate his investments after his purchase.

True False

17. Diversifying your investments can reduce your inflation risk.

True False

18. Fluctuations in market prices of stocks or bonds directly relate to fundamental changes in the financial health of corporations.

True False

19. The price of oil stocks may change due to political unrest in the Middle East.

True False

20. To investors, liquidity means their investments will increase in value.

True False

21. To investors, liquidity is the ability to buy or sell an investment quickly without substantially affecting the investment's value.

True False

22. Since 1926, stocks have earned an average annual return of just over 10 percent.

True False

23. Asset allocation is the process of spreading your assets among several different types of investments to increase risk.

True False

24. The purpose of diversification is to spread your assets among several different types of investments to decrease risk.

True False

25. An unemployed, single parent who just received a \$300,000 divorce settlement would likely prefer income investments over growth investments.

True False

26. A 25-year old single investor with a secure, full-time job that pays \$60,000 would likely prefer income investments over growth investments.

True False

27. The potential return on any investment should be indirectly related to the risk the investor assumes.

True False

28. Government bonds have a higher potential investment return than stocks.

True False

29. As investors age, their investments typically become more aggressive.

True False

30. Younger investors tend to invest in more aggressive portfolios than older investors.

True False

31. Younger investors tend to invest in more aggressive portfolios because they are more concerned about safety than older investors.

True False

32. An easy way to determine what percentage of your assets should be invested in growth investments is to take your age and subtract it from 80.

True False

33. After you invest, it is important to let the investments manage themselves.

True False

34. At the most, you should only keep purchase records of the actual dollar cost of your investments.

True False

35. At the least, you should keep purchase records of the actual dollar cost of your investments including commissions or fees paid.

True False

36. Whether you are making your own decisions or have professional help, you must consider the tax consequences of selling your investments.

True False

37. A corporate bond is a written pledge of a government or municipality to repay a specified sum of money, along with interest.

True False

38. Municipal bonds generally are only tax exempt at the state level.

True False

39. The taxable equivalent yield for a municipal bond will be lower than the tax-exempt yield for that bond.

True False

40. The usual face value of a corporate bond is \$100.

True False

41. In the event of bankruptcy, stockholders have a claim to assets of the corporation before bondholders.

True False

42. As the market value of common stock increases, the market value of a convertible bond decreases.

True False

43. The value of a bond is not tied to the corporation's ability to repay its bond.

True False

44. An investor can typically find more information about stocks and mutual funds online than they can find for bonds.

True False

45. In general, bond rating categories are similar to school grading scales with A being better than C.

True False

**Multiple Choice Questions**

46. Which of the following is NOT a true statement?

- A. No one is going to make you save the money you need to start an investment program.
- B. To be useful, investment objectives must be specific and measurable.
- C. Investment goals must be tailored to the particular financial needs of the individual.
- D. Because investment objectives deal with the future, it is useless to make long-term goals.
- E. A long-term investment goal involves a time period of five years or more.

47. A valid short-term investment goal is:

- A. Saving \$4000 per year for 40 years for retirement.
- B. Spending less than \$500 per month for housing.
- C. Accumulating \$3000 in a savings account over the next 18 months.
- D. Using credit cards less in the next six months.
- E. Purchasing a \$250,000 life insurance policy within the next four years.

48. A valid long-term investment goal is:

- A. Saving \$4000 per year for 40 years for retirement.
- B. Spending less than \$500 per month for housing.
- C. Accumulating \$3000 in a savings account over the next 18 months.
- D. Using credit cards less in the next six months.
- E. Purchasing a \$250,000 life insurance policy within the next four years.

49. Which of the following steps should be completed before starting an investment program?

- A. Pick out at least two stocks or bonds to invest in.
- B. Work to balance your budget.
- C. Save at least \$10,000 to invest.
- D. Invest in certificates of deposit.
- E. These all are completed at the same time.

50. Which of the following steps is NOT a factor to be considered before making your first investment?

- A. Work to balance your budget.
- B. Obtain adequate insurance protection.
- C. Have access to other sources of cash for emergency needs.
- D. Save at least \$10,000 to invest.
- E. Start an emergency fund.

51. All of the following statements are considered to be good advice for the potential investor before starting his or her personal investment program *except*:

- A. Work to balance your budget.
- B. Increase credit purchases and make installment payments in order to increase cash available for investing.
- C. Provide adequate insurance protection.
- D. Start an emergency fund.
- E. Establish a line of credit for emergency needs.

52. A good rule of thumb is to limit installment payments to \_\_\_\_\_ percent of your net (nafter-tax) income.

- A. 20
- B. 30
- C. 40
- D. 50
- E. 60

53. How long will a bankruptcy stay on your credit report?

- A. 1 year
- B. 3 years
- C. 7 years
- D. 10 years
- E. 12 years



54. A \_\_\_\_\_ is an employer-sponsored retirement account.

- A. TRA account
- B. 301(a) account
- C. 509(re) account
- D. 401(k) account
- E. 321(a) account

55. If you invest \$4,000 per year over the next 40 years for retirement, which of the following is correct?

- A. A low rate of return will give you the highest total dollar return.
- B. A high rate of return will give you the highest total dollar return.
- C. The rate of return doesn't matter; your total dollar return will be the same with any investment.
- D. We cannot compare the total dollar return for a low rate of return or a high rate of return.
- E. Your investment will be worth \$160,000 at retirement.

56. Safe investments include all *except*:

- A. Government bonds
- B. Savings accounts
- C. Certificates of deposit
- D. Certain corporate bonds
- E. Commodities

57. Which of the following would be considered speculative investments?

- A. Government bonds
- B. Savings accounts
- C. Certificates of deposit
- D. Certain corporate bonds
- E. Commodities

58. Speculative investments include all *except*:

- A. Options
- B. Commodities
- C. Precious stones
- D. Savings accounts
- E. Precious metals

59. Which of the following would be considered a safe investment?

- A. Options
- B. Collectibles
- C. Precious metals
- D. Savings accounts
- E. Commodities

60. As people approach retirement, which of the following holds true for most?

- A. They choose more speculative investments.
- B. Their choices of investments do not change.
- C. They choose more conservative investments.
- D. They choose more risky investments.
- E. They move all of their money into certificates of deposit.

61. Gwendolyn and Jack Francis are typical investors. As they approach retirement, which approach will they likely take?

- A. They will choose more speculative investments.
- B. Their choices of investments will not change.
- C. They will choose more conservative investments.
- D. They will choose more risky investments.
- E. They will move all of their money into certificates of deposit.

62. The potential return on any investment should
- A. Be directly related to the risk the investor assumes
  - B. Be inversely related to the risk of the investment
  - C. Not have any relationship to the risk of any investment
  - D. Be inversely related to the risk the investor assumes
  - E. Be guaranteed
63. Which of the following is NOT one of the four components of risk to be considered when evaluating investments?
- A. Business failure
  - B. Inflation
  - C. Interest rate
  - D. Market
  - E. Stock
64. When choosing an investment, one should consider risk. The four primary risk components are:
- A. Business failure, inflation, buying power, stock
  - B. Buying power, inflation, interest rate, market
  - C. Inflation, interest rate, business failure, market
  - D. Market, bond, stock, inflation
  - E. Stock, interest rate, market, buying power
65. Which of the following risks reduces your buying power?
- A. Inflation
  - B. Interest rate
  - C. Business failure
  - D. Market
  - E. Stock

66. Which of the following risks associated with preferred stocks or government or corporate bonds is a result of changes in rates in the economy?

- A. Inflation
- B. Interest rate
- C. Business failure
- D. Market
- E. Stock

67. Which of the following risks deals with the possibility that bad management, unsuccessful products, or other factors will cause the firm to be less profitable than originally anticipated?

- A. Inflation
- B. Interest rate
- C. Business failure
- D. Market
- E. Stock

68. Which of the following risks deals with fluctuations due to political or social conditions?

- A. Inflation
- B. Interest rate
- C. Business failure
- D. Market
- E. Stock

69. Inflation risk deals with

- A. A reduction in buying power
- B. Changes in interest rates
- C. Bad management and/or unsuccessful products
- D. Political or social conditions
- E. Predictable sources of income

70. Business failure risk can be due to:

- A. A reduction in buying power
- B. Changes in interest rates
- C. Bad management and/or unsuccessful products
- D. Political or social conditions
- E. Predictable sources of income

71. Market risk is associated with fluctuations in the market due to

- A. A reduction in buying power
- B. Changes in interest rates
- C. Bad management and/or unsuccessful products
- D. Political or social conditions
- E. Predictable sources of income

72. All of the following can be factors that influence business failure risk *except*:

- A. Bad management
- B. Unsuccessful products
- C. Competition
- D. All of the above can affect business failure risk
- E. None of the above can affect business failure risk

73. Business failure risk:

- A. Cannot be diversified
- B. Causes the business to increase its dividends
- C. In the worst case, leads to improved earnings
- D. Is associated with government bonds
- E. Leads to lower profitability than anticipated

74. Timothy Calibe owns common stock in XYZWidgets.com. To reduce his business failure risk, he should

- A. Buy more common stock in XYZWidgets.com.
- B. Buy preferred stock in XYZWidgets.com.
- C. Buy bonds in XYZWidgets.com.
- D. Buy shares in a mutual fund that does not have stock in XYZWidgets.com.
- E. Any of the above would reduce his business failure risk.

75. If your primary investment objective is to receive income, which of the following would NOT be appropriate for your portfolio?

