

Chapter 12 Investing in Stocks

True / False Questions

1. Many people do not know where to get the information they need to evaluate potential investments.

True False

2. Stocks are guaranteed to have large returns.

True False

3. Since 1926, the average annual return for stocks is just over 12 percent as measured by the Standard & Poor 500 stock index.

True False

4. Stocks are equity financing.

True False

5. Companies need to repay money from equity financing.

True False

6. Sandy has invested in a stock. She is assured of receiving a dividend.

True False

7. In 2009, many companies had substantially lower earnings. When companies have experienced low earnings, they may choose to reduce or omit their dividends.

True False

8. Preferred stockholders elect the board of directors.

True False

9. Dividends must be in cash.

True False

10. If the record date is Friday, April 7, the ex-dividend date is Tuesday, April 11.

True False

11. If Jodi owns 200 shares of stock, a 2-for-1 stock split will double the value of her holdings.

True False

12. Many people purchase investments without doing any research.

True False

13. Before investing in a company's stock, an investor should analyze the industry in which the company operates.

True False

14. A micro cap stock is one issued by a company that has a capitalization of \$500 million or less.

True False

15. A midcap stock is one issued by a company that has a capitalization of up to \$250 million.

True False

16. The Internet provides many valid sources of stock information.

True False

17. The Yahoo! Finance Web site provides company-specific news, quotes, and charts.

True False

18. The level of detail of financial reports found on the Yahoo! Finance Web site is greater than at a stock advisory service such as Value Line.

True False

19. An investor can rely completely on the findings of a stock advisory service in order to make decisions about buying or selling stocks.

True False

20. A prospectus is sent annually to stockholders.

True False

21. Many analysts believe that a corporation's ability or inability to generate dividends in the future may be one of the most significant factors that accounts for an increase or decrease in the value of a stock.

True False

22. Corporate earnings are reported in the firm's annual report.

True False

23. Earnings per share equals the corporation's after-tax earnings divided by the number of outstanding shares of a firm's common stock.

True False

24. It is appropriate to compare the profitability of two companies using their earnings per share.

True False

25. The total return can only be calculated if a company pays dividends.

True False

26. The book value of a stock is equal to the result of total assets less total liabilities divided by the number of outstanding shares of common stock.

True False

27. The market value must be higher than the book value.

True False

28. If you purchase stock from your cousin Sam, you are buying stock on the primary market.

True False

29. Buying 100 shares of stock in an IPO is a primary market transaction.

True False

30. The NYSE lists stocks for nearly 40,000 companies.

True False

31. Any company's stock can be listed on the NYSE.

True False

32. Most securities that are considered "over-the-counter" are traded through the NYSE.

True False

33. Joseph has been Leon's account executive for several years. Leon has been questioning Joseph's integrity because it appears as though Joseph might be churning. If Leon wants to take formal action about his concern, he likely will be required to use an arbitration board.

True False

34. A.J. wants to buy a stock at its current market value. He should use a market order.

True False

35. Kenny wanted to sell his stock at a specified price or higher. He should use a stop order.

True False

36. The execution of a limit order will be the highest priority if and when the specified price is reached.

True False

37. If you want to guarantee that your order to sell a stock will be executed, you should place a stop order instead of a limit order.

True False

38. Typically, the commission paid for a stock sale will be lower with a full-service broker than for an online brokerage firm.

True False

39. Glen bought GE stock on November 8, 2007 at a price of \$39.20 and then sold it on March 19, 2009 at \$11.20. Glen can be classified as a speculator.

True False

40. Gloria bought GE stock on March 4, 2009 at a price of \$5.87 and then quickly sold it on March 19, 2009 at \$11.20. Gloria is classified as a speculator.

True False

41. An investor must be classified as using the long-term buy-and-hold technique in order to receive dividends.

True False

42. An example of dollar cost averaging is an employee purchasing shares of his or her company's stock through a payroll deduction as part of a retirement plan.

True False

43. The main goal of dollar cost averaging is buying high and selling low.

True False

44. Either you can take advantage of dollar cost averaging, or you can use a direct investment plan.

True False

45. Long-term investing techniques are generally more risky than short-term investing techniques.

True False

46. An investor may receive a margin call when selling stock short.

True False

47. A put option is the right to buy 100 shares of stock at a guaranteed price before a specified expiration date.

True False

Multiple Choice Questions

48. Which of the following is *incorrect*?

- A. There is no substitute for researching a potential investment.
- B. Beginning investors sometimes worry that they won't know what the information they find about stocks really means.
- C. Some investors do not know where to get the information they need to evaluate potential investments.
- D. The amount of information available about stocks is limited.
- E. All of the above statements are correct.

49. Since 1926, the average annual return for stocks has been about _____

- A. 8 percent
- B. 10 percent
- C. 12 percent
- D. 14 percent
- E. 16 percent

50. Amanda wants to be part of the ownership for a corporation. She should invest in

- A. Bonds
- B. Common stock
- C. Dividends
- D. A savings account
- E. A proxy

51. Another name for equity financing is money received from the sale of

- A. Bonds
- B. Common stock
- C. Dividends
- D. A savings account
- E. A proxy

52. A distribution of money, stock, or other property that is paid to owners of a company is called a

- A. Bond
- B. Common stock
- C. Dividend
- D. Savings account
- E. Proxy

53. A legal form that requests that owners transfer their voting rights to individual(s) is called a

- A. Bond
- B. Common stock
- C. Dividend
- D. Savings account
- E. Proxy

54. All of the following statements are correct *except*

- A. Dividends are paid out of profits.
- B. Dividend payments must be approved by the stockholders.
- C. A dividend can be a distribution of money, but it can also be stock or other property.
- D. Dividends are not mandatory.
- E. Utility companies typically distribute a higher percent of earnings than rapidly growing firms.

55. Alberta owns 100 shares of stock of ABC Company and Bobby owns 200 shares of the same stock. If ABC Company pays a \$5 dividend to all stockholders with a record date of Friday, June 15, then

- A. Alberta will receive the same amount as Bobby if they owned the stock two business days before the record date
- B. Both will receive the dividend as long as they sell their stock three days before the record date
- C. Alberta will receive half as much as Bobby if they owned the stock two business days before the record date
- D. Both will receive the dividend if they bought the stock on the record date
- E. Alberta and Bobby will receive the same amount if they bought the shares at least one month before the record date

56. If you own stock, you may receive income from

- A. Dividends
- B. Appreciation in stock value
- C. Possible increase in stock price due to stock splits
- D. Two of the above are correct
- E. All of the above are correct

57. MNOP, Inc declared a \$1.00 dividend with a record date of Thursday, September 15 and a payment date of Thursday, October 20. Cheri wants to purchase stock and receive the dividend. What is the *latest* date that she needs to have purchased the stock in order to receive the dividend?

- A. September 12
- B. September 13
- C. September 15
- D. September 19
- E. October 18

58. MNOP, Inc declared a \$1.00 dividend with a record date of Thursday, September 15 and a payment date of Thursday, October 20. Cheri does NOT want receive this current dividend. What is the *earliest* date that she should purchase the stock in order to avoid receiving the dividend?

- A. September 12
- B. September 13
- C. September 15
- D. October 18
- E. October 20

59. Why does a company split its stock?

- A. The stock is trading at a low price, and the company wants to increase its stock value
- B. It wants fewer shares outstanding
- C. The stock is trading at a high price, and the company wants to bring the price in line with a theoretical ideal range
- D. It wants the total market capitalization to be lower than the current level
- E. The company wants to guarantee that the stock price will increase

60. Which of the following statements about stock splits is correct?

- A. If a company has a 2-for-1 split, the price will be doubled
- B. If a company has a 3-for-1 split, the price will increase by a factor of three
- C. If a company has a 4-for-1 split, the new number of shares will be four times as many as before the split
- D. If a company has a 5-for-1 split, the new number of shares will be equal to the old number of shares divided by 5
- E. None of the above is correct

61. Which of the following is NOT correct regarding preferred stock?

- A. Preferred stocks are considered to be safer investments than common stocks
- B. Corporations that own preferred stock receive a tax break for their dividend income
- C. Owners of preferred stock receive cash dividends before common stockholders receive their dividends
- D. The dollar amount of the dividend on preferred stock is known before the stock is purchased
- E. The yield on preferred stocks is often much higher than the yield on bonds

62. Daniel wants to invest in a security that can be converted to a different one that provides ownership in a company. What does he want to invest in?

- A. Dividends
- B. Convertible common stock
- C. Proxies
- D. Convertible preferred stock
- E. Stock splits

63. Megan decided to start investing in stocks. Which of the following should she do first?

- A. Base her investing decisions on hot tips she hears at work
- B. Buy stocks based solely on her stockbroker's recommendation
- C. Choose stocks based on a recommendations from her family members
- D. Pick stocks at random
- E. Research the corporations she is interested in as well as their industries

64. Which of the following statements is correct?

- A. The Internet is not to be trusted as a reliable source to evaluate potential investments.
- B. Individual company websites usually charge for access to their own financial reports.
- C. The Internet provides Web sites that may be more up to date and thorough than printed materials.
- D. Web sites like Yahoo! Finance are not dependable.
- E. None of the above is correct.

