

## Chapter 4: Organization and Functioning of Securities Markets

1. All but one of the following is a function of a securities exchange:
  - a. economic function
  - b. continuous pricing function
  - c. investor investment loss insurance function
  - d. fair pricing function
  
2. Which of the following is the best example of the continuous pricing function of security exchanges?
  - a. Market prices tend to be stable.
  - b. One can always have trades made and find a price quote.
  - c. High risk ventures are able to sell their new securities in the primary market.
  - d. The markets are staying open twenty-four hours a day.
  
1. which of the following transactions occurred on the primary market:
  1. Bought 100 shares of Alwataniya Corp.
  2. Bought a certificate of deposit from a local bank.
  3. Bought 100 shares of Al-Ahli from your mother- in-law.
  4. Bought a bond direct from Eltesheelat corp.
  
4. Before a firm goes public:
  - a. it develops a prospectus and files it with the Securities and Exchange Commission (SEC).
  - b. it ultimately sends the prospectus to investors who may want to invest in the initial public offering (IPO).
  - c. it attempts to gauge the price that will be paid for its shares.
  - d. all of the above
  
5. The transaction cost to the issuing firm associated with an IPO is usually \_\_\_\_\_ percent of the funds raised.
  - a. 1
  - b. 3
  - c. 7
  - d. 12
  
6. There is evidence that IPOs of firms perform \_\_\_\_\_ immediately after issuance and \_\_\_\_\_ over a period of a year or longer, on average.
  - a. well; well
  - b. poorly; poorly
  - c. well; poorly
  - d. poorly; well
  
7. Which of the following does NOT correctly finish this sentence: In the US,.....
  - a. the OTC markets does not have a central location
  - b. OTC markets are operated as auction market
  - c. Financial markets function as both primary and secondary markets for debts and equity securities
  - d. New issue securities occur in primary markets
  - e. Auction markets have a physical location

8. The "specialist" on the New York Stock Exchange is best associated with the \_\_\_\_\_ function of security exchanges.
- economic
  - regulation
  - continuous pricing
  - fair pricing
9. Which of the following statements is associated with improved operational efficiency of financial markets?
- New information quickly spreads via the Internet.
  - Competition among companies reduces their product/service prices and increases their profitability.
  - Competition and technology applications have reduced trading commissions to under \$10 per trade.
  - Companies have investor relations specialists to communicate with stock analysts and news reporters.
10. Which of the following NASDAQ terms are associated with a progression from large to small companies?
- pink sheet issues; small-cap issues, national market issues
  - national market issues; pink sheet issues; small-cap issues
  - national market issues; listed issues; small-cap issues
  - national market issues; small-cap issues; pink sheet issues
11. The \_\_\_\_\_ lists stocks that have a price below \$1 per share (penny stocks).
- NASDAQ National Market
  - OTC Bulletin Board
  - New York Stock Exchange
  - none of the above
12. \_\_\_\_\_ stocks are listed on the New York Stock Exchange, and these stocks have a \_\_\_\_\_ aggregate market value than the stocks listed on the NASDAQ.
- Fewer; lower
  - More; higher
  - Fewer; higher
  - More; lower
13. Which of the following statement(s) is/are FALSE?
- IBM plans to issue 500,000 new shares to raise operating funds. This is an example of seasoned offering.
  - Initial Public Offering (IPO) means the issuer is selling securities for the first time. For instance, PALM issued its IPO in 2000.
  - Since stock prices often rise significantly on the day an IPO is issued, investors tend to invest in high return and low risk IPOs.
  - IBM is able to generate additional funds whenever investors buy shares from secondary markets
  - Both c and d are false statements.

