I. Multiple Choice

1. Which of the following best describes why actual transactions prices diverge from the theoretical equilibrium price?
   - A. Supply often exceeds demand for a security.
   - B. Bringing buyers and sellers together in the same location at the same time is difficult.
   - C. The question is irrelevant because actual transactions prices rarely diverge from the theoretical equilibrium price.
   - D. Demand often exceeds the supply of a security.

2. Which one of the following is *not* one of the three main types of securities market organization?
   - A. auction market
   - B. electronic market
   - C. brokered market
   - D. dealer market

3. The market organization of the New York Stock Exchange is best described as a(n) __.
   - A. brokered market
   - B. auction market
   - C. primary market
   - D. dealer market

4. The market organization of the NASDAQ is best described as a(n) __.
   - A. brokered market
   - B. dealer market
   - C. auction market
   - D. primary market

5. The greater the number of buyers and sellers with access to securities markets, the __.
   - A. higher the equilibrium price will be
   - B. less marketable the security
   - C. close securities will be to the true equilibrium
   - D. lower the true equilibrium price will be

6. Which of the following statements about the primary market is *not* true?
   - A. Investment banks advertise their successful underwritings in the financial press in the form of announcements called tombstones.
   - B. For the most part, the primary market operates on the floors of the major exchanges.
   - C. Investment banks get compensated for their underwriting efforts in the form of an underwriting spread.
   - D. When investment banks underwrite a security, they typically purchase the security from the issuer and thereby expose their own capital.
7. Which one of the following statements about the bid-asked spread is not true?
   A. The smaller the bid-asked spread, the less the liquidity
   B. The bid price is less than the asked price.
   C. The bid-asked spread will be less to the extent that the anticipated risk of large equilibrium price changes is low.
   D. The bid-asked spread will be more to the extent that the expected volume of transactions is small.

8. The extent to which new information affecting the underlying value of the security is reflected quickly in equilibrium price changes is referred to as ___.
   A. execution efficiency
   B. securities efficiency
   C. allocation efficiency
   D. operational efficiency

9. Which one of the following best describes the implication of (or what’s popularly referred to as) an “efficient capital market” for trading securities?
   A. Investors should not trade securities because prices quickly incorporate all information.
   B. An efficient capital market implies nothing about the benefits of trading.
   C. Investors should trade securities because the transactions costs associated with trading are low.
   D. Investors should trade securities because prices quickly incorporate all information.

10. Insuring that all information relevant for the pricing of securities is available to the public is the responsibility of the ___.
    A. Federal Reserve Bank
    B. National Association of Securities Dealers
    C. Securities Industry Association
    D. Securities and Exchange Commission

II. True or False
11. Yield curves are drawn at a point in time and not over a period of time. Thus, one can draw a yield curve for government securities on any given day by simply plotting the yield on government issues published daily in the financial pages of major newspapers.
12. According to the supply and demand for securities approach to term structure, the yield curve must be upward sloping.
13. As long as the expected future short-term rates are unchanged, changes in the relative supply of long- and short-term securities will not affect the shape of the yield curve.
14. A rising yield curve (upward sloping) means that the price of short-term securities is higher than the price of long-term securities of the same issuer.

15. According to the expectations theory, investors are indifferent between short-term government securities and long-term corporate securities.

16. According to the liquidity preference theory, investors on balance, will demand a premium for holding long-term securities.

17. No evidence has ever been found that would suggest that liquidity premiums are actually embedded in long-term interest rates.

18. When interest rates are high relative to what they have been, the yield curve should be downward sloping.

19. The evidence indicates that short-term interest rates fluctuate more than long-term interest rates over the course of the business cycle.

20. The fact that over long periods of time the yield curve tends to be upward sloping more often than it is downward sloping is consistent with the expectations theory of the term structure of interest rates.

III. Fill in the Blank

21. When one examines the yield on bonds, it is important to distinguish between four different yields or rates. These are the coupon rate, current yield, yield to maturity, and return.

22. When the price of a bond rises, its yield falls

23. When the yield on a bond drops, its price rises

24. An increase in the level of interest rates will cause the price of short-term bonds to fall less than the price of long-term bonds.

25. The real rate of interest is equal to the difference between the nominal interest rate and the expected inflation rate.

26. Since the interest rate is a price, it must be determined by the interaction of the supply of and demand for credit or loanable funds.
27. The supply-of-funds curve is **upward-sloping**, reflecting the fact that lenders/savers are willing to extend more credit the **higher** the interest rate.

28. When analyzing fluctuations in the interest rate, it is important to distinguish between movements along a demand or supply curve and a **shift** in the curve.

29. The federal government borrows to finance federal **budget deficits**

30. Anything that increases the eagerness to borrow shifts the **demand** curve for loanable funds to the **right** and drives interest rates **higher**.