Financial Economics
VI Semester BA Economics
MCQ

1. To increase a given present value, the discount rate should be adjusted
   a. upward
   b. downward
   c. same
   d. none
2. In 3 years you are to receive 5,000. If the interest rate were to suddenly increase, the present value of that future amount to you would
   a. fall
   b. rise
   c. remain unchanged
   d. cannot be determined without more information
3. Money has time value because:
   a. Individuals prefer future consumption to present consumption.
   b. Money today is more certain than money tomorrow
   c. Money today is worth more than money tomorrow in terms of purchasing power.
   d. There is a possibility of earning risk free return on money invested today.
   e. (b), (c) and (d) above.
4. What does the price-to-earnings ratio (P/E) tell you?
   a. How much each of a company's products sells for on average.
   b. How much investors are willing to pay per unit of a company's earnings.
   c. How much tax per unit investors are willing to pay.
   d. None of the above
5. How is the P/E ratio calculated?
   a. Market value/quick ratio
   b. Earnings per share/market capitalization
   c. Market value per share/earnings per share
   d. None of the above
6. What is the most important use of the P/E ratio for investors?
   a. It helps investors decide how much profit a company is likely to make in future.
   b. It helps investors decide whether a company's shares are overpriced or underpriced.
   c. It helps investors decide on the most appropriate risk to reward ratio.
   d. None of the above
7. What does a high P/E ratio suggest?
   a. A company shares are currently overpriced.
   b. A company shares are currently underpriced.

c. No relation
d. None of the above

8. When operating under a single-period capital-rationing constraint, you may first want to try selecting projects by descending order of their _____ in order to give yourself the best chance to select the mix of projects that adds most to firm value.
   a. Profitability index (PI)
   b. Net present value (NPV)
   c. Internal rate of return (IRR)
   d. Payback period (PBP)
9. High P/E ratios tend to indicate that a company will _____
   a. a) grow quickly
   b. b) grow at the same speed as the average company
   c. c) grow slowly
   d. d) not grow
10. Historically, P/E ratios have tended to be _____.
   a. Higher when inflation has been high
   b. Lower when inflation has been high
   c. Uncorrelated with inflation rates but correlated with other macroeconomic variables
   d. Uncorrelated with any macroeconomic variables including inflation rates
11. The value of a bond and debenture is
   a. Present value of interest payments it gets
   b. Present value of contractual payments it gets till maturity
   c. Present value of redemption amount
   d. None of the above
12. Required rate of return>Coupon rate, the bond will be valued at
   a. Premium
   b. Par value
   c. Discount
   d. None of the above.
13. A bond is said to be issued at premium when
   a. Coupon rate>Required returns
   b. Coupon rate=Required returns
   c. Coupon rate
   d. None of the above
14. If the coupon rate is constant, the value of bond when close to maturity will be
   a. Issued value
   b. Par value
   c. Redemption value
   d. All of the above
15. Interest rates and bond prices
a. move in the same direction

b. move in opposite directions
c. sometimes move in the same direction, sometimes in opposite directions
d. have no relationship with each other (i.e., they are independent).

16. If a bond sells at a high premium, then which of the following relationships hold true? (P_0 represents the price of a bond and YTM is the bond's yield to maturity.)

a. P_0 < par and YTM > the coupon rate
b. P_0 > par and YTM > the coupon rate
c. P_0 > par and YTM < the coupon rate
d. P_0 < par and YTM < the coupon rate

17. The expected rate of return on a bond if bought at its current market price and held to maturity:

a. Yield to maturity
b. Current yield
c. Coupon yield
d. Capital gains yield

18. If an investor may have to sell a bond prior to maturity and interest rates have risen since the bond was purchased, the investor is exposed to

a. the coupon effect.
b. interest rate risk.
c. a perpetuity.
d. an indefinite maturity.

19. If the intrinsic value of a stock is greater than its market value, which of the following is a reasonable conclusion?

a. The stock has a low level of risk.
b. The stock offers a high dividend payout ratio.
c. The market is undervaluing the stock.
d. The market is overvaluing the stock.

20. When the market's required rate of return for a particular bond is much less than its coupon rate, the bond is selling at:

a. a premium.
b. A Discount
c. cannot be determined without more information
d. face value.

21. In the Gordon model, the value of common stock is the _____.

a. Net value of all assets which are liquidated for their exact accounting value
b. Present value of a constant growing dividend stream
c. Actual amount each common stockholder would expect to receive if the firm's assets are sold
d. Present value of a non-growing dividend stream

22. Which of the following best describes the constant-growth dividend discount model?

a. It is the formula for the present value of an ordinary annuity.
b. It is the formula for the present value of a finite, uneven cash flow stream.
c. It is the formula for the present value of a growing annuity.
d. It is the formula for the present value of a growing perpetuity.