- A. Passbook savings account
- B. Certificate of deposit
- C. Municipal bond
- D. Preferred stock
- E. "Growth" common stock

76. Which of the following describes a growth company?

- A. The company pays a large dividend
- B. Earnings are reinvested in the company for future growth
- C. The company isn't growing as fast as in the past
- D. The company invests most of its money in safe securities like government bonds
- E. The company provides a predictable source of income for investors

77. Which of the following does NOT describe a growth company?

- A. The company pays a large dividend
- B. Earnings are reinvested in the company for future growth
- C. Earnings potential is high
- D. Managers can solve problems associated with rapid expansion
- E. Sales revenue is increasing

78. If your main focus is to have your investments increase in value, you are most concerned with

- A. Income
- B. Growth
- C. Liquidity
- D. Business failure risk
- E. Market risk

79. If your main focus is to be able to buy or sell an investment quickly without substantially affecting the investment's value, you are most concerned with

- A. Income
- B. Growth
- C. Liquidity
- D. Business failure risk
- E. Market risk

80. Which of the following investments is the most liquid?

- A. Certificate of deposit
- B. Corporate bond
- C. Interest-bearing checking account
- D. Municipal bond
- E. Preferred stock

81. The process of spreading your assets among several different types of investments to lessen risk is called

- A. Asset allocation
- B. Asset combination
- C. Asset investments
- D. Asset riskiness
- E. Asset returns

82. A proverb that we can associate with diversifying our investments is:

- A. A bird in the hand is worth two in the bush
- B. A stitch in time saves nine
- C. Birds of a feather flock together
- D. Don't judge a book by its cover
- E. Don't put all of your eggs in one basket

83. Which of the following investors would mostly prefer income investments over growth investments?

- A. A 25-year old single investor with a job that pays \$60,000 per year
- B. An unemployed, single parent who just received a \$300,000 divorce settlement
- C. A 30-year old who has a separate trust fund for day-to-day expenses
- D. A dual career couple in their 30s whose combined income is \$95,000
- E. A healthy 45-year old who plans to work in his secure job for at least 25 more years

84. Which of the following investors would mostly prefer growth investments over income investments?

- A. A 25-year old single investor who does not have an emergency fund
- B. An unemployed, single parent who just received a \$300,000 divorce settlement
- C. A 70-year old who uses his dividends and interest to pay his monthly bills
- D. A dual career couple in their 30s whose combined income is \$95,000
- E. A retired couple with \$850,000 in retirement savings

85. Which of the following investments typically has the largest potential investment return?

- A. Bonds
- B. Cash
- C. Cash equivalents
- D. Certificates of deposit
- E. Stocks



86. Which of the following investments typically has the most risk?

- A. Bonds
- B. Cash
- C. Cash equivalents
- D. Certificates of deposit
- E. Stocks

87. A portfolio that is 100 percent invested in stock would be indicative of a(n) \_\_\_\_\_ portfolio.

- A. Aggressive
- B. Bond
- C. Cash
- D. Conservative
- E. Very aggressive

88. A portfolio that has 15 - 20 percent invested in stock would be indicative of a(n) \_\_\_\_\_ portfolio.

- A. Aggressive
- B. Bond
- C. Cash
- D. Conservative
- E. Very aggressive

89. Which of the following would you expect to earn just over 10 percent per year over the long term?

- A. Bonds
- B. Certificates of deposit
- C. Conservative portfolio
- D. Savings account
- E. Stocks

90. If you need access to your funds in less than one year, which of the following investments would be *least* appropriate?

- A. Cash
- B. Certificates of deposit
- C. Short-term government bonds
- D. Corporate bonds
- E. Stocks and mutual funds

91. If you can leave your funds alone for 5 - 10 years or more, which of the following investments would be most appropriate?

- A. Cash
- B. Certificates of deposit
- C. Short-term government bonds
- D. Corporate bonds
- E. Stocks and mutual funds

92. As investors approach retirement age, they are often more interested in \_\_\_\_\_ portfolios.

- A. Aggressive
- B. International
- C. Cash
- D. Conservative
- E. Growth-oriented

93. Young investors are often more interested in \_\_\_\_\_ portfolios than older investors.

- A. Aggressive
- B. Government bond
- C. Cash
- D. Conservative
- E. Safe mutual fund

94. Some financial experts, such as Suze Orman, suggest that investors include a percentage of growth investments as part of their portfolio. This can be calculated by subtracting your age from:

- A. 50
- B. 95
- C. 100
- D. 110
- E. 200

95. When investing, an investor should NOT

- A. Evaluate potential investments
- B. Let the investments manage themselves
- C. Monitor the value of investments
- D. Keep accurate records
- E. Consider tax consequences of selling investments

96. After you purchase an investment, you should

- A. Assume that your investment is tax-free
- B. Monitor its value
- C. Ignore other potential investments
- D. Leave recordkeeping to the financial advisor
- E. Let the investment manage itself

97. When considering the value of your stock investments, it is important to

- A. Wait until you sell them to determine their value
- B. Track the prices in the December copy of a financial magazine
- C. Estimate their values based on similar stocks
- D. Determine their values using the Internet or newspapers
- E. Assume that the values remain the same as long as you hold them

98. To maximize profit or reduce dollar losses when you sell your investments, it is important to do all of the following *except*:

- A. Keep purchase records.
- B. Monitor current values.
- C. Identify commissions or fees paid.
- D. Keep a list of sources of information (such as Internet addresses) for reference.
- E. Identify original cost after you sell the investment.

99. When should you consider the tax consequences of selling your investments?

- A. When you make your own decisions
- B. When you have professional help
- C. When the taxes due are less than \$300 per transaction
- D. Both A and B are correct
- E. Both B and C are correct

100. Which of the following is NOT a U.S. Treasury security?

- A. Treasury note
- B. Treasury bond
- C. Treasury Inflation-Protected Securities (TIPS)
- D. Treasury stock
- E. Treasury bill

101. A discounted security means that the current price is trading at

- A. The face value
- B. Less than the face value
- C. Greater than the face value
- D. The value at maturity
- E. The expected interest rate

102. Which of the following statements is false?

- A. The federal government sells bonds and securities to obtain financing.
- B. U.S. government Treasury securities carry a reduced risk of default when compared to corporate securities.
- C. U.S. Treasury securities offer lower interest rates than corporate bonds.
- D. Individual investors who purchase treasury bills, notes, and bonds must hold the investments until maturity.
- E. Treasury securities may be purchased through banks or brokers.

103. A government security issued in minimum units of \$100 with 4, 13, 26, or 52-week maturities is called a

- A. subordinated bond.
- B. treasury bill.
- C. treasury note.
- D. treasury bond.
- E. savings bond.

104. When comparing the interest rates for government securities, which of the following is correct?

- A. Treasury bonds < treasury bills < treasury notes
- B. Treasury bills < treasury notes < treasury bonds
- C. Treasury notes < treasury bills < treasury bonds
- D. Treasury bills < treasury bonds < treasury notes
- E. Treasury bonds < treasury notes < treasury bills

105. A government security issued in \$100 units with maturities of more than one year but not more than ten years is called a

- A. subordinated bond.
- B. treasury bill.
- C. treasury note.
- D. treasury bond.
- E. savings bond.

106. A government security issued in minimum units of \$100 with a 30-year maturity is called a

- A. subordinated bond.
- B. treasury bill.
- C. treasury note.
- D. treasury bond.
- E. savings bond.

107. A security issued by the U.S. Treasury that protects the investor from inflation is called a

- A. treasury bill.
- B. TIPS.
- C. SAFE.
- D. Treasury Bond.
- E. Treasury Bill.

108. A bond backed by the full faith, credit, and unlimited taxing power of the government that issued it is called a \_\_\_\_\_ bond.

- A. debenture
- B. mortgage
- C. secured
- D. general obligation
- E. revenue

109. A bond that is repaid from the income generated by the project it is designed to finance is called a(n)

- A. treasury bill.
- B. savings bond.
- C. revenue bond.
- D. general obligation bond.
- E. agency bond.

110. A debt security issued by a state or local government is known as a
- A. Treasury bond
  - B. Municipal bond
  - C. Corporate bond
  - D. Subordinated bond
  - E. Federal agency bond
111. Which of the following features is a benefit for investors of municipal bonds?
- A. Interest may be tax-exempt at the federal level
  - B. Interest may be tax-deductible at the federal level
  - C. Face value may be tax-deductible at the state level
  - D. Face value may be a tax-credit at the federal level
  - E. All payments are tax-deductible at all governmental levels
112. The taxable equivalent yield for a municipal bond is calculated using
- A. The investor's tax rate and treasury bill yield
  - B. Tax-exempt yield and current inflation rate
  - C. Tax-exempt yield and the investor's tax rate
  - D. Current inflation rate and number of years until maturity
  - E. Tax-exempt yield and number of years until maturity
113. Which of the following is NOT correct?
- A. The taxable equivalent yield is greater than the tax-exempt yield
  - B. The taxable equivalent yield can be compared to the return on a taxable investment
  - C. An investor can have a capital gain if he sells a municipal bond before maturity
  - D. The taxable equivalent yield is calculated for municipal securities
  - E. The tax exempt yield is primarily associated with federal government securities
114. Generally, interest on corporate bonds is paid every
- A. month.
  - B. three months.
  - C. six months.
  - D. nine months.
  - E. year.

115. Corporations use bonds for

- A. Financing the ongoing business activities
- B. When it is difficult to sell stock
- C. To improve financial leverage
- D. All of the above are correct
- E. None of the above are correct

116. Interest paid to corporate bond holders is

- A. Tax deductible for the investor
- B. Tax deductible for the corporation
- C. Tax-exempt for the investor
- D. Tax-exempt for the corporation
- E. Tax deductible for both the investor and the corporation

117. The financially independent firm or individual that acts as the bondholders' representative is the

- A. chairman of the board.
- B. president of the corporation.
- C. debenture holder.
- D. indenture holder.
- E. trustee.

118. Which of the following statements is correct?

- A. For the corporation, interest paid on corporate bonds is not tax deductible.
- B. Bond financing is seldom used to pay for major corporate purchases.
- C. Bonds are a form of debt financing.
- D. Bonds do not have to be repaid at maturity.
- E. Interest payments to bondholders are at the discretion of the corporation.



119. A bond that is backed only by the reputation of the issuing corporation is called a(n) \_\_\_\_\_ bond.

- A. debenture
- B. mortgage
- C. indenture
- D. preemptive
- E. treasury

120. A corporate bond that is secured by various assets of the issuing firm is called a(n) \_\_\_\_\_ bond.

- A. debenture
- B. mortgage
- C. indenture
- D. preemptive
- E. treasury

121. A bond that can be exchanged, at the owner's option, for a specified number of shares of the corporation's stock is called a(n) \_\_\_\_\_ bond.

- A. debenture
- B. mortgage
- C. indenture
- D. convertible
- E. subordinated

122. Which of the following statements is true?

- A. Convertible corporate bonds are more secure than government bonds.
- B. Convertible bonds often pay 1 to 2 percent more interest than nonconvertible bonds.
- C. Because of the conversion feature, it is not necessary to evaluate convertible, corporate bonds.
- D. In reality, there is no guarantee that bondholders will convert to common stock even if the market value of the common stock does increase in value.
- E. Even after convertible bondholders convert their investment to common stock, the bondholders still receive interest payments.

123. A call feature

- A. allows bondholders to convert their bonds to a specified number of shares of common stock.
- B. is not available for corporate bonds.
- C. allows the corporation to buy outstanding bonds from current bondholders before the maturity date.
- D. is only available with government securities.
- E. is guaranteed by the corporation.

124. A fund to which annual or semiannual deposits are made for the purpose of redeeming a bond issue is called a(n) \_\_\_\_\_ fund.