14. Which of the following statement(s) is/are TRUE regarding the function of investment bankers?
- A. They underwrite new issues to assume risk by buying securities from the issuers and reselling them to investors.
  - B. They help issuers design types of securities, price the securities, and assess the market condition for the sale of securities.
  - C. They can operate both in the primary market and the secondary market.
  - D. In order to maximize the profits, investment bankers prefer to work alone with each IPO deal.
  - E. All the above statements are true, except d.
15. A prospectus
- A. is a "short form registration" to permit qualified companies to place securities on the shelf by auctioning the securities to the lowest cost bidders.
  - B. is a legal document to register securities for trading on NYSE.
  - C. summarizes information about IPO securities to the potential buyers.
  - D. is a legal document to permit companies to sell securities to the public.
61. The **NYSE** is best described as
- a. an agency auction market
  - b. the premier primary market in the world
  - c. a negotiated market where blue chip stocks trade
  - d. an auction market based on the dealer system as opposed to the specialist system
62. **Nasdaq** is best described as
- a. an agency auction market
  - b. a primary market for smaller securities
  - c. a negotiated market consisting of a network of dealers
  - d. an organized exchange with a physical location
63. Which of the following statements is **INCORRECT** in contrasting **Nasdaq vs. the NYSE**?
- a. Nasdaq is a negotiated market while the NYSE is an agency auction market
  - b. Nasdaq is an example of an agency auction market
  - c. The NYSE is an agency auction market while Nasdaq is a computerized network of dealers
  - d. The Nasdaq Stock Market is one of three major marketplaces in the United States
69. Which of the following statements concerning the **current status of the markets** is **INCORRECT**?
- a. The Dow Jones Industrial Index has reached highs in the past of more than 11,000
  - b. The S&P 500 Index is currently around 600
  - c. The American Stock Exchange accounts for roughly 3-4% of total volume traded among all markets
  - d. Dow Jones points are not equal to dollars

16. Select the FALSE statement,
- A. After the merger between AMEX and NASDAQ, all securities are traded in the central marketplace.
  - B. Regional exchanges permit the trading of dual-listed securities.
  - C. NYSE has an advantage over regional exchanges because it can handle big block trades.
  - D. OTC is a negotiated market and handles the trade of unlisted securities.
  - E. NASD is a self-regulated body of brokers and dealers who oversee OTC practices.
17. Which of the following statement(s) is/are TRUE regarding NASDAQ trading?
- A. An order can be executed internally if the broker makes a market in the tentative trading security.
  - B. NASDAQ's National Market System is a screen-based negotiation service that member firms use to quickly obtain efficient order execution.
  - C. As of the year 2000, the dollar volume and share volume on NASDAQ are more than those on NYSE.
  - D. Both a and b.
  - E. Both
18. Which of the following statement(s) is/are TRUE?
- A. Electronic Communication Networks (ECNs) offer automation, lower costs and anonymity to trade securities.
  - B. Institutional Network (Instinet), owned by Reuters, is a system which started the same time as ECNs.
  - C. After-hours trading is highly dependent on standard trading in organized exchanges.
  - D. All of the above.
  - E. Both a and c are true statements.
75. With regard to the **S&P 500 Index**, choose the **CORRECT** statement.
- a. It is less frequently used than the DJIA by institutional investors
  - b. current value of 10000 for this index would indicate that the average price of the 500 stocks in the index is 100 times the base number
  - c. It is a price-weighted index of 500 large stocks
  - d. Stock splits and dividends are automatically accounted for in its calculation
76. The **Russell 1000 Index** is a
- a. price-weighted market index used to measure small cap stocks
  - b. value-weighted market index used to measure large cap stocks
  - c. value-weighted index used to measure small cap stocks
  - d. price-weighted index used to measure mid-cap stocks
19. Which of the statements(s) about Foreign markets is/are TRUE?
- A. The U.S. now makes up about 50% of the world's stock market capitalization.
  - B. London Stock Exchange handles both listed and unlisted securities.
  - C. Chinese companies can be traded on the Hong Kong exchanges and exchanges in China.
  - D. Thin liquidity seems to be the common problem in the emerging markets.
  - E. All of the above, except a.