65. A safe investment that generally attracts conservative investors is called a(n) _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

66. An investment that pays higher than average dividends is called a(n) _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

67. A stock that typically sells for less than \$1 per share is called a(n) _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

68. A stock issued by a corporation that has a capitalization of between \$2 and \$10 billion is called a(n) _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

69. A stock issued by a company that has a capitalization of \$250 million or less is called a _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

70. Cliff retired ten years ago and wants to still own a few stocks. Dividends are important to him, but so is growth. He is most interested in stocks that are safe investments. He should purchase _____ stocks.

- A. Blue chip
- B. Cyclical
- C. Micro Cap
- D. Midcap
- E. Penny

71. Patrick graduated from college five years ago. He has set up an emergency fund and has been paying off his student loans. In addition, he participates in the retirement plan offered by his employer. He wants to take \$75 per month and invest it in very small companies (capitalization of \$250 million or less). He should purchase _____ stocks.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

72. Which of the following is some of the information found on a financial Web site such as www.finance.yahoo.com?

- A. Company name, last price, target price, price change
- B. 52 week price range, number of shares traded (volume)
- C. Market capitalization
- D. Dividend paid and yield
- E. All of the information is included

73. Which of the following usually offers some free information and charges for more detailed information you may need to evaluate a stock investment?

- A. Financial Web sites such as www.finance.yahoo.com
- B. Personal finance Web sites such as www.smartmoney.com
- C. Professional advisory services such as Standard & Poor's Financial Information Services
- D. Search engines such as Yahoo!
- E. Securities and Exchange Commission Web site

74. Which of the following is true?

- A. Mergent's Handbook of Common Stocks is a misnomer because it only analyzes industries.
- B. Standard & Poor's reports are available only in the Internet.
- C. Stock advisory services include printed detailed financial reports.
- D. Value Line is the only reliable stock advisory service used by investors.
- E. All of the above are correct.

75. Financial reports from advisory services include all of the following sections *except*

- A. Stock prices, earnings and dividends
- B. Business summary
- C. Prospects section
- D. Financial Data
- E. All of the above are included in financial reports.

76. Annual reports

- A. Are available from the company for a fee
- B. Are available only to current stockholders
- C. Include the same information as a prospectus
- D. Must be sent to all stockholders on an annual basis
- E. Include estimated financial data only

77. Which of the following is correct?

- A. Earnings are a minor factor in determining the value of a stock.
- B. Corporate earnings are reported in the proxy statement.
- C. Earnings per share uses the price of the stock in the calculation.
- D. The best calculation to use to compare the profitability of two companies is EPS.
- E. The price/earnings ratio is the price of a share of stock divided by the corporation's earnings per share of stock.

78. The earnings per share equals

- A. Total before-tax earnings divided by number of shares of preferred stock
- B. Total before-tax earnings divided by number of shares of common stock
- C. Total after-tax earnings divided by number of shares of preferred stock
- D. Total after-tax earnings divided by number of shares of common and preferred stock
- E. None of the above

79. When analyzing a price-earnings ratio,

- A. A higher price-earnings ratio indicates pessimism because the price is too high compared to the earnings.
- B. The higher the price-earnings ratio, the more investors are paying for earnings.
- C. A low ratio indicates that investors expect higher earnings in the future.
- D. Price-earnings ratios are helpful when comparing two companies in the same industry, but not to the market in general.
- E. The price-earnings ratio provides enough information to allow an investor to decide whether or not to invest in a particular stock.

80. Which of the following is based on historical numbers?

- A. Earnings
- B. Earnings per share
- C. Price-earnings ratio
- D. All of the above
- E. None of the above

81. If you want to compare two companies, you should use

- A. Book value per share
- B. Earnings per share
- C. Price per share
- D. Net income
- E. Price-earnings ratio

82. Which of the following is a profitability ratio that uses the number of outstanding shares in the calculation?

- A. Book value
- B. Earnings per share
- C. Price per share
- D. Net income
- E. Price-earnings ratio

83. This ratio uses the market price per share of the stock and the earning per share for the last year.

- A. Book value per share
- B. Earnings per share
- C. Market price per share
- D. Net income
- E. Price/earnings ratio

84. Which of the following changes would NOT cause analysts to change estimates for a healthcare corporation?

- A. Interest rates
- B. Unemployment rates
- C. The economy in general
- D. Industry
- E. Weather

85. This calculation uses the annual amount of money paid to investors from the company.

- A. Book value
- B. Dividend yield
- C. Earnings per share
- D. Market value
- E. Price-earnings ratio

86. This equals $(\text{Assets} - \text{Liabilities}) / \text{Shares outstanding}$

- A. Book value
- B. Dividend yield
- C. Earnings per share
- D. Market value
- E. Price-earnings

87. This calculation includes the annual dividends in dollars and the increase in the purchase price of the investment.

- A. Book value
- B. Capital gain
- C. Market value
- D. Price-earnings
- E. Total return

88. Total return equals

- A. Dividend yield
- B. Annual dividends in dollars plus capital gains
- C. Capital gains
- D. Annual dividends in dollars less capital gains
- E. Capital gains less annual dividends in dollars

89. Dividend yield equals

- A. Annual dividend amount/price per share
- B. Quarterly dividend amount/price per share
- C. Annual dividend amount/book value per share
- D. Quarterly dividend amount/book value per share
- E. Annual dividend amount/earnings per share

90. Book value equals

- A. $(\text{Assets} + \text{Liabilities}) / \text{Number of shares outstanding}$
- B. $(\text{Liabilities} - \text{Assets}) / \text{Number of shares outstanding}$
- C. $(\text{Assets} + \text{Liabilities}) / \text{Earnings per share}$
- D. $(\text{Liabilities} + \text{Assets}) / \text{Price-earnings ratio}$
- E. $(\text{Assets} - \text{Liabilities}) / \text{Number of shares outstanding}$

91. Abe was contacted by XYZ's _____ when XYZ wanted to sell new securities to the general public for the first time.

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

92. Stephen wanted to become one of the owners of GHI Corp. when it finally was available to the investors who were not directly affiliated with the company. He participated in the _____

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

93. Kelly bought some stock using an intermediary from the issuer of those securities. She bought her shares on the _____

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

94. Patrick sold his GE shares using his online broker. One can say that he sold them on the _____

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

95. Jake wanted to buy and sell various stocks on the NYSE. He was using one of the largest _____ in the world.

- A. Initial public offerings
- B. Investment banks
- C. Primary markets
- D. Secondary markets
- E. Securities exchanges

96. A marketplace where member brokers who represent investors meet to buy and sell securities is called a(n) _____

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

97. NYSE is an example of a(n) _____.

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

98. NYSE stands for

- A. New York Securities Exchange.
- B. New York Stock Exchange.
- C. New York School of Engineering.
- D. Never Yet So Even.
- E. New Year Selling Exchange.

99. Mohammad was interested in purchasing low value securities that were not listed on the NYSE. He probably used _____ to complete his transaction.

- A. An initial public offering
- B. An investment bank
- C. The over-the-counter market
- D. A primary market
- E. The securities exchange commission Web site

100. The licensed individual who buys or sells investments for his or her clients is called a(n)

- _____
- A. Account executive
 - B. Account investor
 - C. Online executive
 - D. Market maker
 - E. Both A and B are correct

101. Peter is a Nasdaq dealer who matches buy and sell orders for Ford. He is known as a(n)

- _____
- A. Account executive
 - B. Account investor
 - C. Discount broker
 - D. Full-service broker
 - E. Market maker

102. Excessive buying and selling of securities to generate commissions is called

- A. Churning
- B. Flipping
- C. Marketing
- D. Prospecting
- E. Scamming

103. Claudia is a licensed individual who buys or sells investment for her clients. Which of the following is NOT correct?

- A. She is an account executive
- B. She should NOT use her discretion without her client's approval
- C. She should focus on churning for her clients
- D. She should provide information and advice to be used in evaluating potential investments
- E. All of the above are correct

104. Terry wants to begin investing and needs some guidance because he is uncomfortable making investment decisions. He should use a(n)

- A. Discount broker
- B. Full-service broker
- C. Market Maker
- D. Online broker
- E. None of the above are correct

105. Tammy feels quite comfortable trading her own stocks using a computer. She should use a(n)

- A. Discount broker
- B. Full-service broker
- C. Market Maker
- D. Online broker
- E. All of the above are correct

106. Tanya understands the "how to" of researching stocks and likes to make her own decisions. However, she is not comfortable using the Internet to trade stocks. She should use a(n)

- A. Discount broker
- B. Full-service broker
- C. Market Maker
- D. Online broker
- E. All of the above are correct

107. Avery is thinking about using the computer to do his investing. He should ask all of the following questions *except*

- A. Can I manage my own investments closely?
- B. Do I have sufficient computer capability?
- C. How large is my investment portfolio?
- D. None of these questions is appropriate.
- E. All of these questions are appropriate to ask.