- A. serial
- B. sinking
- C. debenture
- D. indenture
- E. money

125. Bonds of a single issue that mature on different dates are called \_\_\_\_\_ bonds.

- A. debenture
- B. mortgage
- C. sinking fund
- D. subordinate
- E. serial

126. Which of the following is NOT a rating agency for bonds?

- A. Moody's Investors Service.
- B. Bond Rating Corporation.
- C. Standard & Poor's Corporation.
- D. Fitch Ratings Service.
- E. Mergent, Inc.

127. Bond funds

- A. Allow investors to purchase individual corporate bonds.
- B. Are an indirect way of owning bonds issued by the governments and corporations.
- C. Are not as diversified as individual bond purchases.
- D. Do not have professional management because they do not include stocks in the funds.
- E. Should be the primary investment for investors who have a very aggressive portfolio.

128. Why do investors purchase corporate bonds?

- A. Dividend income
- B. Repayment at maturity
- C. Possible increase in value
- D. A & B are correct
- E. B & C are correct

129. The type of bond that is tracked electronically by the issuing company is a

- A. General obligation bond
- B. Registered bond
- C. Revenue bond
- D. Tax-exempt bond
- E. Zero-coupon bond

130. John Peterson purchased a bond at a price far below its face value, which makes no interest payments, and will be redeemed at its face value at maturity. In all likelihood, he purchased a(n) \_\_\_\_\_ bond.

- A. debenture
- B. convertible
- C. indenture
- D. registered
- E. zero-coupon

131. The IRS requires that an investor in a zero-coupon bond report interest

- A. Only in the first year
- B. Every year as it is earned
- C. When it is received
- D. At maturity
- E. Never since it is a zero-coupon

132. If overall interest rates in the economy rise, a corporate bond with a fixed interest rate will generally

- A. increase in value.
- B. decrease in value.
- C. remain unchanged.
- D. become worthless.
- E. be returned to the corporation.

133. Which of the following securities are rated at various agencies?

- A. Treasury bills
- B. Treasury notes
- C. Corporate bonds
- D. Treasury bonds
- E. TIPS

134. If your monthly expenses total \$2,200, you should save at least \_\_\_\_\_ in an emergency fund before focusing completely on your investment portfolio.

- A. \$1,000
- B. \$2,200
- C. \$4,400
- D. \$6,600
- E. \$10,000
- F. \$26,400

135. If your monthly expenses total \$2,600 you should save at least \_\_\_\_\_ in an emergency fund before focusing completely on your investment portfolio.

- A. \$1,000
- B. \$2,600
- C. \$5,200
- D. \$7,800
- E. \$10,000
- F. \$31,200

136. According to some financial experts like Suze Orman, how much of an investment portfolio should a 30-year old have in growth investments?

- A. 30 percent
- B. 65 percent
- C. 70 percent
- D. 80 percent
- E. 100 percent

137. According to some financial experts like Suze Orman, how much of an investment portfolio should a 30-year old have in safe (non-growth) investments?

- A. 20 percent
- B. 30 percent
- C. 70 percent
- D. 80 percent
- E. 100 percent

138. According to some financial experts like Suze Orman, how much of an investment portfolio should a 50-year old have in growth investments?

- A. 30 percent
- B. 40 percent
- C. 50 percent
- D. 60 percent
- E. 70 percent

139. According to some financial experts like Suze Orman, how much of an investment portfolio should a 50-year old invest in safe (non-growth) investments?

- A. 30 percent
- B. 40 percent
- C. 50 percent
- D. 60 percent
- E. 70 percent

140. You are considering an investment in a municipal bond that has a yield of 4.5 percent. Your tax rate is 25 percent. What is your taxable equivalent yield?

- A. 1.125 percent
- B. 3.375 percent
- C. 4.5 percent
- D. 5.625 percent
- E. 6.0 percent

141. You are considering an investment in a municipal bond that has a yield of 5.2 percent. Your tax rate is 25 percent. What is your taxable equivalent yield?

- A. 1.3 percent
- B. 3.9 percent
- C. 5.2 percent
- D. 6.5 percent
- E. 6.9 percent

142. Assume that you purchase a \$1,000 bond issued by GE that pays  $6\frac{1}{4}$  percent interest each year. What is the annual interest amount?

- A. \$6.25
- B. \$62.25
- C. \$62.40
- D. \$62.50
- E. \$1000

143. Assume that you purchase a \$1,000 bond issued by Harley-Davidson that pays 7 percent interest each year, paid *semiannually*. What is the amount of each interest payment?

- A. \$3.50
- B. \$7.00
- C. \$35.00
- D. \$70.00
- E. \$1000

144. Assume that you purchase a \$1,000 bond issued by Kohls that pays 9 percent interest each year, paid *semiannually*. What is the amount of each interest payment?

- A. \$4.50
- B. \$9.00
- C. \$45.00
- D. \$90.00
- E. \$1000

145. What is the approximate market value of a bond that pays \$60 interest each year if interest rates have dropped to 4 percent?

- A. \$400
- B. \$600
- C. \$1000
- D. \$1500
- E. \$2400

146. If a bond is quoted in the newspaper at 92, what is its price?

- A. \$9.20
- B. \$92
- C. \$920
- D. \$1,000
- E. \$1,092

147. If a bond is quoted in the newspaper at 102, what is its price?

- A. \$1.02
- B. \$10.20
- C. \$102.00
- D. \$1,000
- E. \$1,020

148. Gwendolyn Francis is interested in buying a bond that pays \$80 annually. The current price of the bond is \$600. What is her current yield?

- A. 6 percent
- B. 7.5 percent
- C. 8 percent
- D. 12 percent
- E. 13.3 percent

**Essay Questions**

149. What factors should be considered before making your first investment?

150. Describe the steps you can take to survive a financial crisis.



151. Paul Paulson recently heard about layoffs at his company. What are at least three steps he can take to make sure his financial affairs are in order?

152. Contrast a safe investment with a speculative investment. Include at least one example of each.

153. As a person ages, his or her investment choices may change. Why?

154. Paul Paulson is thinking about investing in some securities. What are the four main risk components he should consider?

155. The text discusses investment income, growth, and liquidity. Discuss these in terms of investment types and objectives.

156. Contrast the types of investments typically chosen for the following two investors:

- a. Retired couple with \$850,000 in retirement savings
- b. A 25-year old single investor with a secure high paying job

157. Describe asset allocation and its importance.

158. Assume that you are a young investor earning a high salary in a secure job. Suggest an investment portfolio for your retirement funds. Include the percentages you would consider investing in each of the various investment classes you listed.

159. Using suggestions from financial experts like Suze Orman, calculate the amount of your assets that should be invested in growth investments as well as the amount to be invested in safer, conservative investments. Identify your assumptions and show your work.

160. Successful investors evaluate their investments and do not let their investments manage themselves. What are at least two specific factors you can consider to be successful as an investor?

161. Compare and contrast treasury securities and municipal securities.

162. What is the difference between a U.S. government treasury bill, treasury note, and treasury bond?

163. Cliff Clarkson is 70 years old and wants to diversify his investment portfolio. He must decide if he should invest in tax-free municipal bonds or in corporate bonds. The tax-free bonds are highly rated and pay 4.5 percent. The corporate bonds are more speculative and pay 7.0 percent

- a. If Cliff is in the 33 percent tax bracket, what is the taxable equivalent yield for the municipal bond?
- b. If you were Cliff, would you choose the municipal bonds or the corporate bonds? Justify your answer.

164. Define three of the six terms presented below:

- a. corporate bond
- b. bond indenture
- c. trustee
- d. mortgage bond
- e. debenture bond
- f. convertible bond

165. Timothy Calibe is interested in purchasing an ABC bond that pays \$70 interest per year. However, similar bonds pay interest of 9 percent. Approximately how much should Timothy be willing to pay for his ABC bond?

166. Marissa Christianson is interested in purchasing an XYZ bond that pays \$70 interest per year. However, similar bonds pay interest of 5 percent. Approximately how much should Marissa be willing to pay for her XYZ bond?

167. Rebecca Gladlyn is interested in purchasing an XYZ bond that pays 7 percent interest each year. The interest will be paid *semiannually*. How often should Rebecca receive interest? What amount should she receive?

168. Rebecca Gladlyn is interested in purchasing an LMN bond that pays 8.5 percent interest each year. The interest will be paid *semiannually*. How often should Rebecca receive interest? What amount should she receive?

169. Identify at least one advantage of investing in a corporate bond.

170. If a bond is quoted at a price of 105, what is its current price?

171. List five items that appear in a corporate bond quote.

172. You are trying to evaluate two bond issues. One bond issue is rated "A" by Moody's; the other is rated "B." How important are the bond ratings issued by Moody's Investors Service? Based on your answer, would you purchase the "A" bond or the "B" bond?

173. Marissa Christianson is interested in buying a bond whose interest rate is 7 percent and current quote is 105. What is her current yield?

174. Cliff Clarkson is interested in buying a bond that pays \$80 annually. The current quote is 60. What is his current yield?

## Chapter 11 Investing Basics and Evaluating Bonds **Answer Key**

### **True / False Questions**

1. (p. 350) Investment goals are always oriented to the future.

**TRUE**

*Bloom's: Knowledge  
Difficulty: Easy  
Learning Objective: 1  
Topic: Investment goals*

2. (p. 350) Short term goals should be completed in 30 days or less.

**FALSE**

Short term goals should be completed in less than two years.

*Bloom's: Knowledge  
Difficulty: Easy  
Learning Objective: 1  
Topic: Investment goals*

3. (p. 350) Intermediate goals should be accomplished in two to five years.

**TRUE**

*Bloom's: Knowledge  
Difficulty: Easy  
Learning Objective: 1  
Topic: Investment goals*



4. (p. 350) Long term goals should be completed in two to five years.

**FALSE**

Intermediate goals should be completed in two to five years. Long term goals should be accomplished beyond five years.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 1*  
*Topic: Investment goals*

5. (p. 351) It isn't important to know how much you owe in order to survive a financial crisis.

**FALSE**

To survive a financial crisis, it is important to know what you owe.

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 1*  
*Topic: Financial crisis*

6. (p. 351) To help survive a financial crisis, it is important to establish a larger than usual emergency fund.

**TRUE**

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 1*  
*Topic: Financial crisis*

7. (p. 352) If you are unable to make your credit card payments, you should not contact your credit card company.

**FALSE**

It is important to contact your credit card company. Some lenders may be willing to work with you and lower your interest rate, reduce your monthly payment, or extend the time for repayment.

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 1  
Topic: Financial crisis*

8. (p. 352) To survive a financial crisis, one should track the value of his/her stock, mutual fund and retirement accounts.

**TRUE**

Tracking the value can help you decide which investments to sell if you need cash for emergencies.

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 1  
Topic: Financial crisis*

9. (p. 352) A bankruptcy can stay on your credit report for up to 12 years.