23. Which of the following is another name for the required return on a stock?

a. Retention ratio.
b. Discount rate
c. Dividend payout ratio
d. Value

24. Which of the following is equal to the present value of all cash proceeds received by a stock investor?

a. Discount rate
b. Dividend payout ratio
c. Retention ratio.
d. Value

25. This type of risk is avoidable through proper diversification.
a. Portfolio risk
b. Systematic risk
c. Unsystematic risk
d. Total risk
26. A statistical measure of the degree to which two variables (e.g., securities' returns) move together.
a. Coefficient of variation
b. Variance
c. Covariance
d. Certainty equivalent
27. An "aggressive" common stock would have a "beta"
a. equal to zero.
b. greater than one.
c. equal to one
d. less than one.
28. A line that describes the relationship between an individual security's returns and returns on the market portfolio.
a. characteristic line
b. security market line
c. capital market line
d. beta
29. According to the capital-asset pricing model (CAPM), a security's expected (required) return is equal to the risk-free rate plus a premium

a. equal to the security's beta.
b. based on the unsystematic risk of the security.
c. based on the total risk of the security.
d. based on the systematic risk of the security.

30. The risk-free security has a beta equal to _____, while the market portfolio's beta is equal to _____.
a. one; more than one.
b. one; less than one.
c. zero; one.
d. less than zero; more than zero.

31. Beta is the slope of
a. the security market line.
b. the capital market line.
c. a characteristic line.
d. the CAPM.

32. A measure of "risk per unit of expected return."
a. Standard deviation
b. Coefficient of variation
c. Coefficient of correlation
d. Beta

33. The greater the beta, the _____ of the security involved.
a. greater the unavoidable risk
b. greater the avoidable risk
c. less the unavoidable risk
d. less the avoidable risk

34. Which of the following was not an assumption for the MM theory?

a. No transaction costs

b. Securities are infinitely divisible

c. Investors have homogeneous expectations

d. All the firms pay tax on their income at the same rate

35. An asset’s market (systematic) risk is measured by its
a. Variance of returns.
b. Beta coefficient.
c. Standard deviation.
d. Total return.

36. This type of risk is avoidable through proper diversification.
a. Portfolio risk
b. Systematic risk
c. Unsystematic risk
d. Total risk

37. Modigliani and Miller argue that the dividend decision _____.
a. is irrelevant as the value of the firm is based on the earning power of its assets
b. is relevant as the value of the firm is not based just on the earning power of its assets
c. is irrelevant as dividends represent cash leaving the firm to shareholders, who own the

firm anyway
d. is relevant as cash outflow always influences other firm decisions
38. The payoffs for financial derivatives are linked to
a. securities that will be issued in the future.
b. the volatility of interest rates.
c. previously issued securities.
d. government regulations specifying allowable rates of return.
39. Financial derivatives include
a. stocks.
b. bonds.
c. futures.
d. none of the above.
40. Which of the following is not a financial derivative?
a. Stock
b. Futures
c. Options
d. Forward contracts
41. By hedging a portfolio, a bank manager
a. reduces interest rate risk.
b. increases reinvestment risk.
c. increases exchange rate risk.
d. increases the probability of gains.
42. Which of the following is a reason to hedge a portfolio?
a. To increase the probability of gains.
b. To limit exposure to risk.
c. To profit from capital gains when interest rates fall.
d. All of the above.
43. Hedging risk for a long position is accomplished by
a. taking another long position.
b. taking a short position.
c. taking additional long and short positions in equal amounts.
d. taking a neutral position.
44. A contract that requires the investor to buy securities on a future date is called a
a. short contract.
b. long contract.
c. hedge.
d. cross.
45. To say that the forward market lacks liquidity means that
a. forward contracts usually result in losses.
b. forward contracts cannot be turned into cash.
c. it may be difficult to make the transaction.
d. forward contracts cannot be sold for cash.
46. A disadvantage of a forward contract is that
a. it may be difficult to locate a counterparty.
b. the forward market suffers from lack of liquidity.
c. these contracts have default risk.