108. Mallory wants to purchase stock at the current market price. She should use a

- A. Current sale order
- B. Limit order
- C. Market order
- D. Stop order
- E. Stop-loss order

109. Devin wants to purchase DEF stock for \$40.00 or less. He should use a

- A. Current sale order
- B. Limit order
- C. Market order
- D. Stop order
- E. Stop-loss order

110. Gavin has owned MNOP stock for several years and has seen the stock increase in value from \$20 to \$35. He wants to "lock in" his gains, so he needs to place an order that will sell his stock at the next available opportunity after its market price drops to \$33. What kind of order should he use?

- A. Current sale order
- B. Limit order
- C. Market order
- D. Stop-loss order
- E. None of the above

111. Ethan wants to purchase some stock for the first time. Which of the following is correct?

- A. His account executive should be encouraged to churn Ethan's account to maximize his return.
- B. He should use an online broker to get specific advice about purchasing stock.
- C. His purchase price will exactly equal the number of shares he purchases times the price per share and is known in advance.
- D. If he uses a market order, he can lock in the price at which he wants to buy the stock.
- E. His commission should be lower at an online broker than at a full-service broker.

112. If you bought a stock on June 15, 2008 and sold it on July 15, 2009, you would likely be classified as a(n)

- A. Speculator
- B. Trader
- C. Investor
- D. Two of the above are correct
- E. All of the above are correct

113. If you bought a stock on July 1, 2009 and sold it on July 15, 2009, you may be a(n)

- A. Speculator
- B. Trader
- C. Investor
- D. Two of the above are correct
- E. All of the above are correct

114. Brenda purchases stock and never plans to sell them. She could be considered to be using a _____

- A. Buy-and-hold technique
- B. Direct investment plan
- C. Direct reinvestment plan
- D. Dollar cost averaging technique
- E. Margin technique

115. Marissa purchases \$500 of stock from a corporation without having to use an account executive or a brokerage firm. She is using a _____

- A. Buy-and-hold technique
- B. Direct investment plan
- C. Direct reinvestment plan
- D. Dollar cost averaging technique
- E. Margin technique

116. Rebecca owns stock that pays a dividend. She does not want the cash now; instead, she would prefer to have more shares of stock. She should use a _____

- A. Buy-and-hold technique
- B. Direct investment plan
- C. Dividend reinvestment plan
- D. Dollar cost averaging technique
- E. Margin technique

117. Timothy has \$100 automatically invested in a stock each month. This way, he doesn't buy high and sell low. He is using a _____

- A. Buy-and-hold technique
- B. Direct investment plan
- C. Direct reinvestment plan
- D. Dollar cost averaging technique
- E. Margin technique

118. Faye sometimes borrows money from her broker to buy her stock. She is buying

- A. A call option
- B. A direct investment
- C. On margin
- D. A put option
- E. A short sale

119. Investors who earn larger returns because they borrow part of the money needed to buy a particular stock are using which of the following techniques?

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. Selling short

120. If you buy or sell with this technique, you may be required to pledge additional collateral or cash for a loan.

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. Selling short

121. Ben borrowed some securities from his broker and planned to replace them at a later date. Which of the following strategies did he use?

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. Selling short

122. Which of the following is correct?

- A. The broker pays you interest on money borrowed to purchase stock on margin.
- B. Selling short is the opposite of buying long.
- C. A put option is the right, but not the obligation to purchase a stock at a specified price by a given date.
- D. A brokerage firm receives double its commission when stock is bought and sold when the investor is selling short.
- E. If the stock price increases and you purchased stock on margin, you may receive a margin call.

123. Which of the following is NOT correct?

- A. You pay interest on money borrowed to purchase stock on margin.
- B. Selling short is the opposite of buying long.
- C. A call option is the right, but not the obligation to purchase a stock at a specified price by a given date.
- D. A brokerage firm receives double its commission when stock is bought and sold when the investor is selling short.
- E. If the stock price decreases and you purchased that stock on margin, you may receive a margin call.

124. The opportunity, but not the obligation, to buy a security within a specified period of time is

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. A short sale

125. The opportunity, but not the obligation, to sell a security within a specified period of time is

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. A short sale

126. Mary Sue owns 500 shares of QRS Moving Company. QRS pays a quarterly dividend of \$.50 per share. What is the total annual dividend that Mary Sue will receive?

- A. \$.50.
- B. \$2.00.
- C. \$250.00.
- D. \$500.00.
- E. \$1000.00.

127. Mary Jane owns 2000 shares of TUV Trucking Company. TUV pays a quarterly dividend of \$.25 per share. What is the total annual dividend that Mary Jane will receive?

- A. \$.25.
- B. \$1.00.
- C. \$500.
- D. \$1000.
- E. \$2000.

128. Gregory bought 500 shares of stock at a price of \$57 per share. He later sold his stock at a price of \$53. What was his total return on his investment?

- A. \$2000 loss
- B. \$57 loss
- C. \$4 gain
- D. \$2000 gain
- E. \$26,500 gain

129. On July 3, 2007, Devin purchased 100 shares of CDEF stock at a cost of \$28 per share. His commission was \$29. He sold his shares on July 6, 2009 at a price of \$43 per share less another \$29 commission. During the time he held the stock, he earned dividends of \$2.50 per share. What was his total return on his investment?

- A. \$250
- B. \$1,492
- C. \$1,692
- D. \$1,721
- E. \$1,750

130. Using the information below, what are the earnings per share for DEF Company?

- After-tax income = \$150,000
- Number of shares outstanding = 60,000
- Price per share = \$30
- Book value per share = \$10

- A. \$0.33
- B. \$1.33
- C. \$2.50
- D. \$3.00
- E. \$4.00

131. Using the information below, what are the earnings per share for GHI Company?

- After-tax income = \$300,000
- Number of shares outstanding = 120,000
- Price per share = \$60
- Book value per share = \$20

- A. \$0.33
- B. \$1.33
- C. \$2.50
- D. \$3.00
- E. \$4.00

132. Using the information below, what is the price-earnings ratio for DEF Company?

- After-tax income = \$150,000
- Number of shares outstanding = 60,000
- Price per share = \$30
- Book value per share = \$10
- Earnings per share = \$2.50

- A. \$3.00
- B. \$4.00
- C. \$7.50
- D. \$12.00
- E. \$20.00

133. Using the information below, what is the price-earnings ratio for DEF Company? (*Hint: this is a two step calculation*)

- After-tax income = \$150,000
 - Number of shares outstanding = 60,000
 - Price per share = \$30
 - Book value per share = \$10
- A. \$3.00
B. \$4.00
C. \$7.50
D. \$12.00
E. \$20.00

134. Given the information below for NMOP, Inc., calculate the dividend yield.

- Annual dividend = \$2.00
 - Current market value per share = \$30.00
- A. 6.7 percent
B. \$0.67
C. 15 percent
D. \$1.50
E. Need more information to calculate

135. Given the information below for NMOP, Inc., calculate the dividend yield.

- Annual dividend = \$2.00
 - Number of shares outstanding = 40,000
 - Current market value per share = \$30.00
 - Book value per share = \$8.00
- A. 6.7 percent
B. 7.5 percent
C. 15 percent
D. 20 percent
E. 25 percent

136. Given the information below for QRS, Inc., calculate the book value.

- Assets = \$15,000,000
 - Liabilities = \$7,000,000
 - Number of shares outstanding = 2,000,000
- A. \$1.33
B. \$2.50
C. \$3.50
D. \$4.00
E. \$7.50

137. Given the information below for TUV, Inc., calculate the total return.

- Dividends per share = \$1.50
 - Purchase price (July 15, 2008) = \$48.00
 - Sell price (July 15, 2009) = \$54.00
- A. (\$6.00)
B. (\$4.50)
C. \$1.50
D. \$6.00
E. \$7.50

138. Gregory purchased 300 shares of QRS stock at a price of \$50 per share. In addition, he paid a commission of \$30 for the transaction. How much did he need to pay his broker?

- A. \$9,000
B. \$15,470
C. \$15,000
D. \$15,030
E. \$15,060

139. If you bought stock *using dollar cost averaging* as listed below, what is your average cost?

June 15	\$50	1.75 shares
July 15	\$50	1.65 shares
August 15	\$50	2.00 shares

- A. \$27.50
- B. \$27.78
- C. \$27.96
- D. \$28.57
- E. \$30.00

140. Mike bought 200 shares of PDQ stock on margin at \$10/share. The stock increased to \$16/share. What was Mike's profit?

- A. \$600
- B. \$1,200
- C. \$2,000
- D. \$3,200
- E. \$5,200

Essay Questions

141. Stocks have been tracked for years. What has the average annual return for stocks been since 1926?

142. What are two characteristics of common stock?

143. Why might you want to invest in common stocks?

144. What is a difference between common stock and preferred stock?

145. What is one of the most important things an investor should do before investing in any stocks?

146. Is the Internet a valid tool to use for evaluating stocks? Why or why not?

147. List five things that can be found at a website such as <http://finance.yahoo.com> to evaluate stock investments.

148. Stock advisory services provide detailed information about corporations. What are three sections that appear in a report?

149. Whose responsibility is it to determine whether a company's stock is a good investment?

150. What are three calculations that can be used to evaluate the profitability of a corporation?

151. What is the relationship between the price-earnings ratio and confidence by investors in the company?

152. What is the difference between a primary market and a secondary market?

153. Discuss full-service, discount, and online brokers.

154. When choosing a broker for your securities transactions, you should ask yourself some questions. What are three questions you should ask?