**FALSE**

A bankruptcy remains on your credit report for up to 10 years.

*Bloom's: Knowledge  
Difficulty: Easy  
Learning Objective: 1  
Topic: Financial crisis*

10. (p. 352) For many people, the easiest way to begin an investment program is to participate in an employer-sponsored 401(k) or 403(b) retirement account.

**TRUE**

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Long-term investment programs*

11. (p. 355) Investments that earn a lower rate of interest will have a higher total dollar return than those that earn a high rate of interest.

**FALSE**

Higher rates of return will lead to higher total dollar returns.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Long-term investment programs*

12. (p. 356) An example of an investment with high risk is a government bond.

**FALSE**

A government bond is considered to have low risk.

*Bloom's: Knowledge*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Safety and risk*

13. (p. 357) The potential return of any investment should be directly related to the risk that the investor assumes.

**TRUE**

*Bloom's: Knowledge*

*Difficulty: Medium*

*Learning Objective: 2*

*Topic: Safety and risk*

14. (p. 356) Investors choose safe investments because they know there is a moderate chance that these investments will become worthless.

**FALSE**

Safe investments have a very little chance of becoming worthless.

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 2  
Topic: Safety and risk*

15. (p. 358) The prices of some investments may fluctuate because of periods of economic expansion followed by periods of recession.

**TRUE**

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 2  
Topic: Risk*

16. (p. 358) Patrick Guitman wants to protect himself against losses in his investments. To do this, he should evaluate the companies he wants to purchase and continue to evaluate his investments after his purchase.

**TRUE**

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 2  
Topic: Risk*

17. (p. 358) Diversifying your investments can reduce your inflation risk.

**FALSE**

Diversifying reduces business failure risk.

*Bloom's: Comprehension  
Difficulty: Hard  
Learning Objective: 2  
Topic: Risk*

18. (p. 358) Fluctuations in market prices of stocks or bonds directly relate to fundamental changes in the financial health of corporations.

**FALSE**

Fluctuations in market prices may be due to market risk (political or social conditions).

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 2  
Topic: Risk*

19. (p. 359) The price of oil stocks may change due to political unrest in the Middle East.

**TRUE**

This is an example of market risk.

*Bloom's: Comprehension  
Difficulty: Easy  
Learning Objective: 2  
Topic: Risk*

20. (p. 359) To investors, liquidity means their investments will increase in value.

**FALSE**

Growth means investments will increase in value.

*Bloom's: Comprehension  
Difficulty: Medium  
Learning Objective: 2  
Topic: Investment growth*

21. (p. 359) To investors, liquidity is the ability to buy or sell an investment quickly without substantially affecting the investment's value.

**TRUE**

*Bloom's: Comprehension  
Difficulty: Easy  
Learning Objective: 2  
Topic: Investment liquidity*

22. (p. 361) Since 1926, stocks have earned an average annual return of just over 10 percent.

**TRUE**

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investments*

23. (p. 361) Asset allocation is the process of spreading your assets among several different types of investments to increase risk.

**FALSE**

The purpose of asset allocation is to lessen risk.

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

24. (p. 361) The purpose of diversification is to spread your assets among several different types of investments to decrease risk.

**TRUE**

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

25. (p. 362) An unemployed, single parent who just received a \$300,000 divorce settlement would likely prefer income investments over growth investments.

**TRUE**

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investments*

26. (p. 363) A 25-year old single investor with a secure, full-time job that pays \$60,000 would likely prefer income investments over growth investments.

**FALSE**

*Bloom's: Comprehension  
Difficulty: Easy  
Learning Objective: 3  
Topic: Investments*

27. (p. 361) The potential return on any investment should be indirectly related to the risk the investor assumes.

**FALSE**

These are directly related.

*Bloom's: Comprehension  
Difficulty: Easy  
Learning Objective: 3  
Topic: Asset allocation*

28. (p. 365) Government bonds have a higher potential investment return than stocks.

**FALSE**

Stocks and mutual funds offer higher potential investment returns than government bonds.

*Bloom's: Knowledge  
Difficulty: Easy  
Learning Objective: 3  
Topic: Asset allocation*

29. (p. 363) As investors age, their investments typically become more aggressive.

**FALSE**

Older investors tend to be more conservative.

*Bloom's: Comprehension  
Difficulty: Easy  
Learning Objective: 3  
Topic: Asset allocation*

30. (p. 363) Younger investors tend to invest in more aggressive portfolios than older investors.

**TRUE**

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 3*

*Topic: Asset allocation*

31. (p. 363) Younger investors tend to invest in more aggressive portfolios because they are more concerned about safety than older investors.

**FALSE**

Older investors are typically more concerned about safety and invest in more conservative investments.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*

32. (p. 363) An easy way to determine what percentage of your assets should be invested in growth investments is to take your age and subtract it from 80.

**FALSE**

Financial experts like Suze Orman suggest subtracting your age from 110 to determine the percent of your assets to invest in growth investments.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*



33. (p. 363) After you invest, it is important to let the investments manage themselves.

**FALSE**

It is important to continually evaluate investments.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investment process*

34. (p. 363) At the most, you should only keep purchase records of the actual dollar cost of your investments.

**FALSE**

At the *least*, dollar cost plus commissions or fees paid should be documented.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Investment process*

35. (p. 363) At the least, you should keep purchase records of the actual dollar cost of your investments including commissions or fees paid.

**TRUE**

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Investment process*

36. (p. 364) Whether you are making your own decisions or have professional help, you must consider the tax consequences of selling your investments.

**TRUE**

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Investment process*

37. (p. 365) A corporate bond is a written pledge of a government or municipality to repay a specified sum of money, along with interest.

**FALSE**

A government bond makes this a true statement.

*Bloom's: Knowledge  
Difficulty: Medium  
Learning Objective: 4  
Topic: Bonds*

38. (p. 367) Municipal bonds generally are only tax exempt at the state level.

**FALSE**

Municipal bonds may be exempt at the federal level. They are generally exempt from state and local taxes only in the state where they are issued.

*Bloom's: Knowledge  
Difficulty: Medium  
Learning Objective: 4  
Topic: Municipal bonds*

39. (p. 368) The taxable equivalent yield for a municipal bond will be lower than the tax-exempt yield for that bond.

**FALSE**

The tax equivalent yield = tax exempt yield/(1 - tax rate). The interest rate on municipal bonds is lower than those on taxable bonds because municipal bond interest is tax-exempt.

*Bloom's: Comprehension  
Difficulty: Hard  
Learning Objective: 4  
Topic: Municipal bonds*

40. (p. 368) The usual face value of a corporate bond is \$100.

**FALSE**

The usual face value is \$1000.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

41. (p. 370) In the event of bankruptcy, stockholders have a claim to assets of the corporation before bondholders.

**FALSE**

Bondholders have a claim prior to stockholders.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

42. (p. 370) As the market value of common stock increases, the market value of a convertible bond decreases.

**FALSE**

The market value of the convertible bond will also increase.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

43. (p. 370) The value of a bond is not tied to the corporation's ability to repay its bond.

**FALSE**

The value IS closely tied to the corporation's ability to repay its bond indebtedness.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

44. (p. 375) An investor can typically find more information about stocks and mutual funds online than they can find for bonds.

**TRUE**

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 6*  
*Topic: Corporate bonds*

45. (p. 376) In general, bond rating categories are similar to school grading scales with A being better than C.

**TRUE**

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 6*  
*Topic: Bond rating*

**Multiple Choice Questions**

46. (p. 350) Which of the following is NOT a true statement?

- A. No one is going to make you save the money you need to start an investment program.
- B. To be useful, investment objectives must be specific and measurable.
- C. Investment goals must be tailored to the particular financial needs of the individual.
- D.** Because investment objectives deal with the future, it is useless to make long-term goals.
- E. A long-term investment goal involves a time period of five years or more.

It is important to make long-term goals.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Investment goals*

47. (p. 350) A valid short-term investment goal is:

- A. Saving \$4000 per year for 40 years for retirement.
- B. Spending less than \$500 per month for housing.
- C.** Accumulating \$3000 in a savings account over the next 18 months.
- D. Using credit cards less in the next six months.
- E. Purchasing a \$250,000 life insurance policy within the next four years.

Short-term goals are to be completed in less than two years (including B, C, and D); C specifically deals with investments.

*Bloom's: Comprehension*

*Difficulty: Hard*

*Learning Objective: 1*

*Topic: Investment goals*

48. (p. 350) A valid long-term investment goal is:

- A.** Saving \$4000 per year for 40 years for retirement.
- B. Spending less than \$500 per month for housing.
- C. Accumulating \$3000 in a savings account over the next 18 months.
- D. Using credit cards less in the next six months.
- E. Purchasing a \$250,000 life insurance policy within the next four years.

Long-term goals have a time horizon of more than five years; A specifically deals with investments.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Investment goals*

49. (p. 350) Which of the following steps should be completed before starting an investment program?

- A. Pick out at least two stocks or bonds to invest in.
- B.** Work to balance your budget.
- C. Save at least \$10,000 to invest.
- D. Invest in certificates of deposit.
- E. These all are completed at the same time.

Before beginning an investment program, personal financial affairs should be in good shape. This includes working to balance a budget.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Financial Checkup*

50. (p. 350) Which of the following steps is NOT a factor to be considered before making your first investment?

- A. Work to balance your budget.
- B. Obtain adequate insurance protection.
- C. Have access to other sources of cash for emergency needs.
- D.** Save at least \$10,000 to invest.
- E. Start an emergency fund.

Before beginning an investment program, personal financial affairs should be in good shape.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Financial Checkup*

51. (p. 350) All of the following statements are considered to be good advice for the potential investor before starting his or her personal investment program *except*:

- A. Work to balance your budget.
- B.** Increase credit purchases and make installment payments in order to increase cash available for investing.
- C. Provide adequate insurance protection.
- D. Start an emergency fund.
- E. Establish a line of credit for emergency needs.

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 1*

*Topic: Financial Checkup*

52. (p. 350) A good rule of thumb is to limit installment payments to \_\_\_\_\_ percent of your net (nafter-tax) income.

- A.** 20
- B. 30
- C. 40
- D. 50
- E. 60

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 1*

*Topic: Financial Checkup*

53. (p. 352) How long will a bankruptcy stay on your credit report?

- A. 1 year
- B. 3 years
- C. 7 years
- D. 10 years**
- E. 12 years

A bankruptcy stays on a credit report for up to 10 years.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 1*  
*Topic: Financial crisis*

54. (p. 353) A \_\_\_\_\_ is an employer-sponsored retirement account.