20. The Securities Investor Protection Corporation (SIPC), established in 1970 is intended to:
- protect investors against loss in the securities market.
  - protect securities firms from customer fraud, etc.
  - protect the SIPC from fraud from brokers and securities firms.
  - protect investors from fraud and securities firm failure.
21. Circuit breakers and trading curbs on the NYSE are designed to promote which of the following functions of exchanges?
- economic function
  - safety function
  - continuous pricing function
  - fair pricing function
22. Which of the following is the best example of the continuous pricing function of security exchanges?
- Market prices tend to be stable
  - One can always have trades made and find a price quote.
  - High risk ventures are able to sell their new securities in the primary market.
  - The markets are staying open twenty-four hours a day.
23. The "specialist" on the New York Stock Exchange is best associated with the \_\_\_\_\_ function of security exchanges.
- economic
  - regulation
  - continuous pricing
  - fair pricing
24. A bid price is associated with what someone will \_\_\_\_\_, while the ask price is best associated with what someone will \_\_\_\_\_.
- sell; buy
  - buy; sell
  - ask to sell; buy
  - sell; sell
25. Which of the following statements best indicates the economic function of security exchanges?
- The volume of secondary trading is very high.
  - Investors can check the Internet for the current prices of their securities.
  - Exchanges facilitate the flow of saving to investment and provide liquidity.
  - A security exchange has a high volume of trading by many diverse investors.
26. The SEC's Division of Market Regulation:
- reviews the registration statement files when a firm goes public.
  - requires the orderly disclosure of securities trades by various organizations that facilitate the trading of securities.
  - assesses possible violations of the SEC's regulations and can take action against offenders.
  - none of the above

27. Which of the following are considered secondary markets?

- I. Kuwait Stock Exchange (kse) j
- II. Over the counter markets
- III. Fourth market
- IV. American Stock Exchange (AM EX)

- a. I only.
- b. I and II only.
- c. I, II, and IV only.
- d. I, II, III, and IV.

28. Which of the following stocks is most likely to influence the S&P 400 Industrial Average?

- a. A medium size manufacturing company.
- b. A very small technology company.
- c. A very large bank.
- d. A stock with a high price per share

29. Which of the following activities are *not* conducted by specialists on the NYSE ?  
*(1991 CFA exam) 2*

- a. Acting as dealers for their own accounts.
- b. Monitoring compliance with margin requirements.
- c. Providing liquidity to the market.
- d. Monitoring and executing unfilled limit orders.

30. The role of investment banker does *not* include:

- A. giving companies advice on the price, amount and timing of an issue.
- B. a commitment to maintain a continuous primary market for listed issues.-
- C. managing a syndicate for distribution on a firm-price (dealer) or best-efforts (broker) basis.
- D. helping maintain an after market for OTC issues.

31. What is a securities market characterized by dealers who buy and sell securities for their own inventories traditionally called ? *(1991 CFA exam)*

- a. A primary market.
- b. A secondary market.
- c. An over-the-counter market.
- d. An institutional market.

32. What is the over-the-counter market for exchange-listed securities called ? *(1991 CFA exam)*

- a. Third market.
- b. Fourth market.
- c. After-market.
- d. Block market.

33. Which of the following statements are correct about selling stocks short?

- I. A short sale can only be made on an uptick.
- II. Dividends are paid to the short seller for the risk taken.
- III. Short sellers must provide a margin.
- IV. Only listed stocks can be shorted.

- a. I and III.
- b. I and IV.
- c. I, II, and III.
- d. I, II, III, and IV

34. The fourth market

- A) is another name for the global market.
- B) is another name for 24-hour trading.
- C) refers to trading done on regional exchanges.
- D) refers to transactions made directly between large institutions, bypassing brokers and dealers.

35. A trading order that is canceled unless executed within a designated time period is called a: <sup>4</sup>

- A. stop-loss order..
- B. limit order.
- C. market order.
- D. none of these.