155. You bought Harley-Davidson stock at \$9 in March, 2009 and saw the value increase to \$22, then drop to \$17 by early June, 2009. Looking back, you realized that you missed a chance to "lock in" your profits and sell the stock at a price of \$21 or higher. If you did NOT want to use a market order, what should you have used to lock in your profit?

156. List two long-term investing techniques.

157. List two short-term investing techniques.

158. Why is short-term investing riskier than long-term? Explain your answer.

Chapter 12 Investing in Stocks **Answer Key**

True / False Questions

1. (p. 390) Many people do not know where to get the information they need to evaluate potential investments.

TRUE

*Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stock*

2. (p. 390) Stocks are guaranteed to have large returns.

FALSE

Investors who want larger returns choose stocks; however, there are no guarantees.

*Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stock*

3. (p. 390) Since 1926, the average annual return for stocks is just over 12 percent as measured by the Standard & Poor 500 stock index.

FALSE

The average return has been just over 10 percent per year.

*Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock*

4. (p. 392) Stocks are equity financing.

TRUE

Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 1
Topic: Investing on stock

5. (p. 392) Companies need to repay money from equity financing.

FALSE

Money obtained from equity financing does not need to be repaid.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock

6. (p. 392) Sandy has invested in a stock. She is assured of receiving a dividend.

FALSE

Dividends are not guaranteed.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock

7. (p. 392) In 2009, many companies had substantially lower earnings. When companies have experienced low earnings, they may choose to reduce or omit their dividends.

TRUE

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock

8. (p. 393) Preferred stockholders elect the board of directors.

FALSE

Common stockholders elect the board of directors.

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock

9. (p. 393) Dividends must be in cash.

FALSE

Dividends can be in cash, additional stock, or company products.

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock

10. (p. 393) If the record date is Friday, April 7, the ex-dividend date is Tuesday, April 11.

FALSE

The ex-dividend date is two days prior to the record date, Wednesday, April 5.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock

11. (p. 394) If Jodi owns 200 shares of stock, a 2-for-1 stock split will double the value of her holdings.

FALSE

A 2:1 stock split will double the number of shares and halve the price per share. Her total value at the time of the split should remain unchanged. Nevertheless, stock splits may lead to a slight increase in stock price.

*Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stock*

12. (p. 397) Many people purchase investments without doing any research.

TRUE

*Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 2
Topic: Evaluating stocks*

13. (p. 397) Before investing in a company's stock, an investor should analyze the industry in which the company operates.

TRUE

*Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks*

14. (p. 398) A micro cap stock is one issued by a company that has a capitalization of \$500 million or less.

FALSE

Micro caps have capitalization of \$250 million or less.

*Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks*

15. (p. 398) A midcap stock is one issued by a company that has a capitalization of up to \$250 million.

FALSE

Microcaps have capitalization of \$250 million or less. Midcaps are between \$2 and \$10 billion.

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

16. (p. 398) The Internet provides many valid sources of stock information.

TRUE

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 2
Topic: Evaluating stocks

17. (p. 398) The Yahoo! Finance Web site provides company-specific news, quotes, and charts.

TRUE

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

18. (p. 399) The level of detail of financial reports found on the Yahoo! Finance Web site is greater than at a stock advisory service such as Value Line.

FALSE

Bloom's: Analysis
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

19. (p. 399) An investor can rely completely on the findings of a stock advisory service in order to make decisions about buying or selling stocks.

FALSE

It is the investor's job to interpret such information and decide whether the company's stock is a good investment.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

20. (p. 402) A prospectus is sent annually to stockholders.

FALSE

An annual report is sent annually. A prospectus is provided to disclose information about new issues of securities to potential investors.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

21. (p. 402) Many analysts believe that a corporation's ability or inability to generate dividends in the future may be one of the most significant factors that accounts for an increase or decrease in the value of a stock.

FALSE

The corporation's ability to generate EARNINGS is more important in valuing the stock.

Bloom's: Comprehension
Difficulty: Hard
Learning Objective: 3
Topic: Financial evaluation

22. (p. 402) Corporate earnings are reported in the firm's annual report.

TRUE

Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 3
Topic: Financial evaluation

23. (p. 402) Earnings per share equals the corporation's after-tax earnings divided by the number of outstanding shares of a firm's common stock.

TRUE

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

24. (p. 404) It is appropriate to compare the profitability of two companies using their earnings per share.

FALSE

No meaningful average for a company's profitability exists. EPS trends for a particular company are appropriate; however, if two companies are to be compared, the PE ratio is a better tool.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

25. (p. 407) The total return can only be calculated if a company pays dividends.

FALSE

Total return = dividends + capital gain. If dividends equal 0, then the total return would be equal to the capital gain.

Bloom's: Comprehension
Difficulty: Hard
Learning Objective: 3
Topic: Financial evaluation

26. (p. 407) The book value of a stock is equal to the result of total assets less total liabilities divided by the number of outstanding shares of common stock.

TRUE

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

27. (p. 407) The market value must be higher than the book value.

FALSE

The market value may be greater than or less than the book value. There is little correlation between these two.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

28. (p. 408) If you purchase stock from your cousin Sam, you are buying stock on the primary market.

FALSE

This would be a secondary market transaction.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 4
Topic: Buying and selling stocks

29. (p. 407) Buying 100 shares of stock in an IPO is a primary market transaction.

TRUE

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 4
Topic: Buying and selling stocks

30. (p. 409) The NYSE lists stocks for nearly 40,000 companies.

FALSE

The NYSE lists stocks for nearly 4,000 companies.

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 4
Topic: Buying and selling stocks

31. (p. 409) Any company's stock can be listed on the NYSE.

FALSE

The NYSE has specific requirements to be listed on the exchange.

Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 4
Topic: Buying and selling stocks

32. (p. 409) Most securities that are considered "over-the-counter" are traded through the NYSE.

FALSE

Most OTC trades are through Nasdaq.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 4
Topic: Buying and selling stocks

33. (p. 410) Joseph has been Leon's account executive for several years. Leon has been questioning Joseph's integrity because it appears as though Joseph might be churning. If Leon wants to take formal action about his concern, he likely will be required to use an arbitration board.

TRUE

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 4
Topic: Buying and selling stocks

34. (p. 412) A.J. wants to buy a stock at its current market value. He should use a market order.

TRUE

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

35. (p. 412) Kenny wanted to sell his stock at a specified price or higher. He should use a stop order.

FALSE

He should use a limit order.

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

36. (p. 412) The execution of a limit order will be the highest priority if and when the specified price is reached.

FALSE

A limit order will not be executed until all other previously received orders have been fulfilled.

Bloom's: Comprehension

Difficulty: Hard

Learning Objective: 4

Topic: Buying and selling stocks

37. (p. 412) If you want to guarantee that your order to sell a stock will be executed, you should place a stop order instead of a limit order.

TRUE

Bloom's: Analysis

Difficulty: Hard

Learning Objective: 4

Topic: Buying and selling stocks

38. (p. 412) Typically, the commission paid for a stock sale will be lower with a full-service broker than for an online brokerage firm.

FALSE

Full-service and discount brokerage firms generally charge higher commissions than those charged by online brokerage firms.

Bloom's: Comprehension

Difficulty: Easy

Learning Objective: 4

Topic: Buying and selling stocks

39. (p. 414) Glen bought GE stock on November 8, 2007 at a price of \$39.20 and then sold it on March 19, 2009 at \$11.20. Glen can be classified as a speculator.

FALSE

Speculators (or traders) routinely buy and then sell stocks within a short period of time (speculators hold investments less than one year). Prices are from www.finance.yahoo.com

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 5

Topic: Investing strategies

40. (p. 414) Gloria bought GE stock on March 4, 2009 at a price of \$5.87 and then quickly sold it on March 19, 2009 at \$11.20. Gloria is classified as a speculator.

TRUE

Prices are from www.finance.yahoo.com

Bloom's: Comprehension

Difficulty: Easy

Learning Objective: 5

Topic: Investing strategies

41. (p. 414) An investor must be classified as using the long-term buy-and-hold technique in order to receive dividends.

FALSE

Any investor is eligible to receive a dividend.

Bloom's: Comprehension
Difficulty: Hard
Learning Objective: 5
Topic: Investing strategies

42. (p. 414) An example of dollar cost averaging is an employee purchasing shares of his or her company's stock through a payroll deduction as part of a retirement plan.

TRUE

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

43. (p. 414) The main goal of dollar cost averaging is buying high and selling low.

FALSE

The main goals of dollar cost averaging are to minimize the average cost per share and to avoid the common pitfall of buying high and selling low.

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 5
Topic: Investing strategies

44. (p. 414) Either you can take advantage of dollar cost averaging, or you can use a direct investment plan.

FALSE

With a direct investment plan, you can take advantage of dollar cost averaging.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

45. (p. 414) Long-term investing techniques are generally more risky than short-term investing techniques.

FALSE

The opposite is true.

Bloom's: Analysis
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

46. (p. 416) An investor may receive a margin call when selling stock short.