- A. TRA account
- B. 301(a) account
- C. 509(re) account
- D. 401(k) account**
- E. 321(a) account

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 1*  
*Topic: Investment goals*

55. (p. 355) If you invest \$4,000 per year over the next 40 years for retirement, which of the following is correct?

- A. A low rate of return will give you the highest total dollar return.
- B. A high rate of return will give you the highest total dollar return.**
- C. The rate of return doesn't matter; your total dollar return will be the same with any investment.
- D. We cannot compare the total dollar return for a low rate of return or a high rate of return.
- E. Your investment will be worth \$160,000 at retirement.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 1*  
*Topic: Long-term investment programs*



56. (p. 356) Safe investments include all *except*:

- A. Government bonds
- B. Savings accounts
- C. Certificates of deposit
- D. Certain corporate bonds
- E.** Commodities

Commodities are speculative investments.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 2*

*Topic: Safety and risk*

57. (p. 356) Which of the following would be considered speculative investments?

- A. Government bonds
- B. Savings accounts
- C. Certificates of deposit
- D. Certain corporate bonds
- E.** Commodities

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Safety and risk*

58. (p. 356) Speculative investments include all *except*:

- A. Options
- B. Commodities
- C. Precious stones
- D.** Savings accounts
- E. Precious metals

Savings accounts are safe investments.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 2*

*Topic: Safety and risk*

59. (p. 356) Which of the following would be considered a safe investment?

- A. Options
- B. Collectibles
- C. Precious metals
- D.** Savings accounts
- E. Commodities

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Safety and risk*

60. (p. 356) As people approach retirement, which of the following holds true for most?

- A. They choose more speculative investments.
- B. Their choices of investments do not change.
- C.** They choose more conservative investments.
- D. They choose more risky investments.
- E. They move all of their money into certificates of deposit.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 2*

*Topic: Safety and risk*

61. (p. 365) Gwendolyn and Jack Francis are typical investors. As they approach retirement, which approach will they likely take?

- A. They will choose more speculative investments.
- B. Their choices of investments will not change.
- C.** They will choose more conservative investments.
- D. They will choose more risky investments.
- E. They will move all of their money into certificates of deposit.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 2*

*Topic: Safety and risk*

62. (p. 356) The potential return on any investment should
- A. Be directly related to the risk the investor assumes
  - B. Be inversely related to the risk of the investment
  - C. Not have any relationship to the risk of any investment
  - D. Be inversely related to the risk the investor assumes
  - E. Be guaranteed

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Safety and risk*

63. (p. 358) Which of the following is NOT one of the four components of risk to be considered when evaluating investments?
- A. Business failure
  - B. Inflation
  - C. Interest rate
  - D. Market
  - E. Stock

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 2*  
*Topic: Risk*

64. (p. 358) When choosing an investment, one should consider risk. The four primary risk components are:
- A. Business failure, inflation, buying power, stock
  - B. Buying power, inflation, interest rate, market
  - C. Inflation, interest rate, business failure, market
  - D. Market, bond, stock, inflation
  - E. Stock, interest rate, market, buying power

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 2*  
*Topic: Risk*

65. (p. 358) Which of the following risks reduces your buying power?

- A.** Inflation
- B. Interest rate
- C. Business failure
- D. Market
- E. Stock

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 2*  
*Topic: Risk*

66. (p. 358) Which of the following risks associated with preferred stocks or government or corporate bonds is a result of changes in rates in the economy?

- A. Inflation
- B.** Interest rate
- C. Business failure
- D. Market
- E. Stock

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 2*  
*Topic: Risk*

67. (p. 358) Which of the following risks deals with the possibility that bad management, unsuccessful products, or other factors will cause the firm to be less profitable than originally anticipated?

- A. Inflation
- B. Interest rate
- C.** Business failure
- D. Market
- E. Stock

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 2*  
*Topic: Risk*

68. (p. 358) Which of the following risks deals with fluctuations due to political or social conditions?

- A. Inflation
- B. Interest rate
- C. Business failure
- D. Market**
- E. Stock

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 2*  
*Topic: Risk*

69. (p. 358) Inflation risk deals with

- A. A reduction in buying power**
- B. Changes in interest rates
- C. Bad management and/or unsuccessful products
- D. Political or social conditions
- E. Predictable sources of income

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Risk*

70. (p. 358) Business failure risk can be due to:

- A. A reduction in buying power
- B. Changes in interest rates
- C. Bad management and/or unsuccessful products**
- D. Political or social conditions
- E. Predictable sources of income

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Risk*

71. (p. 358) Market risk is associated with fluctuations in the market due to
- A. A reduction in buying power
  - B. Changes in interest rates
  - C. Bad management and/or unsuccessful products
  - D. Political or social conditions**
  - E. Predictable sources of income

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Risk*

72. (p. 358) All of the following can be factors that influence business failure risk *except*:
- A. Bad management
  - B. Unsuccessful products
  - C. Competition
  - D. All of the above can affect business failure risk**
  - E. None of the above can affect business failure risk

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 2*  
*Topic: Risk*

73. (p. 358) Business failure risk:
- A. Cannot be diversified
  - B. Causes the business to increase its dividends
  - C. In the worst case, leads to improved earnings
  - D. Is associated with government bonds
  - E. Leads to lower profitability than anticipated**

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Risk*

74. (p. 358) Timothy Calibe owns common stock in XYZWidgets.com. To reduce his business failure risk, he should

- A. Buy more common stock in XYZWidgets.com.
- B. Buy preferred stock in XYZWidgets.com.
- C. Buy bonds in XYZWidgets.com.
- D.** Buy shares in a mutual fund that does not have stock in XYZWidgets.com.
- E. Any of the above would reduce his business failure risk.

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Risk*

75. (p. 359) If your primary investment objective is to receive income, which of the following would NOT be appropriate for your portfolio?

- A. Passbook savings account
- B. Certificate of deposit
- C. Municipal bond
- D. Preferred stock
- E.** "Growth" common stock

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Investment income*

76. (p. 359) Which of the following describes a growth company?

- A. The company pays a large dividend
- B.** Earnings are reinvested in the company for future growth
- C. The company isn't growing as fast as in the past
- D. The company invests most of its money in safe securities like government bonds
- E. The company provides a predictable source of income for investors

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 2*

*Topic: Investments*

77. (p. 359) Which of the following does NOT describe a growth company?

- A.** The company pays a large dividend
- B. Earnings are reinvested in the company for future growth
- C. Earnings potential is high
- D. Managers can solve problems associated with rapid expansion
- E. Sales revenue is increasing

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Investments*

78. (p. 359) If your main focus is to have your investments increase in value, you are most concerned with

- A. Income
- B.** Growth
- C. Liquidity
- D. Business failure risk
- E. Market risk

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Investments*

79. (p. 359) If your main focus is to be able to buy or sell an investment quickly without substantially affecting the investment's value, you are most concerned with

- A. Income
- B. Growth
- C.** Liquidity
- D. Business failure risk
- E. Market risk

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Investments*



80. (p. 360) Which of the following investments is the most liquid?

- A. Certificate of deposit
- B. Corporate bond
- C. Interest-bearing checking account**
- D. Municipal bond
- E. Preferred stock

*Bloom's: Knowledge*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Investments*

81. (p. 361) The process of spreading your assets among several different types of investments to lessen risk is called

- A. Asset allocation**
- B. Asset combination
- C. Asset investments
- D. Asset riskiness
- E. Asset returns

*Bloom's: Knowledge*

*Difficulty: Easy*

*Learning Objective: 3*

*Topic: Asset allocation*

82. (p. 361) A proverb that we can associate with diversifying our investments is:

- A. A bird in the hand is worth two in the bush
- B. A stitch in time saves nine
- C. Birds of a feather flock together
- D. Don't judge a book by its cover
- E. Don't put all of your eggs in one basket**

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 3*

*Topic: Asset allocation*

83. (p. 363) Which of the following investors would mostly prefer income investments over growth investments?

- A. A 25-year old single investor with a job that pays \$60,000 per year
- B.** An unemployed, single parent who just received a \$300,000 divorce settlement
- C. A 30-year old who has a separate trust fund for day-to-day expenses
- D. A dual career couple in their 30s whose combined income is \$95,000
- E. A healthy 45-year old who plans to work in his secure job for at least 25 more years

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investments*

84. (p. 363) Which of the following investors would mostly prefer growth investments over income investments?

- A. A 25-year old single investor who does not have an emergency fund
- B. An unemployed, single parent who just received a \$300,000 divorce settlement
- C. A 70-year old who uses his dividends and interest to pay his monthly bills
- D.** A dual career couple in their 30s whose combined income is \$95,000
- E. A retired couple with \$850,000 in retirement savings

A should set up an emergency fund prior to beginning an investment program. B, C, E should prefer income investments.

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 3*  
*Topic: Investments*

85. (p. 361) Which of the following investments typically has the largest potential investment return?

- A. Bonds
- B. Cash
- C. Cash equivalents
- D. Certificates of deposit
- E.** Stocks

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

86. (p. 361) Which of the following investments typically has the most risk?

- A. Bonds
- B. Cash
- C. Cash equivalents
- D. Certificates of deposit
- E.** Stocks

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

87. (p. 361) A portfolio that is 100 percent invested in stock would be indicative of a(n) \_\_\_\_\_ portfolio.

- A. Aggressive
- B. Bond
- C. Cash
- D. Conservative
- E.** Very aggressive

A very aggressive portfolio has 80 - 100 percent invested in stocks and mutual funds

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

88. (p. 361) A portfolio that has 15 - 20 percent invested in stock would be indicative of a(n) \_\_\_\_\_ portfolio.

- A. Aggressive
- B. Bond
- C. Cash
- D. Conservative**
- E. Very aggressive

A conservative portfolio has 15 - 20 percent invested in stocks and mutual funds, 70 - 75 percent in bonds and CDs, and 5 - 15 percent in cash.

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

89. (p. 362) Which of the following would you expect to earn just over 10 percent per year over the long term?

- A. Bonds
- B. Certificates of deposit
- C. Conservative portfolio
- D. Savings account
- E. Stocks**

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Asset allocation*

90. (p. 362) If you need access to your funds in less than one year, which of the following investments would be *least* appropriate?

- A. Cash
- B. Certificates of deposit
- C. Short-term government bonds
- D. Corporate bonds
- E.** Stocks and mutual funds

Stocks and bonds are appropriate if you can leave your investments for 5 - 10 years or more.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*

91. (p. 362) If you can leave your funds alone for 5 - 10 years or more, which of the following investments would be most appropriate?

- A. Cash
- B. Certificates of deposit
- C. Short-term government bonds
- D. Corporate bonds
- E.** Stocks and mutual funds

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*

92. (p. 362) As investors approach retirement age, they are often more interested in \_\_\_\_\_ portfolios.