d. all of the above.
47. Forward contracts are risky because they
a. are subject to lack of liquidity
b. are subject to default risk.
c. hedge a portfolio.
d. both (a) and (b) are true.
48. Hedging in the futures market
a. eliminates the opportunity for gains.
b. eliminates the opportunity for losses.
c. increases the earnings potential of the portfolio.
d. both (a) and (b) of the above.
49. Futures markets have grown rapidly because futures
a. are standardized.
b. have lower default risk.
c. are liquid.
d. all of the above.
50. On the expiration date of a futures contract, the price of the contract
a. always equals the purchase price of the contract.
b. always equals the average price over the life of the contract.
c. always equals the price of the underlying asset.
d. always equals the average of the purchase price and the price of underlying asset.
51. Elimination of riskless profit opportunities in the futures market is
a. hedging.
b. arbitrage.
c. speculation.
d. underwriting.
52. The number of futures contracts outstanding is called
a. liquidity.
b. volume.
c. float.
d. turnover.
53. The payoffs for financial derivatives linked to
a. Securities that will be issued in the future
b. The volatility of interest rates
c. previously issued securities
d. none of the above.
54. The amount paid for an option is the
a. Strike price
b. Discount
c. Premium
d. Yield
55. An option allowing the owner to sell an asset at a future date is a ……
a. Put option
b. Call option
c. Forward option
d. Future contract

56. Futures differ from forwards because they are
a. used to hedge portfolios.
b. used to hedge individual securities.
c. used in both financial and foreign exchange markets.
d. a standardized contract.
57. Options are contracts that give the purchasers the
a. option to buy or sell an underlying asset.
b. the obligation to buy or sell an underlying asset.
c. the right to hold an underlying asset.
d. the right to switch payment streams.
58. The price specified on an option that the holder can buy or sell the underlying asset is called
a. premium.
b. call.
c. strike price.
d. None of the above
59. The seller of an option has the
a. right to buy or sell the underlying asset.
b. the obligation to buy or sell the underlying asset.
c. ability to reduce transaction risk.
d. right to exchange one payment stream for another.
60. An option that gives the owner the right to buy a financial instrument at the exercise price within a specified period of time is a
a. call option.
b. put option.
c. American option.
d. European option.
61. An option allowing the owner to sell an asset at a future date is a
a. put option.
b. call option.
c. swap.
d. forward contract.
62. According to the Black Scholes model, the trading of securities and the stock prices moves respectively
a. Constant and randomly
b. Randomly and constant
c. Randomly and continuously
d. Continuously and randomly
63. In Binomial approach of option pricing model, the value of stock is subtracted from call option obligation value to calculate
a. Current value of portfolio
b. Future value of portfolio
c. Put option value
d. Call option value
64. According to put call parity relationship, the call option plus the present value of exercise price minus stock is to calculate
a. Present value of option

b. call option
c. put option
d. future value of option

65. According to the Black Scholes model, the selling and buying of the stock have
    a. Discount rate
    b. Transaction costs
    c. No transaction costs
    d. No discounts

66. The pricing model approach in which it is assumed that stock price can have one of the two values of stock is classified as
    a. Valued approach
    b. Marketability approach
    c. Stock approach
    d. Binomial approach

67. The investor who buys shares and writes a call option on stock is classified as
    a. Put investor
    b. Call investor
    c. Hedger
    d. Volatile hedge

68. Option pricing model developed John Cox, Stephen Ross and Mark Rubinstein is
    a. Binomial Option pricing model
    b. Black scholes model
    c. Cost of carry model
    d. Backwardation model

69. Which of the following is not used in Future pricing
a. Cost of carry model
b. Expectation model
c. CAPM
d. Binomial model

70. Which of the following is not used in Option pricing
a. Cost of carry model
b. the Put Call Parity Theorem;
c. Binomial option pricing model (BOPM)
d. Black-Scholes option pricing model.

71. Cost of capital refers to:
a. Flotation cost
b. Dividend
c. Minimum required rate of return
d. None of the above

72. Cost of capital is highest in case of
a. Debt
b. Equity
c. Loans
d. Bonds

73. Minimum rate of return that a firm must earn in order to satisfy its investors, is also known as:
a. Average return on investment
b. Weighted average cost of capital
c. Net profit ratio
d. Average cost of borrowing
74. Cost of capital is lowest in case of:
a. Debt
b. Equity
c. Loans
d. Bonds
75. In order to find out cost of equity under CAPM, which of the following is not required:
a. Beta of the stock
b. Market rate of return
c. Market price of equity share
d. Risk free rate of interest
76. Interest on government bonds is also known as:
a. Beta of the stock
b. Market rate of return
c. Market price of equity share
d. Risk free rate of interest
77. Which of the following method is not used for calculation of cost of equity?
a. Dividend yield approach
b. CAPM
c. Rate of Pref. Dividend plus risk
d. Price Earnings ratio
78. Cost of equity share capital is more than cost of debt because:
a. Equity shares are highly liquid
b. Equity shares have higher risk than debt
c. Market price of equity is highly volatile
d. Face value of equity is less than debentures
79. CAPM accounts for:
a. Unsystematic risk
b. Systematic risk
c. Both a and b
d. None of the above
80. Capital market line is:
a. Capital allocation line of a market portfolio
b. Capital allocation line of a risk free asset
c. Both a and b