FALSE

A margin call applies only when buying stock on margin.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

47. (p. 418) A put option is the right to buy 100 shares of stock at a guaranteed price before a specified expiration date.

FALSE

A put option is the right to SELL stock.

*Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies*

Multiple Choice Questions

48. (p. 392) Which of the following is *incorrect*?

- A. There is no substitute for researching a potential investment.
- B. Beginning investors sometimes worry that they won't know what the information they find about stocks really means.
- C. Some investors do not know where to get the information they need to evaluate potential investments.
- D.** The amount of information available about stocks is limited.
- E. All of the above statements are correct.

*Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stocks*

49. (p. 395) Since 1926, the average annual return for stocks has been about _____

- A. 8 percent
- B.** 10 percent
- C. 12 percent
- D. 14 percent
- E. 16 percent

*Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stocks*

50. (p. 392) Amanda wants to be part of the ownership for a corporation. She should invest in
- A. Bonds
 - B. Common stock**
 - C. Dividends
 - D. A savings account
 - E. A proxy

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

51. (p. 392) Another name for equity financing is money received from the sale of
- A. Bonds
 - B. Common stock**
 - C. Dividends
 - D. A savings account
 - E. A proxy

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

52. (p. 392) A distribution of money, stock, or other property that is paid to owners of a company is called a
- A. Bond
 - B. Common stock
 - C. Dividend**
 - D. Savings account
 - E. Proxy

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

53. (p. 393) A legal form that requests that owners transfer their voting rights to individual(s) is called a

- A. Bond
- B. Common stock
- C. Dividend
- D. Savings account
- E.** Proxy

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

54. (p. 393) All of the following statements are correct *except*

- A. Dividends are paid out of profits.
- B.** Dividend payments must be approved by the stockholders.
- C. A dividend can be a distribution of money, but it can also be stock or other property.
- D. Dividends are not mandatory.
- E. Utility companies typically distribute a higher percent of earnings than rapidly growing firms.

Bloom's: Analysis
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

55. (p. 393) Alberta owns 100 shares of stock of ABC Company and Bobby owns 200 shares of the same stock. If ABC Company pays a \$5 dividend to all stockholders with a record date of Friday, June 15, then

- A. Alberta will receive the same amount as Bobby if they owned the stock two business days before the record date
- B. Both will receive the dividend as long as they sell their stock three days before the record date
- C.** Alberta will receive half as much as Bobby if they owned the stock two business days before the record date
- D. Both will receive the dividend if they bought the stock on the record date
- E. Alberta and Bobby will receive the same amount if they bought the shares at least one month before the record date

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 1
Topic: Investing in stocks

56. (p. 393) If you own stock, you may receive income from

- A. Dividends
- B. Appreciation in stock value
- C. Possible increase in stock price due to stock splits
- D. Two of the above are correct
- E.** All of the above are correct

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

57. (p. 393) MNOP, Inc declared a \$1.00 dividend with a record date of Thursday, September 15 and a payment date of Thursday, October 20. Cheri wants to purchase stock and receive the dividend. What is the *latest* date that she needs to have purchased the stock in order to receive the dividend?

- A.** September 12
- B. September 13
- C. September 15
- D. September 19
- E. October 18

For her to receive the dividend, she must own the stock at the open of the ex-dividend date, two business days before the record date.

Bloom's: Analysis
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

58. (p. 393) MNOP, Inc declared a \$1.00 dividend with a record date of Thursday, September 15 and a payment date of Thursday, October 20. Cheri does NOT want receive this current dividend. What is the *earliest* date that she should purchase the stock in order to avoid receiving the dividend?

- A. September 12
- B.** September 13
- C. September 15
- D. October 18
- E. October 20

For her to NOT receive the dividend, she must purchase the stock no sooner than at the open of the ex-dividend date (September 13), two business days before the record date.

Bloom's: Analysis
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

59. (p. 394) Why does a company split its stock?

- A. The stock is trading at a low price, and the company wants to increase its stock value
- B. It wants fewer shares outstanding
- C.** The stock is trading at a high price, and the company wants to bring the price in line with a theoretical ideal range
- D. It wants the total market capitalization to be lower than the current level
- E. The company wants to guarantee that the stock price will increase

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

60. (p. 394) Which of the following statements about stock splits is correct?

- A. If a company has a 2-for-1 split, the price will be doubled
- B. If a company has a 3-for-1 split, the price will increase by a factor of three
- C.** If a company has a 4-for-1 split, the new number of shares will be four times as many as before the split
- D. If a company has a 5-for-1 split, the new number of shares will be equal to the old number of shares divided by 5
- E. None of the above is correct

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 1
Topic: Investing in stocks

61. (p. 396) Which of the following is NOT correct regarding preferred stock?

- A. Preferred stocks are considered to be safer investments than common stocks
- B. Corporations that own preferred stock receive a tax break for their dividend income
- C. Owners of preferred stock receive cash dividends before common stockholders receive their dividends
- D. The dollar amount of the dividend on preferred stock is known before the stock is purchased
- E.** The yield on preferred stocks is often much higher than the yield on bonds

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

62. (p. 396) Daniel wants to invest in a security that can be converted to a different one that provides ownership in a company. What does he want to invest in?

- A. Dividends
- B. Convertible common stock
- C. Proxies
- D. Convertible preferred stock**
- E. Stock splits

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

63. (p. 397) Megan decided to start investing in stocks. Which of the following should she do first?

- A. Base her investing decisions on hot tips she hears at work
- B. Buy stocks based solely on her stockbroker's recommendation
- C. Choose stocks based on a recommendations from her family members
- D. Pick stocks at random
- E. Research the corporations she is interested in as well as their industries**

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

64. (p. 398) Which of the following statements is correct?

- A. The Internet is not to be trusted as a reliable source to evaluate potential investments.
- B. Individual company websites usually charge for access to their own financial reports.
- C. The Internet provides Web sites that may be more up to date and thorough than printed materials.**
- D. Web sites like Yahoo! Finance are not dependable.
- E. None of the above is correct.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

65. (p. 398) A safe investment that generally attracts conservative investors is called a(n) _____ stock.

- A.** Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E. Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

66. (p. 398) An investment that pays higher than average dividends is called a(n) _____ stock.

- A. Blue chip
- B.** Income
- C. Micro Cap
- D. Midcap
- E. Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

67. (p. 398) A stock that typically sells for less than \$1 per share is called a(n) _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap
- E.** Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

68. (p. 398) A stock issued by a corporation that has a capitalization of between \$2 and \$10 billion is called a(n) _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap
- D. Midcap**
- E. Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

69. (p. 398) A stock issued by a company that has a capitalization of \$250 million or less is called a _____ stock.

- A. Blue chip
- B. Income
- C. Micro Cap**
- D. Midcap
- E. Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

70. (p. 398) Cliff retired ten years ago and wants to still own a few stocks. Dividends are important to him, but so is growth. He is most interested in stocks that are safe investments. He should purchase _____ stocks.

- A. Blue chip**
- B. Cyclical
- C. Micro Cap
- D. Midcap
- E. Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

71. (p. 398) Patrick graduated from college five years ago. He has set up an emergency fund and has been paying off his student loans. In addition, he participates in the retirement plan offered by his employer. He wants to take \$75 per month and invest it in very small companies (capitalization of \$250 million or less). He should purchase _____ stocks.

- A. Blue chip
- B. Income
- C. Micro Cap**
- D. Midcap
- E. Penny

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

72. (p. 400) Which of the following is some of the information found on a financial Web site such as www.finance.yahoo.com?

- A. Company name, last price, target price, price change
- B. 52 week price range, number of shares traded (volume)
- C. Market capitalization
- D. Dividend paid and yield
- E. All of the information is included**

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 2
Topic: Evaluating stocks

73. (p. 400) Which of the following usually offers some free information and charges for more detailed information you may need to evaluate a stock investment?

- A. Financial Web sites such as www.finance.yahoo.com
- B. Personal finance Web sites such as www.smartmoney.com
- C. Professional advisory services such as Standard & Poor's Financial Information Services**
- D. Search engines such as Yahoo!
- E. Securities and Exchange Commission Web site

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

74. (p. 400) Which of the following is true?

- A. Mergent's Handbook of Common Stocks is a misnomer because it only analyzes industries.
- B. Standard & Poor's reports are available only in the Internet.
- C.** Stock advisory services include printed detailed financial reports.
- D. Value Line is the only reliable stock advisory service used by investors.
- E. All of the above are correct.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

75. (p. 401) Financial reports from advisory services include all of the following sections *except*

- A. Stock prices, earnings and dividends
- B. Business summary
- C. Prospects section
- D. Financial Data
- E.** All of the above are included in financial reports.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

76. (p. 402) Annual reports

- A. Are available from the company for a fee
- B. Are available only to current stockholders
- C. Include the same information as a prospectus
- D.** Must be sent to all stockholders on an annual basis
- E. Include estimated financial data only

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

77. (p. 404) Which of the following is correct?