- A. Aggressive
- B. International
- C. Cash
- D.** Conservative
- E. Growth-oriented

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*

93. (p. 363) Young investors are often more interested in \_\_\_\_\_ portfolios than older investors.

- A.** Aggressive
- B. Government bond
- C. Cash
- D. Conservative
- E. Safe mutual fund

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Asset allocation*

94. (p. 363) Some financial experts, such as Suze Orman, suggest that investors include a percentage of growth investments as part of their portfolio. This can be calculated by subtracting your age from:

- A. 50
- B. 95
- C. 100
- D.** 110
- E. 200

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Asset allocation*

95. (p. 363) When investing, an investor should NOT

- A. Evaluate potential investments
- B.** Let the investments manage themselves
- C. Monitor the value of investments
- D. Keep accurate records
- E. Consider tax consequences of selling investments

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investment process*

96. (p. 363) After you purchase an investment, you should
- A. Assume that your investment is tax-free
  - B. Monitor its value**
  - C. Ignore other potential investments
  - D. Leave recordkeeping to the financial advisor
  - E. Let the investment manage itself

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investment process*

97. (p. 363) When considering the value of your stock investments, it is important to
- A. Wait until you sell them to determine their value
  - B. Track the prices in the December copy of a financial magazine
  - C. Estimate their values based on similar stocks
  - D. Determine their values using the Internet or newspapers**
  - E. Assume that the values remain the same as long as you hold them

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investment process*

98. (p. 363) To maximize profit or reduce dollar losses when you sell your investments, it is important to do all of the following *except*:
- A. Keep purchase records.
  - B. Monitor current values.
  - C. Identify commissions or fees paid.
  - D. Keep a list of sources of information (such as Internet addresses) for reference.
  - E. Identify original cost after you sell the investment.**

*Bloom's: Comprehension*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Investment process*

99. (p. 364) When should you consider the tax consequences of selling your investments?

- A. When you make your own decisions
- B. When you have professional help
- C. When the taxes due are less than \$300 per transaction
- D.** Both A and B are correct
- E. Both B and C are correct

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investment process*

100. (p. 365) Which of the following is NOT a U.S. Treasury security?

- A. Treasury note
- B. Treasury bond
- C. Treasury Inflation-Protected Securities (TIPS)
- D.** Treasury stock
- E. Treasury bill

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government debt*

101. (p. 366) A discounted security means that the current price is trading at

- A. The face value
- B.** Less than the face value
- C. Greater than the face value
- D. The value at maturity
- E. The expected interest rate

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Debt*



102. (p. 366) Which of the following statements is false?

- A. The federal government sells bonds and securities to obtain financing.
- B. U.S. government Treasury securities carry a reduced risk of default when compared to corporate securities.
- C. U.S. Treasury securities offer lower interest rates than corporate bonds.
- D.** Individual investors who purchase treasury bills, notes, and bonds must hold the investments until maturity.
- E. Treasury securities may be purchased through banks or brokers.

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 4*  
*Topic: Government debt*

103. (p. 366) A government security issued in minimum units of \$100 with 4, 13, 26, or 52-week maturities is called a

- A. subordinated bond.
- B.** treasury bill.
- C. treasury note.
- D. treasury bond.
- E. savings bond.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government debt*

104. (p. 366) When comparing the interest rates for government securities, which of the following is correct?

- A. Treasury bonds < treasury bills < treasury notes
- B.** Treasury bills < treasury notes < treasury bonds
- C. Treasury notes < treasury bills < treasury bonds
- D. Treasury bills < treasury bonds < treasury notes
- E. Treasury bonds < treasury notes < treasury bills

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 4*  
*Topic: Government securities*

105. (p. 366) A government security issued in \$100 units with maturities of more than one year but not more than ten years is called a

- A. subordinated bond.
- B. treasury bill.
- C. treasury note.**
- D. treasury bond.
- E. savings bond.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government debt*

106. (p. 367) A government security issued in minimum units of \$100 with a 30-year maturity is called a

- A. subordinated bond.
- B. treasury bill.
- C. treasury note.
- D. treasury bond.**
- E. savings bond.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government debt*

107. (p. 367) A security issued by the U.S. Treasury that protects the investor from inflation is called a

- A. Treasury Note.
- B. TIPS.**
- C. SAFE.
- D. Treasury Bond.
- E. Treasury Bill.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government debt*

108. (p. 367) A bond backed by the full faith, credit, and unlimited taxing power of the government that issued it is called a \_\_\_\_\_ bond.

- A. debenture
- B. mortgage
- C. secured
- D. general obligation**
- E. revenue

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government debt*

109. (p. 367) A bond that is repaid from the income generated by the project it is designed to finance is called a(n)

- A. treasury bill.
- B. savings bond.
- C. revenue bond.**
- D. general obligation bond.
- E. agency bond.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 4*  
*Topic: Government debt*

110. (p. 367) A debt security issued by a state or local government is known as a

- A. Treasury bond
- B. Municipal bond**
- C. Corporate bond
- D. Subordinated bond
- E. Federal agency bond

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 4*  
*Topic: Government debt*

111. (p. 367) Which of the following features is a benefit for investors of municipal bonds?

- A. Interest may be tax-exempt at the federal level
- B. Interest may be tax-deductible at the federal level
- C. Face value may be tax-deductible at the state level
- D. Face value may be a tax-credit at the federal level
- E. All payments are tax-deductible at all governmental levels

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 4*  
*Topic: Municipal bonds*

112. (p. 368) The taxable equivalent yield for a municipal bond is calculated using

- A. The investor's tax rate and treasury bill yield
- B. Tax-exempt yield and current inflation rate
- C. Tax-exempt yield and the investor's tax rate
- D. Current inflation rate and number of years until maturity
- E. Tax-exempt yield and number of years until maturity

Taxable equivalent yield = tax-exempt yield / (1.0 - your tax rate)

*Bloom's: Application*  
*Difficulty: Hard*  
*Learning Objective: 4*  
*Topic: Municipal bonds*

113. (p. 368) Which of the following is NOT correct?

- A. The taxable equivalent yield is greater than the tax-exempt yield
- B. The taxable equivalent yield can be compared to the return on a taxable investment
- C. An investor can have a capital gain if he sells a municipal bond before maturity
- D. The taxable equivalent yield is calculated for municipal securities
- E. The tax exempt yield is primarily associated with federal government securities

Tax exempt yields are associated with municipal bonds.

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 4*  
*Topic: Municipal bonds*

114. (p. 368) Generally, interest on corporate bonds is paid every
- A. month.
  - B. three months.
  - C. six months.**
  - D. nine months.
  - E. year.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Corporate debt*

115. (p. 368) Corporations use bonds for
- A. Financing the ongoing business activities
  - B. When it is difficult to sell stock
  - C. To improve financial leverage
  - D. All of the above are correct**
  - E. None of the above are correct

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

116. (p. 368) Interest paid to corporate bond holders is
- A. Tax deductible for the investor
  - B. Tax deductible for the corporation**
  - C. Tax-exempt for the investor
  - D. Tax-exempt for the corporation
  - E. Tax deductible for both the investor and the corporation

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

117. (p. 368) The financially independent firm or individual that acts as the bondholders' representative is the
- A. chairman of the board.
  - B. president of the corporation.
  - C. debenture holder.
  - D. indenture holder.
  - E. trustee.**

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

118. (p. 370) Which of the following statements is correct?
- A. For the corporation, interest paid on corporate bonds is not tax deductible.
  - B. Bond financing is seldom used to pay for major corporate purchases.
  - C. Bonds are a form of debt financing.**
  - D. Bonds do not have to be repaid at maturity.
  - E. Interest payments to bondholders are at the discretion of the corporation.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

119. (p. 370) A bond that is backed only by the reputation of the issuing corporation is called a(n) \_\_\_\_\_ bond.
- A. debenture**
  - B. mortgage
  - C. indenture
  - D. preemptive
  - E. treasury

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

120. (p. 370) A corporate bond that is secured by various assets of the issuing firm is called a(n) \_\_\_\_\_ bond.

- A. debenture
- B. mortgage**
- C. indenture
- D. preemptive
- E. treasury

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

121. (p. 370) A bond that can be exchanged, at the owner's option, for a specified number of shares of the corporation's stock is called a(n) \_\_\_\_\_ bond.

- A. debenture
- B. mortgage
- C. indenture
- D. convertible**
- E. subordinated

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

122. (p. 370) Which of the following statements is true?

- A. Convertible corporate bonds are more secure than government bonds.
- B. Convertible bonds often pay 1 to 2 percent more interest than nonconvertible bonds.
- C. Because of the conversion feature, it is not necessary to evaluate convertible, corporate bonds.
- D. In reality, there is no guarantee that bondholders will convert to common stock even if the market value of the common stock does increase in value.**
- E. Even after convertible bondholders convert their investment to common stock, the bondholders still receive interest payments.

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

123. (p. 370) A call feature

- A. allows bondholders to convert their bonds to a specified number of shares of common stock.
- B. is not available for corporate bonds.
- C.** allows the corporation to buy outstanding bonds from current bondholders before the maturity date.
- D. is only available with government securities.
- E. is guaranteed by the corporation.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 5*

*Topic: Corporate bonds*

124. (p. 371) A fund to which annual or semiannual deposits are made for the purpose of redeeming a bond issue is called a(n) \_\_\_\_\_ fund.

- A. serial
- B.** sinking
- C. debenture
- D. indenture
- E. money

*Bloom's: Knowledge*

*Difficulty: Medium*

*Learning Objective: 5*

*Topic: Corporate bonds*

125. (p. 371) Bonds of a single issue that mature on different dates are called \_\_\_\_\_ bonds.

- A. debenture
- B. mortgage
- C. sinking fund
- D. subordinate
- E.** serial

*Bloom's: Knowledge*

*Difficulty: Medium*

*Learning Objective: 5*

*Topic: Corporate bonds*



126. (p. 371) Which of the following is NOT a rating agency for bonds?

- A. Moody's Investors Service.
- B. Bond Rating Corporation.**
- C. Standard & Poor's Corporation.
- D. Fitch Ratings Service.
- E. Mergent, Inc.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

127. (p. 372) Bond funds

- A. Allow investors to purchase individual corporate bonds.
- B. Are an indirect way of owning bonds issued by the governments and corporations.**
- C. Are not as diversified as individual bond purchases.
- D. Do not have professional management because they do not include stocks in the funds.
- E. Should be the primary investment for investors who have a very aggressive portfolio.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

128. (p. 372) Why do investors purchase corporate bonds?

- A. Dividend income
- B. Repayment at maturity
- C. Possible increase in value
- D. A & B are correct
- E. B & C are correct**

A is incorrect - investors purchase bonds for *interest* income.