36. An order to buy/sell at the best price prevailing in the market at the moment is a(n):

- a. market order
- b. limit order
- c. stop order
- d. fill or kill

37. A limit order to buy/sell stock varies from a market order. Which of the following statements best differentiates the limit from the market order?

- a. The limit order must specify a price.
- b. The limit order specifies the minimum amount of funds paid/received.
- c. The limit order specifies a price and a time limit for the order.
- d. The limit order is generally executed before the market order.

38. A stop order is most likely to be used in which of the following situations?

- a. A person who wishes to halt the processing of a prior order.
- b. A person who owns stock can set a price above the market price in order to minimize possible losses.
- c. A person who owns stock can set a price above/below the current market price in order to protect profits/reduce losses, respectively.
- d. A person who is considering buying stock.

39. You bought a stock for \$20 and want to make sure that you sell if it falls to \$15. What type of order do you place with your broker? 3
- Market
  - Stop limit
  - Stop loss
  - Fill or kill
40. You short 300 shares of EBAY at \$40 per share with a 50% initial margin. If you cover your short position (i.e., buy 300 shares) at \$35 per share, what is your percentage return?
- 75%
  - 25%
  - 12.5%
  - 25%
  - 75%
41. You purchased 30 shares of common stock on margin for \$50 per share. The initial margin is 60% and the stock pays no dividend. Your rate of return would be if you sell the stock at \$40 per share. Ignore interest margin.
- 33%
  - 33%
  - 44%
  - 56%
42. What's the maximum amount of money you could lose if you short 100 shares of EBAY at \$60 per share, assuming EBAY has a total of 1 million shares outstanding?
- \$6,000
  - \$60,000,000
  - \$100,000,000
  - \$600,000,000,000
43. Assume that an investor purchases a stock on margin. The margin requirement is 50%, the market value of the stock at purchase is \$20,000, the annual interest rate is 10%, and the stock has a dividend yield of 4%. The commission is \$200. What is your return if the stock price increases by 25% after 6 months and is sold?
- 50%
  - 42%
  - 45%
  - 47%
44. You short 2,000 shares of Burkeen Enterprises at a price of \$60 per share and a 50 % margin. If the maintenance margin is 40 %, you will receive a margin call if the stock price is: 3
- below \$64.29
  - below \$68.27
  - above \$64.29
  - above \$68.27
  - above \$72.13

45. You purchased 800 shares of stock at a price of \$121 per share with a 60% initial margin. If the maintenance margin is 35%, at what price will you receive a margin call? <sup>2</sup>

- A) \$67.25
- B) \$74.46
- C) \$82.38
- D) \$86.24
- E) \$91.87

46. A \$100,000 purchase on 50% initial margin, 30% maintenance margin declines to \$90,000. Which of the following statements is true?

- a. A maintenance margin call is in order!
- b. The customer still has buying power.
- c. The stop order triggered by the 30% maintenance margin has sold stock to cover the loan.
- d. The customer had an original equity proportion of 50%, but now it is 30%.

47. Small cap stocks tend to have low:

- a. price-book ratios. <sup>1</sup>
- b. sales revenues.
- c. book values.
- d. net income.

48. In the finance literature, small cap stocks are small in terms of:

- a. market value. <sup>1</sup>
- b. sales.
- c. book value.
- d. all of the above.

49. A 10K report is filed \_\_\_\_\_, while a 10Q report is filed \_\_\_\_\_.

- A) annually...monthly
- B) semi-annually...quarterly
- C) quarterly...annually
- D) annually...quarterly

7. A sale by Microsoft of new stock to the public would be a(n)

- A) short sale.
- B) initial public offering.
- C) secondary market transaction.
- D) seasoned new issue offering.
- E) none of the above.

8. You sell short 200 shares of Bad Co. at a market price of \$55 per share. Your maximum possible loss is

- A) \$11,000.
- B) zero.
- C) unlimited.
- D) \$22,000.
- E) cannot tell from the given information.