- A. Earnings are a minor factor in determining the value of a stock.
- B. Corporate earnings are reported in the proxy statement.
- C. Earnings per share uses the price of the stock in the calculation.
- D. The best calculation to use to compare the profitability of two companies is EPS.
- E.** The price/earnings ratio is the price of a share of stock divided by the corporation's earnings per share of stock.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

78. (p. 406) The earnings per share equals

- A. Total before-tax earnings divided by number of shares of preferred stock
- B. Total before-tax earnings divided by number of shares of common stock
- C. Total after-tax earnings divided by number of shares of preferred stock
- D. Total after-tax earnings divided by number of shares of common and preferred stock
- E.** None of the above

EPS equals total after-tax earnings divided by number of shares of common stock outstanding.

Bloom's: Knowledge
Difficulty: Hard
Learning Objective: 3
Topic: Financial evaluation

79. (p. 404) When analyzing a price-earnings ratio,

- A. A higher price-earnings ratio indicates pessimism because the price is too high compared to the earnings.
- B.** The higher the price-earnings ratio, the more investors are paying for earnings.
- C. A low ratio indicates that investors expect higher earnings in the future.
- D. Price-earnings ratios are helpful when comparing two companies in the same industry, but not to the market in general.
- E. The price-earnings ratio provides enough information to allow an investor to decide whether or not to invest in a particular stock.

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 3
Topic: Financial evaluation

80. (p. 405) Which of the following is based on historical numbers?

- A. Earnings
- B. Earnings per share
- C. Price-earnings ratio
- D. All of the above**
- E. None of the above

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

81. (p. 404) If you want to compare two companies, you should use

- A. Book value per share
- B. Earnings per share
- C. Price per share
- D. Net income
- E. Price-earnings ratio**

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

82. (p. 404) Which of the following is a profitability ratio that uses the number of outstanding shares in the calculation?

- A. Book value
- B. Earnings per share**
- C. Price per share
- D. Net income
- E. Price-earnings ratio

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

83. (p. 404) This ratio uses the market price per share of the stock and the earning per share for the last year.

- A. Book value per share
- B. Earnings per share
- C. Market price per share
- D. Net income
- E.** Price/earnings ratio

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 3
Topic: Financial evaluation

84. (p. 405) Which of the following changes would NOT cause analysts to change estimates for a healthcare corporation?

- A. Interest rates
- B. Unemployment rates
- C. The economy in general
- D. Industry
- E.** Weather

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 3
Topic: Financial evaluation

85. (p. 406) This calculation uses the annual amount of money paid to investors from the company.

- A. Book value
- B.** Dividend yield
- C. Earnings per share
- D. Market value
- E. Price-earnings ratio

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

86. (p. 407) This equals $(\text{Assets} - \text{Liabilities}) / \text{Shares outstanding}$

- A.** Book value
- B. Dividend yield
- C. Earnings per share
- D. Market value
- E. Price-earnings

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

87. (p. 407) This calculation includes the annual dividends in dollars and the increase in the purchase price of the investment.

- A. Book value
- B. Capital gain
- C. Market value
- D. Price-earnings
- E.** Total return

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

88. (p. 407) Total return equals

- A. Dividend yield
- B.** Annual dividends in dollars plus capital gains
- C. Capital gains
- D. Annual dividends in dollars less capital gains
- E. Capital gains less annual dividends in dollars

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 3
Topic: Financial evaluation

89. (p. 406) Dividend yield equals

- A. Annual dividend amount/price per share
- B. Quarterly dividend amount/price per share
- C. Annual dividend amount/book value per share
- D. Quarterly dividend amount/book value per share
- E. Annual dividend amount/earnings per share

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

90. (p. 407) Book value equals

- A. (Assets + Liabilities)/Number of shares outstanding
- B. (Liabilities - Assets)/Number of shares outstanding
- C. (Assets + Liabilities)/Earnings per share
- D. (Liabilities + Assets)/Price-earnings ratio
- E. (Assets - Liabilities)/Number of shares outstanding

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

91. (p. 408) Abe was contacted by XYZ's _____ when XYZ wanted to sell new securities to the general public for the first time.

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 4
Topic: Buying and selling stocks

92. (p. 408) Stephen wanted to become one of the owners of GHI Corp. when it finally was available to the investors who were not directly affiliated with the company. He participated in the _____

- A.** Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E. Securities exchange

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

93. (p. 408) Kelly bought some stock using an intermediary from the issuer of those securities. She bought her shares on the _____

- A. Initial public offering
- B. Investment bank
- C.** Primary market
- D. Secondary market
- E. Securities exchange

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

94. (p. 408) Patrick sold his GE shares using his online broker. One can say that he sold them on the _____

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D.** Secondary market
- E. Securities exchange

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

95. (p. 408) Jake wanted to buy and sell various stocks on the NYSE. He was using one of the largest _____ in the world.

- A. Initial public offerings
- B. Investment banks
- C. Primary markets
- D. Secondary markets
- E.** Securities exchanges

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

96. (p. 408) A marketplace where member brokers who represent investors meet to buy and sell securities is called a(n) _____.

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E.** Securities exchange

Bloom's: Knowledge

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

97. (p. 409) NYSE is an example of a(n) _____.

- A. Initial public offering
- B. Investment bank
- C. Primary market
- D. Secondary market
- E.** Securities exchange

Bloom's: Knowledge

Difficulty: Easy

Learning Objective: 4

Topic: Buying and selling stocks

98. (p. 409) NYSE stands for
- A. New York Securities Exchange.
 - B. New York Stock Exchange.**
 - C. New York School of Engineering.
 - D. Never Yet So Even.
 - E. New Year Selling Exchange.

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 4
Topic: Buying and selling stocks

99. (p. 409) Mohammad was interested in purchasing low value securities that were not listed on the NYSE. He probably used _____ to complete his transaction.
- A. An initial public offering
 - B. An investment bank
 - C. The over-the-counter market**
 - D. A primary market
 - E. The securities exchange commission Web site

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 4
Topic: Buying and selling stocks

100. (p. 410) The licensed individual who buys or sells investments for his or her clients is called a(n) _____
- A. Account executive**
 - B. Account investor
 - C. Online executive
 - D. Market maker
 - E. Both A and B are correct

Bloom's: Comprehension
Difficulty: Hard
Learning Objective: 4
Topic: Buying and selling stocks

101. (p. 410) Peter is a Nasdaq dealer who matches buy and sell orders for Ford. He is known as a(n) _____

- A. Account executive
- B. Account investor
- C. Discount broker
- D. Full-service broker
- E.** Market maker

Bloom's: Comprehension

Difficulty: Hard

Learning Objective: 4

Topic: Buying and selling stocks

102. (p. 410) Excessive buying and selling of securities to generate commissions is called

- A.** Churning
- B. Flipping
- C. Marketing
- D. Prospecting
- E. Scamming

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

103. (p. 410) Claudia is a licensed individual who buys or sells investment for her clients. Which of the following is NOT correct?

- A. She is an account executive
- B. She should NOT use her discretion without her client's approval
- C.** She should focus on churning for her clients
- D. She should provide information and advice to be used in evaluating potential investments
- E. All of the above are correct

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

104. (p. 411) Terry wants to begin investing and needs some guidance because he is uncomfortable making investment decisions. He should use a(n)

- A. Discount broker
- B. Full-service broker**
- C. Market Maker
- D. Online broker
- E. None of the above are correct

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

105. (p. 411) Tammy feels quite comfortable trading her own stocks using a computer. She should use a(n)

- A. Discount broker
- B. Full-service broker
- C. Market Maker
- D. Online broker**
- E. All of the above are correct

Bloom's: Comprehension

Difficulty: Easy

Learning Objective: 4

Topic: Buying and selling stocks

106. (p. 411) Tanya understands the "how to" of researching stocks and likes to make her own decisions. However, she is not comfortable using the Internet to trade stocks. She should use a(n)

- A. Discount broker**
- B. Full-service broker
- C. Market Maker
- D. Online broker
- E. All of the above are correct

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

107. (p. 411) Avery is thinking about using the computer to do his investing. He should ask all of the following questions *except*

- A. Can I manage my own investments closely?
- B. Do I have sufficient computer capability?
- C. How large is my investment portfolio?
- D. None of these questions is appropriate.
- E.** All of these questions are appropriate to ask.

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

108. (p. 412) Mallory wants to purchase stock at the current market price. She should use a

- A. Current sale order
- B. Limit order
- C.** Market order
- D. Stop order
- E. Stop-loss order

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

109. (p. 412) Devin wants to purchase DEF stock for \$40.00 or less. He should use a

- A. Current sale order
- B.** Limit order
- C. Market order
- D. Stop order
- E. Stop-loss order

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

110. (p. 412) Gavin has owned MNOP stock for several years and has seen the stock increase in value from \$20 to \$35. He wants to "lock in" his gains, so he needs to place an order that will sell his stock at the next available opportunity after its market price drops to \$33. What kind of order should he use?

- A. Current sale order
- B. Limit order
- C. Market order
- D.** Stop-loss order
- E. None of the above

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

111. (p. 412) Ethan wants to purchase some stock for the first time. Which of the following is correct?

- A. His account executive should be encouraged to churn Ethan's account to maximize his return.
- B. He should use an online broker to get specific advice about purchasing stock.
- C. His purchase price will exactly equal the number of shares he purchases times the price per share and is known in advance.
- D. If he uses a market order, he can lock in the price at which he wants to buy the stock.
- E.** His commission should be lower at an online broker than at a full-service broker.