*Bloom's: Analysis*  
*Difficulty: Hard*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

129. (p. 373) The type of bond that is tracked electronically by the issuing company is a
- A. General obligation bond
  - B. Registered bond**
  - C. Revenue bond
  - D. Tax-exempt bond
  - E. Zero-coupon bond

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

130. (p. 373) John Peterson purchased a bond at a price far below its face value, which makes no interest payments, and will be redeemed at its face value at maturity. In all likelihood, he purchased a(n) \_\_\_\_\_ bond.
- A. debenture
  - B. convertible
  - C. indenture
  - D. registered
  - E. zero-coupon**

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

131. (p. 373) The IRS requires that an investor in a zero-coupon bond report interest
- A. Only in the first year
  - B. Every year as it is earned**
  - C. When it is received
  - D. At maturity
  - E. Never since it is a zero-coupon

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

132. (p. 374) If overall interest rates in the economy rise, a corporate bond with a fixed interest rate will generally

- A. increase in value.
- B. decrease in value.**
- C. remain unchanged.
- D. become worthless.
- E. be returned to the corporation.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 5*

*Topic: Corporate bonds*

133. (p. 376) Which of the following securities are rated at various agencies?

- A. Treasury bills
- B. Treasury notes
- C. Corporate bonds**
- D. Treasury bonds
- E. TIPS

Municipal and corporate bonds are rated. U.S. government securities are not because they are risk free for practical purposes.

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 6*

*Topic: Bond rating*

134. (p. 351) If your monthly expenses total \$2,200, you should save at least \_\_\_\_\_ in an emergency fund before focusing completely on your investment portfolio.

- A. \$1,000
- B. \$2,200
- C. \$4,400
- D. \$6,600**
- E. \$10,000
- F. \$26,400

Minimum emergency fund = Monthly expenses  $\times$  3months.  $\$2,200 \times 3 = \$6,600$

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 1*  
*Topic: Emergency fund*

135. (p. 351) If your monthly expenses total \$2,600 you should save at least \_\_\_\_\_ in an emergency fund before focusing completely on your investment portfolio.

- A. \$1,000
- B. \$2,600
- C. \$5,200
- D. \$7,800**
- E. \$10,000
- F. \$31,200

Minimum emergency fund = Monthly expenses  $\times$  3months.  $\$2,600 \times 3 = \$7,800$

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 1*  
*Topic: Emergency fund*

136. (p. 363) According to some financial experts like Suze Orman, how much of an investment portfolio should a 30-year old have in growth investments?

- A. 30 percent
- B. 65 percent
- C. 70 percent
- D.** 80 percent
- E. 100 percent

Investments in growth investments =  $110 - \text{your age} \rightarrow 110 - 30 = 80\%$

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Asset allocation*

137. (p. 363) According to some financial experts like Suze Orman, how much of an investment portfolio should a 30-year old have in safe (non-growth) investments?

- A.** 20 percent
- B. 30 percent
- C. 70 percent
- D. 80 percent
- E. 100 percent

Investments in growth investments =  $110 - \text{age} \rightarrow 110 - 30 = 80\%$ . Therefore, safe (non-growth) investments =  $100\% - 80\% = 20\%$

*Bloom's: Application*  
*Difficulty: Hard*  
*Learning Objective: 3*  
*Topic: Asset allocation*

138. (p. 363) According to some financial experts like Suze Orman, how much of an investment portfolio should a 50-year old have in growth investments?

- A. 30 percent
- B. 40 percent
- C. 50 percent
- D. 60 percent**
- E. 70 percent

Investments in growth investments =  $110 - \text{age} \rightarrow 110 - 50 = 60\%$ .

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Asset allocation*

139. (p. 363) According to some financial experts like Suze Orman, how much of an investment portfolio should a 50-year old invest in safe (non-growth) investments?

- A. 30 percent
- B. 40 percent**
- C. 50 percent
- D. 60 percent
- E. 70 percent

Investments in growth investments =  $110 - \text{age} \rightarrow 110 - 50 = 60\%$ . Therefore, safe (non-growth) investments =  $100\% - 60\% = 40\%$

*Bloom's: Application*  
*Difficulty: Hard*  
*Learning Objective: 3*  
*Topic: Asset allocation*

140. (p. 368) You are considering an investment in a municipal bond that has a yield of 4.5 percent. Your tax rate is 25 percent. What is your taxable equivalent yield?

- A. 1.125 percent
- B. 3.375 percent
- C. 4.5 percent
- D. 5.625 percent
- E.** 6.0 percent

$$\text{Taxable equivalent yield} = \text{tax-exempt yield} / (1.0 - \text{tax rate}) = .045 / (1.0 - .25) = .06 = 6.0\%$$

*Bloom's: Application*

*Difficulty: Medium*

*Learning Objective: 4*

*Topic: Taxable equivalent yield*

141. (p. 368) You are considering an investment in a municipal bond that has a yield of 5.2 percent. Your tax rate is 25 percent. What is your taxable equivalent yield?

- A. 1.3 percent
- B. 3.9 percent
- C. 5.2 percent
- D. 6.5 percent
- E.** 6.9 percent

$$\text{Taxable equivalent yield} = \text{tax-exempt yield} / (1.0 - \text{tax rate}) = .052 / (1.0 - .25) = .0693 = 6.93\%$$

*Bloom's: Application*

*Difficulty: Medium*

*Learning Objective: 4*

*Topic: Taxable equivalent yield*

142. (p. 368) Assume that you purchase a \$1,000 bond issued by GE that pays 6 ¼ percent interest each year. What is the annual interest amount?

- A. \$6.25
- B. \$62.25
- C. \$62.40
- D. \$62.50**
- E. \$1000

Face amount  $\times$  annual interest rate =  $\$1,000 \times .0625 = \$62.50$  annual interest

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

143. (p. 368) Assume that you purchase a \$1,000 bond issued by Harley-Davidson that pays 7 percent interest each year, paid *semiannually*. What is the amount of each interest payment?

- A. \$3.50
- B. \$7.00
- C. \$35.00**
- D. \$70.00
- E. \$1000

Face value  $\times$  interest rate/2 =  $\$1000 \times .07/2 = \$35.00$

*Bloom's: Application*  
*Difficulty: Hard*  
*Learning Objective: 5*  
*Topic: Corporate bonds*



144. (p. 368) Assume that you purchase a \$1,000 bond issued by Kohls that pays 9 percent interest each year, paid *semiannually*. What is the amount of each interest payment?

- A. \$4.50
- B. \$9.00
- C. \$45.00**
- D. \$90.00
- E. \$1000

$$\text{Face value} \times \text{interest rate}/2 = \$1000 \times .09/2 = \$45.00$$

*Bloom's: Application*  
*Difficulty: Hard*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

145. (p. 373) What is the approximate market value of a bond that pays \$60 interest each year if interest rates have dropped to 4 percent?

- A. \$400
- B. \$600
- C. \$1000
- D. \$1500**
- E. \$2400

$$\text{Approximate market value} = \text{Dollar amount of annual interest}/\text{comparable interest rate} \rightarrow \\ \$60/.04 = \$1500$$

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

Chapter 11 - Investing Basics and Evaluating Bonds

146. (p. 375) If a bond is quoted in the newspaper at 92, what is its price?

- A. \$9.20
- B. \$92
- C. \$920**
- D. \$1,000
- E. \$1,092

Current price = bond price quotation  $\times$  face value  $\rightarrow 92\% \times \$1,000 = \$920$

*Bloom's: Application*

*Difficulty: Medium*

*Learning Objective: 6*

*Topic: Buying and selling bonds*

147. (p. 375) If a bond is quoted in the newspaper at 102, what is its price?

- A. \$1.02
- B. \$10.20
- C. \$102.00
- D. \$1,000
- E. \$1,020**

Current price = bond price quotation  $\times$  face value  $\rightarrow 102\% \times \$1,000 = \$1,020$

*Bloom's: Application*

*Difficulty: Medium*

*Learning Objective: 6*

*Topic: Buying and selling bonds*

148. (p. 377) Gwendolyn Francis is interested in buying a bond that pays \$80 annually. The current price of the bond is \$600. What is her current yield?

- A. 6 percent
- B. 7.5 percent
- C. 8 percent
- D. 12 percent
- E.** 13.3 percent

Current yield = annual interest amount/current price  $\rightarrow 80/600 = .1333 = 13.33\%$

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 6*  
*Topic: Bond yield*

#### **Essay Questions**

149. (p. 350) What factors should be considered before making your first investment?

Before beginning an investment program, your financial affairs should be in good shape. Specifically, the following factors should be considered:

- Work to balance your budget.
- Obtain adequate insurance protection.
- Start an emergency fund.
- Have access to other sources of cash for emergency.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 1*  
*Topic: Financial Checkup*

150. (p. 351) Describe the steps you can take to survive a financial crisis.

Seven steps include:

1. Establish a larger than usual emergency fund.
2. Know what you owe.
3. Reduce spending.
4. Pay off credit cards.
5. Apply for a line of credit at your bank, credit union, or financial institution.
6. Notify credit card companies and lenders if you are unable to make payments.
7. Monitor the value of your investment and retirement accounts.

Overall, don't panic!

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 1*  
*Topic: Financial crisis*

151. (p. 351) Paul Paulson recently heard about layoffs at his company. What are at least three steps he can take to make sure his financial affairs are in order?

Student answers should include three of the following seven steps:

1. Establish a larger than usual emergency fund.
2. Know what you owe.
3. Reduce spending.
4. Pay off credit cards.
5. Apply for a line of credit at your bank, credit union, or financial institution.
6. Notify credit card companies and lenders if you are unable to make payments.
7. Monitor the value of your investment and retirement accounts.

Overall, don't panic!

*Bloom's: Comprehension*  
*Difficulty: Hard*  
*Learning Objective: 1*  
*Topic: Financial crisis*

152. (p. 356) Contrast a safe investment with a speculative investment. Include at least one example of each.

A safe investment is one that has a very small chance that it will become worthless. Examples include government bonds, savings accounts, certificates of deposit, and certain corporate bonds, stocks, and mutual funds. Real estate may also be a very safe investment.

A speculative investment is one that has a high-risk and is made in the hope of earning a relatively large profit in a short time. Examples include speculative stocks, certain bonds, some mutual funds, some real estate, commodities, options, precious metals, precious stones, and collectibles.

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Investments*

153. (p. 356) As a person ages, his or her investment choices may change. Why?

As people approach retirement, they may choose more conservative investments because they have a lower chance of losing a large part of their nest egg than with speculative investments.