d. None of the above
81. Risk of two securities with different expected return can be compared with:
a. Coefficient of variation
b. Standard deviation of securities
c. Variance of Securities
d. None of the above
82. A portfolio having two risky securities can be turned risk less if
a. The securities are completely positively correlated
b. If the correlation ranges between zero and one
c. The securities are completely negatively correlated
d. None of the above.
83. Risk-Return trade off implies
a. Minimization of risk,
b. Maximization of risk,
c. Ignorance of risk
d. Optimization of risk
84. The____ is an effort to achieve a balance between the desire for the lowest possible risk and the highest possible return.
a. group
b. investment
c. risk return trade off
d. securities
85. Higher _____ is associated with greater probability of higher return.
a. return
b. risk
c. investment
d. All
86. _____ is a technique of reducing the risk involved in a portfolio.
a. Beta
b. Variance
c. range
d. Diversification
87. Systematic risk is _____risk because the investors cannot avoid or reduce the risk arising.
a. Diversification
b. undiversificaion
c. risk
d. beta
88. The_____model is a model that describes the relationship between systematic risk and expected return for assets, particularly stocks.
a. CAPM

b. Return
c. Risk
d. Investment

89. Capital Market Line (CML) is the _____ line drawn from the point of the risk-free asset to the feasible region for risky assets.

a. Non-tangent
b. opposite
c. adjacent
d. Tangent

90. _____ is a model, which help in the identification of portfolios and individual securities as undervalued of Overvalued with the help of CML and SML.

a. CRPM
b. CAPR
c. CAPM
d. CDAM

91. The Security Market Line has a _____ slope, indicating that the expected return increases with risk (B).

a. Negative
b. Positive
c. zero
d. Beta

92. _____ is a linear relationship between expected return and systematic risk (Beta) on which both portfolios and individual securities can lie.

a. Security market line
b. Capital market line
c. Tangent Market Line
d. None of the above

93. The interest rate used in the present value calculation is often referred to as?

a. Discount rate
b. Inflation rate
c. Nominal rate
d. None of the given option

94. Which one of the following is the procedure of finding out the Present Value (PV)?

a. Discounting
b. Compounding
c. Time value of money
d. All of above

95. Which of the following is the variability of return on stocks or portfolios associated with changes in return on the market as a whole?

a. Systematic risk

b. Standard deviation
c. Unsystematic risk
d. Coefficient of variation

96. The conventional measure of dispersion is _____?
a. A probability distribution
b. The expected return
c. The standard deviation
d. Coefficient of variation

97. The rate of return you earn on an investment before adjusting for inflation is called the _____ rate?
a. Nominal
b. Real
c. Premium
d. Coupon

98. The additional return we must expect to receive for assuming risk?
a. Risk discount
b. Risk premium
c. Par risk
d. Risk free rate of return

99. The single investment risk that investor would face if he or she held only one financial asset is called _____?
a. Stand alone risk
b. Portfolio risk
c. Diversifiable risk
d. Systematic risk

100. If we multiply each possible outcome by its probability of occurrence and then sum these products than we get?
a. Variance
b. Expected Rate of Return
c. Standard Deviation
d. Co-efficient of Variation

Answers

1.B	**11.B**	**21.B**	**31.C**	**41.A**	**51.B**	**61.A**	**71.C**	**81.A**	**91.B**
2.A	**12.C**	**22.D**	**32.B**	**42.B**	**52.A**	**62.D**	**72.B**	**82.A**	**92.A**
3.E	**13.A**	**23.B**	**33.A**	**43.B**	**53.C**	**63.A**	**73.B**	**83.D**	**93.A**
4.B	**14.C**	**24.D**	**34.D**	**44.B**	**54.C**	**64.C**	**74.A**	**84.C**	**94.A**
5.C	**15.B**	**25.C**	**35.B**	**45.C**	**55.A**	**65.B**	**75.C**	**85.B**	**95.A**
6.B	**16.C**	**26.C**	**36.C**	**46.D**	**56.D**	**66.D**	**76.D**	**86.D**	**96.C**
7.A	**17.A**	**27.B**	**37.A**	**47.D**	**57.A**	**67.C**	**77.C**	**87.B**	**97.A**
8.A	**18.B**	**28.A**	**38.C**	**48.D**	**58.C**	**68.A**	**78.B**	**88.A**	**98.B**
9.A	**19.C**	**29.D**	**39.C**	**49.D**	**59.B**	**69.D**	**79.B**	**89.D**	**99.A**
10.B	**20.A**	**30.C**	**40.A**	**50.C**	**60.A**	**70.A**	**80.C**	**90.C**	**100.B**

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