Bloom's: Analysis

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

112. (p. 414) If you bought a stock on June 15, 2008 and sold it on July 15, 2009, you would likely be classified as a(n)

- A. Speculator
- B. Trader
- C.** Investor
- D. Two of the above are correct
- E. All of the above are correct

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 5

Topic: Investing strategies

113. (p. 414) If you bought a stock on July 1, 2009 and sold it on July 15, 2009, you may be a(n)
- A. Speculator
 - B. Trader
 - C. Investor
 - D. Two of the above are correct**
 - E. All of the above are correct

Individuals who routinely buy and then sell stocks within a short period of time are called speculators or traders.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

114. (p. 414) Brenda purchases stock and never plans to sell them. She could be considered to be using a _____
- A. Buy-and-hold technique**
 - B. Direct investment plan
 - C. Direct reinvestment plan
 - D. Dollar cost averaging technique
 - E. Margin technique

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

115. (p. 414) Marissa purchases \$500 of stock from a corporation without having to use an account executive or a brokerage firm. She is using a _____
- A. Buy-and-hold technique
 - B. Direct investment plan**
 - C. Direct reinvestment plan
 - D. Dollar cost averaging technique
 - E. Margin technique

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

116. (p. 416) Rebecca owns stock that pays a dividend. She does not want the cash now; instead, she would prefer to have more shares of stock. She should use a _____

- A. Buy-and-hold technique
- B. Direct investment plan
- C. Dividend reinvestment plan**
- D. Dollar cost averaging technique
- E. Margin technique

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

117. (p. 414) Timothy has \$100 automatically invested in a stock each month. This way, he doesn't buy high and sell low. He is using a _____

- A. Buy-and-hold technique
- B. Direct investment plan
- C. Direct reinvestment plan
- D. Dollar cost averaging technique**
- E. Margin technique

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

118. (p. 416) Faye sometimes borrows money from her broker to buy her stock. She is buying

- A. A call option
- B. A direct investment
- C. On margin**
- D. A put option
- E. A short sale

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

119. (p. 416) Investors who earn larger returns because they borrow part of the money needed to buy a particular stock are using which of the following techniques?

- A. A call option
- B. Direct investing
- C. Buying on margin**
- D. A put option
- E. Selling short

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

120. (p. 3416) If you buy or sell with this technique, you may be required to pledge additional collateral or cash for a loan.

- A. A call option
- B. Direct investing
- C. Buying on margin**
- D. A put option
- E. Selling short

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

121. (p. 417) Ben borrowed some securities from his broker and planned to replace them at a later date. Which of the following strategies did he use?

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. Selling short**

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

122. (p. 417) Which of the following is correct?

- A. The broker pays you interest on money borrowed to purchase stock on margin.
- B.** Selling short is the opposite of buying long.
- C. A put option is the right, but not the obligation to purchase a stock at a specified price by a given date.
- D. A brokerage firm receives double its commission when stock is bought and sold when the investor is selling short.
- E. If the stock price increases and you purchased stock on margin, you may receive a margin call.

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 5
Topic: Investing strategies

123. (p. 417) Which of the following is NOT correct?

- A. You pay interest on money borrowed to purchase stock on margin.
- B. Selling short is the opposite of buying long.
- C. A call option is the right, but not the obligation to purchase a stock at a specified price by a given date.
- D.** A brokerage firm receives double its commission when stock is bought and sold when the investor is selling short.
- E. If the stock price decreases and you purchased that stock on margin, you may receive a margin call.

Bloom's: Comprehension
Difficulty: Hard
Learning Objective: 5
Topic: Investing strategies

124. (p. 418) The opportunity, but not the obligation, to buy a security within a specified period of time is

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. A short sale

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

125. (p. 418) The opportunity, but not the obligation, to sell a security within a specified period of time is

- A. A call option
- B. Direct investing
- C. Buying on margin
- D. A put option
- E. A short sale

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

126. (p. 396) Mary Sue owns 500 shares of QRS Moving Company. QRS pays a quarterly dividend of \$.50 per share. What is the total annual dividend that Mary Sue will receive?

- A. \$.50.
- B. \$2.00.
- C. \$250.00.
- D. \$500.00.
- E. \$1000.00.

Total dividend = number of shares \times quarterly dividend rate \times 4 quarters/year = $500 \times \$0.50 \times 4$
= \$1000.00

Bloom's: Application
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stocks

127. (p. 396) Mary Jane owns 2000 shares of TUV Trucking Company. TUV pays a quarterly dividend of \$.25 per share. What is the total annual dividend that Mary Jane will receive?

- A. \$.25.
- B. \$1.00.
- C. \$500.
- D. \$1000.
- E. \$2000.**

Total dividend = number of shares \times quarterly dividend rate \times 4 quarters/year = $2000 \times \$0.25 \times 4 = \2000.00

Bloom's: Application
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stocks

128. (p. 397) Gregory bought 500 shares of stock at a price of \$57 per share. He later sold his stock at a price of \$53. What was his total return on his investment?

- A. \$2000 loss**
- B. \$57 loss
- C. \$4 gain
- D. \$2000 gain
- E. \$26,500 gain

Total return on investment = (Price Change) \times # shares = $(\$53 - \$57) \times 500 = (\$2000)$

Bloom's: Application
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

129. (p. 397) On July 3, 2007, Devin purchased 100 shares of CDEF stock at a cost of \$28 per share. His commission was \$29. He sold his shares on July 6, 2009 at a price of \$43 per share less another \$29 commission. During the time he held the stock, he earned dividends of \$2.50 per share. What was his total return on his investment?

- A. \$250
- B. \$1,492
- C. \$1,692**
- D. \$1,721
- E. \$1,750

Total return on investment = (Price Change) × # shares - commission (for buy and sell) + Dividends × # shares = $(\$43 - \$28) \times 100 - (\$29 + \$29) + \$2.50 \times 100 = \$1500 - \$58 + \$250 = \$1,692$

Bloom's: Application
Difficulty: Hard
Learning Objective: 1
Topic: Investing in stocks

130. (p. 404) Using the information below, what are the earnings per share for DEF Company?

- After-tax income = \$150,000
- Number of shares outstanding = 60,000
- Price per share = \$30
- Book value per share = \$10

- A. \$0.33
- B. \$1.33
- C. \$2.50**
- D. \$3.00
- E. \$4.00

Earnings per share = After-tax income/number of shares outstanding = $\$150,000/60,000 = \2.50

Bloom's: Application
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

131. (p. 404) Using the information below, what are the earnings per share for GHI Company?

- After-tax income = \$300,000
- Number of shares outstanding = 120,000
- Price per share = \$60
- Book value per share = \$20

- A. \$0.33
- B. \$1.33
- C. \$2.50**
- D. \$3.00
- E. \$4.00

Earnings per share = After-tax income/number of shares outstanding = $\$300,000/120,000 = \2.50

Bloom's: Application
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

132. (p. 405) Using the information below, what is the price-earnings ratio for DEF Company?

- After-tax income = \$150,000
- Number of shares outstanding = 60,000
- Price per share = \$30
- Book value per share = \$10
- Earnings per share = \$2.50

- A. \$3.00
- B. \$4.00
- C. \$7.50
- D. \$12.00**
- E. \$20.00

Price-earnings ratio = Price per share/Earnings per share = $\$30/\$2.50 = \$12.00$

Bloom's: Application
Difficulty: Medium
Learning Objective: 3
Topic: Financial evaluation

133. (p. 405) Using the information below, what is the price-earnings ratio for DEF Company?
(Hint: this is a two step calculation)

- After-tax income = \$150,000
 - Number of shares outstanding = 60,000
 - Price per share = \$30
 - Book value per share = \$10
- A. \$3.00
B. \$4.00
C. \$7.50
D. \$12.00
E. \$20.00

First, earnings per share needs to be calculated: = After-tax income/number of shares outstanding = $\$150,000/60,000 = \2.50

Then Price-earnings ratio can be determined: = Price per share/Earnings per share = $\$30/\$2.50 = \$12.00$

Bloom's: Application
Difficulty: Hard
Learning Objective: 3
Topic: Financial evaluation

134. (p. 406) Given the information below for NMOP, Inc., calculate the dividend yield.

- Annual dividend = \$2.00
 - Current market value per share = \$30.00
- A. 6.7 percent**
B. \$0.67
C. 15 percent
D. \$1.50
E. Need more information to calculate

Dividend yield = dividends per share/current market value = $\$2.00/\$30.00 = .067 = 6.7\%$

Bloom's: Application
Difficulty: Easy
Learning Objective: 3
Topic: Financial evaluation

135. (p. 406) Given the information below for NMOP, Inc., calculate the dividend yield.

- Annual dividend = \$2.00
- Number of shares outstanding = 40,000
- Current market value per share = \$30.00
- Book value per share = \$8.00

- A.** 6.7 percent
- B. 7.5 percent
- C. 15 percent
- D. 20 percent
- E. 25 percent

Dividend yield = dividends per share/current market value = $\$2.00/\$30.00 = .067 = 6.7\%$

Bloom's: Application

Difficulty: Medium

Learning Objective: 3

Topic: Financial evaluation

136. (p. 407) Given the information below for QRS, Inc., calculate the book value.