*Bloom's: Comprehension*

*Difficulty: Easy*

*Learning Objective: 2*

*Topic: Investments*

154. (p. 358) Paul Paulson is thinking about investing in some securities. What are the four main risk components he should consider?

The four components include

1. Inflation risk - the reduction in buying power.
2. Interest rate risk - changes in the value of investments when interest rates change.
3. Business failure risk - the possibility that bad management, unsuccessful products, competition, or other factors will cause the business to be less profitable than originally anticipated.
4. Market risk - fluctuations in the market price for stocks and bonds that are due to political or social conditions.

*Bloom's: Knowledge*  
*Difficulty: Hard*  
*Learning Objective: 2*  
*Topic: Risk*

155. (p. 359) The text discusses investment income, growth, and liquidity. Discuss these in terms of investment types and objectives.

- Investment income is most often affiliated with conservative investments such as passbook savings accounts, certificates of deposit and securities issues by the United States government. These also provide the most predictable sources of income.
- Investment growth means that the investments will increase in value. These companies generally pay little or no dividend; instead, they choose to use their earnings to finance future growth.
- Investment liquidity refers to the ability to buy or sell an investment quickly without substantially affecting the investment's value. Examples include interest-bearing checking and savings accounts.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 2*  
*Topic: Investments*

156. (p. 359) Contrast the types of investments typically chosen for the following two investors:

- a. Retired couple with \$850,000 in retirement savings
- b. A 25-year old single investor with a secure high paying job

The young investor would likely choose to invest in growth investments and possibly some speculative investments. The retired couple would be more conservative and invest in income investments.

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investments*

157. (p. 361) Describe asset allocation and its importance.

Asset allocation is the process of spreading your assets among several different types of investments to lessen risk. It allows an investor to diversify and avoid the risks associated with having all funds in one security. Assets can be invested in conservative or aggressive portfolios.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 3*  
*Topic: Asset allocation*

158. (p. 361) Assume that you are a young investor earning a high salary in a secure job. Suggest an investment portfolio for your retirement funds. Include the percentages you would consider investing in each of the various investment classes you listed.

Student answers will vary. However, they should be similar to the aggressive or very aggressive portfolio shown in Exhibit 11-4.

The aggressive portfolio consists of

65 - 70 percent stocks and mutual funds

20 - 25 percent bonds and CDs

5 - 15 percent cash and equivalents

The very aggressive portfolio consists of

80 - 100 percent stocks and mutual funds

0 - 10 percent bonds and CDs

0 - 10 percent cash and equivalents

*Bloom's: Comprehension*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*

159. (p. 363) Using suggestions from financial experts like Suze Orman, calculate the amount of your assets that should be invested in growth investments as well as the amount to be invested in safer, conservative investments. Identify your assumptions and show your work.

Answers will vary based on the students' ages. Recall that experts suggest:

110 - Age = Percentage of assets in growth investments.

100 - percent Growth investments = assets in safer, conservative investments.

*Bloom's: Application*

*Difficulty: Medium*

*Learning Objective: 3*

*Topic: Asset allocation*



160. (p. 363) Successful investors evaluate their investments and do not let their investments manage themselves. What are at least two specific factors you can consider to be successful as an investor?

Some factors are:

- Evaluate potential investments
- Monitor the value of investments
- Keep accurate records
- Consider tax consequences of selling investments

*Bloom's: Comprehension*  
*Difficulty: Medium*  
*Learning Objective: 3*  
*Topic: Investment process*

161. (p. 367) Compare and contrast treasury securities and municipal securities.

Both are considered safe, or conservative, investments.

Both are government bonds, written pledges of the government or municipality to repay a specified sum of money, along with interest.

Both are securities issued by governments: Treasuries are at the federal level. Municipals are at the state or local level.

Both can be held until maturity or sold before maturity.

Municipal bonds may be exempt from federal taxes.

*Bloom's: Knowledge*  
*Difficulty: Medium*  
*Learning Objective: 4*  
*Topic: Government bonds*

162. (p. 366 - 367) What is the difference between a U.S. government treasury bill, treasury note, and treasury bond?

Treasury bills, sometimes called T-bills, are issued in minimum units of \$100 with 4, 13, 26, and 52-week maturities. Treasury notes are issued in \$100 units with maturities that are more than one year but not more than ten years. Treasury bonds are issued in minimum units of \$100 with a 30-year maturity.

Feedback: This is similar to self-test problem #2.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 4*  
*Topic: Government bonds*

163. (p. 368) Cliff Clarkson is 70 years old and wants to diversify his investment portfolio. He must decide if he should invest in tax-free municipal bonds or in corporate bonds. The tax-free bonds are highly rated and pay 4.5 percent. The corporate bonds are more speculative and pay 7.0 percent

- a. If Cliff is in the 33 percent tax bracket, what is the taxable equivalent yield for the municipal bond?
- b. If you were Cliff, would you choose the municipal bonds or the corporate bonds? Justify your answer.

- a. Taxable equivalent yield = tax-exempt yield / (1.0 - tax rate)  $\rightarrow .045 / (1 - .33) = .0672 = 6.72\%$
- b. The municipal bonds have a lower taxable equivalent yield, so the corporate bonds provide a higher return. However, the corporate bonds are speculative, so if Cliff is more interested in security, he should consider the municipal bonds.

*Bloom's: Evaluation*  
*Difficulty: Hard*  
*Learning Objective: 4*  
*Topic: Taxable equivalent yield*

164. (p. 368 - 369) Define three of the six terms presented below:

- a. corporate bond
- b. bond indenture
- c. trustee
- d. mortgage bond
- e. debenture bond
- f. convertible bond

(A) A corporate bond is a corporation's written pledge that it will repay a specified amount of money, with interest;

(B) A bond indenture is a legal document that details all of the conditions relating to a bond issue;

(C) A trustee is a financially independent firm that acts as the bondholders' representative;

(D) A mortgage bond is a corporate bond that is secured by various assets of the issuing firm;

(E) A debenture bond is a bond that is backed only by the reputation of the issuing corporation;

(F) A convertible bond is a bond that can be exchanged, at the owner's option, for a specified number of shares of the corporation's common stock.

*Bloom's: Knowledge*

*Difficulty: Easy*

*Learning Objective: 5*

*Topic: Corporate bonds*

165. (p. 373) Timothy Calibe is interested in purchasing an ABC bond that pays \$70 interest per year. However, similar bonds pay interest of 9 percent. Approximately how much should Timothy be willing to pay for his ABC bond?

Approximate market value = Dollar value of annual interest/Comparable interest rate →  
 $\$70/.09 = \$777.78$

*Bloom's: Application*

*Difficulty: Medium*

*Learning Objective: 5*

*Topic: Corporate bonds*

166. (p. 373) Marissa Christianson is interested in purchasing an XYZ bond that pays \$70 interest per year. However, similar bonds pay interest of 5 percent. Approximately how much should Marissa be willing to pay for her XYZ bond?

Approximate market value = Dollar value of annual interest/Comparable interest rate →  
 $\$70/.05 = \$1,400.00$

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

167. (p. 374) Rebecca Gladlyn is interested in purchasing an XYZ bond that pays 7 percent interest each year. The interest will be paid *semiannually*. How often should Rebecca receive interest? What amount should she receive?

Semiannual payments will be paid every six months.

Her interest payment will be Face value × interest rate/2 payments per year. →  $\$1000 \times 7\%/2 = \$35$ .

*Bloom's: Application*  
*Difficulty: Easy*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

168. (p. 374) Rebecca Gladlyn is interested in purchasing an LMN bond that pays 8.5 percent interest each year. The interest will be paid *semiannually*. How often should Rebecca receive interest? What amount should she receive?

Semiannual payments will be paid every six months.

Her interest payment will be Face value × interest rate/2 payments per year. →  $\$1000 \times 8.5\%/2 = \$42.50$ .

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 5*  
*Topic: Corporate bonds*

169. (p. 374) Identify at least one advantage of investing in a corporate bond.

- Bonds are safer than stock because bonds pay interest (required payments); stocks pay dividends only if they choose to do so. If a corporation does not pay interest on its bonds, it can be forced into bankruptcy.

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 6*  
*Topic: Corporate bonds*

170. (p. 375) If a bond is quoted at a price of 105, what is its current price?

Current price = Bond price quotation  $\times$  face value.  $\rightarrow 105\% \times \$1000 = \$1,050$

*Bloom's: Application*  
*Difficulty: Easy*  
*Learning Objective: 6*  
*Topic: Buying or selling bonds*

171. (p. 376) List five items that appear in a corporate bond quote.

Possible answers include:

- Corporation name
- Price
- Coupon
- Maturity date
- Yield to maturity
- Current yield
- Fitch ratings (or other agency)
- Coupon payment frequency
- First coupon date
- Type (corporate)
- Callable

*Bloom's: Knowledge*  
*Difficulty: Easy*  
*Learning Objective: 6*  
*Topic: Bond ratings*

172. (p. 376) You are trying to evaluate two bond issues. One bond issue is rated "A" by Moody's; the other is rated "B." How important are the bond ratings issued by Moody's Investors Service? Based on your answer, would you purchase the "A" bond or the "B" bond?

To determine the quality and risk associated with bond issues, investors rely on the bond ratings provided by Moody's. Moody's ranks thousands of corporate and municipal bond issues. As illustrated in Exhibit 11.7, bond ratings generally range from ratings Aaa (the highest) to C (the lowest). For Moody's, the first four individual ratings (Aaa through Baa) represent investment-grade securities. Bonds in the next two ratings (Ba and B) are considered speculative in nature. Finally, the C category is used to rank bonds that may be in default because of poor prospects of repayment or even continued payment of interest. Students may choose the A bond or the B bond as part of their answer to this question. They should also provide some justification for their answer.

*Bloom's: Knowledge*  
*Difficulty: Hard*  
*Learning Objective: 6*  
*Topic: Bond ratings*

173. (p. 377) Marissa Christianson is interested in buying a bond whose interest rate is 7 percent and current quote is 105. What is her current yield?

Current price = quote  $\times$  face value = 105%  $\times$  \$1000 = \$1050.

Current yield = annual interest amount/current price  $\rightarrow$  7%  $\times$  1000/1050 = .0667 = 6.67%.

*Bloom's: Application*  
*Difficulty: Hard*  
*Learning Objective: 6*  
*Topic: Bond yield*

174. (p. 375) Cliff Clarkson is interested in buying a bond that pays \$80 annually. The current quote is 60. What is his current yield?

Current price = quote  $\times$  face value = 60%  $\times$  \$1000 = \$600.

Current yield = annual interest amount/current price  $\rightarrow$  80/600 = .1333 = 13.33%.

*Bloom's: Application*  
*Difficulty: Medium*  
*Learning Objective: 6*  
*Topic: Bond yield*