- Assets = \$15,000,000
- Liabilities = \$7,000,000
- Number of shares outstanding = 2,000,000

- A. \$1.33
- B. \$2.50
- C. \$3.50
- D.** \$4.00
- E. \$7.50

Book value = (Assets - liabilities)/Shares outstanding = $(\$15,000,000 - \$7,000,000)/2,000,000 = \$4.00$

Bloom's: Application

Difficulty: Easy

Learning Objective: 3

Topic: Financial evaluation

137. (p. 407) Given the information below for TUV, Inc., calculate the total return.

- Dividends per share = \$1.50
 - Purchase price (July 15, 2008) = \$48.00
 - Sell price (July 15, 2009) = \$54.00
- A. (\$6.00)
B. (\$4.50)
C. \$1.50
D. \$6.00
E. \$7.50

Total return = Dividends + capital gain = $\$1.50 + (\$54 - \$48) = \7.50

Bloom's: Application
Difficulty: Easy
Learning Objective: 3
Topic: Financial evaluation

138. (p. 408) Gregory purchased 300 shares of QRS stock at a price of \$50 per share. In addition, he paid a commission of \$30 for the transaction. How much did he need to pay his broker?

- A. \$9,000
B. \$15,470
C. \$15,000
D. \$15,030
E. \$15,060

Gregory's total payment = (# shares \times price per share) + commission = $(300 \times \$50) + 30 = \$15,030$.

Bloom's: Application
Difficulty: Easy
Learning Objective: 4
Topic: Buying and selling stocks

139. (p. 414) If you bought stock *using dollar cost averaging* as listed below, what is your average cost?

June 15	\$50	1.75 shares
July 15	\$50	1.65 shares
August 15	\$50	2.00 shares

- A. \$27.50
- B. \$27.78**
- C. \$27.96
- D. \$28.57
- E. \$30.00

Average cost = (total investment cost)/(total number of shares purchased) = $(\$50 \times 3)/(1.75 + 1.65 + 2.0) = \$150/5.4 \text{ shares} = \$27.78/\text{share}$

Bloom's: Application
Difficulty: Hard
Learning Objective: 5
Topic: Investing strategies

140. (p. 416) Mike bought 200 shares of PDQ stock on margin at \$10/share. The stock increased to \$16/share. What was Mike's profit?

- A. \$600
- B. \$1,200**
- C. \$2,000
- D. \$3,200
- E. \$5,200

Profit = 200 shares \times increase in price = 200 shares \times (\$16 - \$10) = 200 \times 6 = \$1200.

Bloom's: Application
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

Essay Questions

141. (p. 390) Stocks have been tracked for years. What has the average annual return for stocks been since 1926?

The average annual return is just over 10 percent.

Bloom's: Knowledge
Difficulty: Easy
Learning Objective: 1
Topic: Investing in stocks

142. (p. 392) What are two characteristics of common stock?

Common stocks:

- Are the most basic form of ownership for a corporation
- Are equity financing
- May pay dividends
- Use proxies for many stockholders' voting

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

143. (p. 392) Why might you want to invest in common stocks?

You might want to invest in common stocks because of your potential profitability due to appreciation of stock value, dividend payments, and potential increases in stock value after stock splits.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

144. (p. 392) What is a difference between common stock and preferred stock?

Common stockholders may receive variable dividends while preferred stockholders receive a constant, known dividend before common dividends are paid.
Common stockholders can vote while preferred stockholders normally do not vote.

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 1
Topic: Investing in stocks

145. (p. 392) What is one of the most important things an investor should do before investing in any stocks?

An investor should research and evaluate the company as well as the industry in which it operates.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

146. (p. 398) Is the Internet a valid tool to use for evaluating stocks? Why or why not?

The Internet IS a valid tool since it is accessible and may be more up to date and thorough than printed material. Company Web sites, financial Web sites and stock advisory services all provide financial information on companies.

Bloom's: Comprehension
Difficulty: Easy
Learning Objective: 2
Topic: Evaluating stocks

147. (p. 400) List five things that can be found at a website such as <http://finance.yahoo.com> to evaluate stock investments.

<http://finance.yahoo.com> includes the following and more:

- Company name and ticker symbol
- Stock quotes
- Charts
- News
- Information
- Analyst coverage
- Ownership
- Financials
- Dividends
- Volume
- Stock price changes and ranges

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

148. (p. 400) Stock advisory services provide detailed information about corporations. What are three sections that appear in a report?

The text provides an example from Mergent's that includes six sections:

- Top section - stock prices, earnings, dividends.
- Business summary - company's major operations.
- Recent developments - current information about the company's net income and sales revenue
- Prospects - company's outlook.
- Financial data - data for the past 7 years plus the last 3-month reporting period. Includes: total revenues, earnings per share, dividends per share, return on equity, and net income.
- Final section - auditors, where principal office is located, transfer agent, corporate officers.

Bloom's: Comprehension
Difficulty: Hard
Learning Objective: 2
Topic: Evaluating stocks

149. (p. 402) Whose responsibility is it to determine whether a company's stock is a good investment?

It is the investor's job to interpret information and decide whether the company's stock is a good investment.

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 2
Topic: Evaluating stocks

150. (p. 404) What are three calculations that can be used to evaluate the profitability of a corporation?

Possible answers include:

- Earnings per share
- Price-earnings ratio
- Dividend yield
- Total return
- Capital gain
- Return on assets (not discussed in this section of the text, nevertheless, some students may be aware of this ratio)
- Return on equity (not discussed in this section of the text, nevertheless, some students may be aware of this ratio)

Bloom's: Comprehension
Difficulty: Medium
Learning Objective: 3
Topic: Evaluating stocks

151. (p. 404) What is the relationship between the price-earnings ratio and confidence by investors in the company?

A direct relationship exists in that a high price-earnings ratio often indicates investor optimism because of the expectation of higher earnings in the future.

Bloom's: Evaluation
Difficulty: Medium
Learning Objective: 3
Topic: Evaluating stocks

152. (p. 408) What is the difference between a primary market and a secondary market?

In a primary market, investors purchase stock from the issuer of the securities (e.g., initial public offering). A secondary market deals with existing securities (e.g., you sell your shares to another investor).

Bloom's: Analysis

Difficulty: Easy

Learning Objective: 4

Topic: Buying and selling stocks

153. (p. 411) Discuss full-service, discount, and online brokers.

A full-service broker is appropriate for beginning investors with little or no experience and for those who are uncomfortable making investment decisions. Commissions generally are highest with full-service brokers.

A discount broker is for individuals who are uncomfortable trading stocks online and for people who understand the "how to" of researching stocks and prefer to make their own decisions.

An online broker is also appropriate for people who understand the "how to" of researching stocks and prefer to make their own decisions. This is also for individuals who are comfortable trading stocks online. Online brokers generally have the lowest commissions.

Bloom's: Analysis

Difficulty: Easy

Learning Objective: 4

Topic: Buying and selling stocks

154. (p. 411) When choosing a broker for your securities transactions, you should ask yourself some questions. What are three questions you should ask?

Possible questions include:

- Can I buy or sell stocks over the phone?
- Can I trade stocks online?
- Where is your nearest office located?
- Do you have a toll-free telephone number for customer use?
- How often do I get statements?
- Is there a charge for statements, research reports, and other financial reports?
- Are there any fees in addition to the commissions I pay when I buy or sell stocks?

Bloom's: Comprehension

Difficulty: Medium

Learning Objective: 4

Topic: Buying and selling stocks

155. (p. 412) You bought Harley-Davidson stock at \$9 in March, 2009 and saw the value increase to \$22, then drop to \$17 by early June, 2009. Looking back, you realized that you missed a chance to "lock in" your profits and sell the stock at a price of \$21 or higher. If you did NOT want to use a market order, what should you have used to lock in your profit?

You should have used a stop-loss order to sell the Harley stock at the next available opportunity after its market price reached \$21.

Bloom's: Analysis

Difficulty: Hard

Learning Objective: 4

Topic: Buying and selling stocks

156. (p. 414) List two long-term investing techniques.

Long-term techniques include

- Buy-and-hold
- Dollar cost averaging
- Direct investment plan
- Dividend reinvestment plan

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

157. (p. 416) List two short-term investing techniques.

Short-term techniques include

- Buying stock on margin
- Selling short
- Call options
- Put options

Bloom's: Knowledge
Difficulty: Medium
Learning Objective: 5
Topic: Investing strategies

158. (p. 416) Why is short-term investing riskier than long-term? Explain your answer.

Short-term investing (speculating or trading) is more risky because of the strategies used. Buying on margin uses financial leverage which can provide larger returns when the stock value increases as well as lower returns when the stock value decreases. Selling short is risky because the stock is sold before it is purchased. If the stock price decreases, it can be purchased at a lower price; however, if the price increases, the investment will provide a loss (buy high and sell low). Options are risky because changes in price need to occur before the expiration date or the investor can lose the money invested in the option.

Bloom's: Analysis
Difficulty: Hard
Learning Objective: 5
Topic: Investing strategies