# ETS Finance Review Quiz

**Time Value of Money**

1. Bill plans to fund his individual retirement account (IRA) with a contribution of $2,000 at the end of each year for the next 20 years. If Bill can earn 12 percent on his contributions, how much will he have at the end of the twentieth year?
   1. $19,292
   2. $14,938
   3. $40,000
   4. $144,104
2. \_\_\_\_\_\_\_ refers to finding the present value of a lump sum (e.g. moving it back in time)?
   1. Compounding
   2. Discounting
3. Generally, an increase in risk will result in required return or interest rate.
   1. an undetermined
   2. a lower
   3. an unchanged
   4. a higher
4. The future value of $1,000 given today will be larger if the investor earns an interest rate compounded more frequently.
   1. True
   2. False
5. The present value of $1,000 promised in the future (i.e., FV = $1,000) will be larger if the investor requires a higher interest rate.
   1. True
   2. False
6. Based on the notion of the time value of money, which of the following equally risky alternatives would you prefer?
   1. $5000 today
   2. $5000 in one year
   3. $4000 in four years
   4. $4,000 in ten years

**Capital Budgeting / Cost of Capital**

1. The primary goal of the financial manager is
   1. minimize return.
   2. maximize shareholder wealth.
   3. maximize profit.
   4. minimize risk.
2. The basic variables that must be considered in determining the initial investment associated with a capital budgeting project are all of the following EXCEPT:
   1. proceeds from the sale of the existing assets.
   2. cost of the new asset.
   3. incremental annual savings produced by the new asset.
   4. taxes on the sale of an existing asset.
3. A firm is evaluating three (independent) projects. The NPV for each project follows. The firm should:

Project NPV

1 $100

2 $ 10

3 -$100

* 1. reject all projects
  2. accept projects 1 and 2 and reject project 3
  3. accept projects 1 and 3 and reject project 2
  4. accept projects 1 and reject projects 2 and 3

1. WACC will never be greater than the firm’s cost of equity, nor less than the firm’s after-tax cost of debt.
   1. True
   2. False

**Financial Markets – Firm Valuation**

1. An efficient portfolio is one that
   1. maximizes return for a given level of risk
   2. minimizes return for a given level of risk
   3. maximizes risk for a given level of risk
   4. maximizes return at all risk levels
2. Combining negatively correlated assets having the same expected return results in a portfolio with level of expected return and level of risk
   1. a higher; a lower
   2. a lower; a higher
   3. the same; a lower
   4. the same; a higher
3. Required return and risk
   1. positively affect stock price.
   2. negatively affect on stock price.
   3. have opposite effects on stock price.
   4. have no effect on stock price.
4. \_\_\_\_\_\_\_\_\_ risk represents the portion of an asset's risk that can be eliminated by combining assets with less than perfect positive correlation
   1. nondiversifiable
   2. market
   3. total
   4. diversifiable
5. Asset P has a beta of 0.9. The risk-free rate of return is 8 percent, while the return on the market portfolio of assets is 14 percent. The asset's required rate of return is:
   1. 10 percent
   2. 6.0 percent
   3. 5.4 percent
   4. 13.4 percent
6. ALMOST DONE ☺
7. How might an exporter hedge interest rate risk?
   1. Buy a call option
   2. Short a futures contract
   3. Enter into forward contract to purchase the foreign currency
8. Foreign exchange risk refers to the risk created by
   1. the potential seizure of an MNC's operations in a host country
   2. the potential nationalization of the MNC's operations by a host government
   3. the fixed exchange rate between two currencies
   4. the varying exchange rate between two countries
9. In the capital asset pricing model, the beta coefficient is a measure of risk and an index of the degree of movement of an asset's return in response to a change in .
   1. nondiversifiable; the Treasury Bill rate
   2. diversifiable; the bond index rate
   3. nondiversifiable; the market return
   4. diversifiable; the prime rate
10. In a primary market for securities:
    1. existing securities are traded among investors.
    2. only the securities of safer firms are traded.
    3. security dealers trade securities imbuing themselves.
    4. new issues of securities are traded.
11. If a supplier's invoice must be paid in euros, and the purchaser's currency is U.S. dollars, the purchaser can be protected against exchange-rate risk by:
    1. buying U.S. dollars forward.
    2. buying euros forward.
    3. selling U.S. dollars forward.
    4. selling euros forward.
12. \_\_\_\_\_\_\_ analysis involves the comparison of different firms financial ratios at the same point in time
    1. cross-sectional
    2. time-series
    3. marginal
    4. quantitative
13. If the FED wants to stimulate (expand) the economy, it would:
    1. increase the Fed Funds rate
    2. buy government securities
14. If financial leverage is increasing, the firm’s use of debt must be .
    1. increasing
    2. decreasing
15. Other things held constant, which of the following will cause an increase in net working capital (NWC)?
    1. Cash is used to buy marketable securities.
    2. A cash dividend is declared and paid.
    3. Merchandise is sold at a profit, but the sale is on credit.
    4. Long‑term bonds are retired with the proceeds of a preferred stock issue.

**ANSWERS**

1. D (only one value > $40,000 which is the principle amount - 20\*$2000, so interest would make FV higher than this)

2. B

3. D

4. A

5. B

6. A

7. B

8. C (will occur at t=1,2,3,…N but not t=0)

9. B (D would be correct only if they were mutually exclusive)

10. A (WACC is an average of these two costs, so it cannot be below or above)

11. A

12. C (return is an average; unique risk can be shed away for negatively correlated assets)

13. B (stock price is the PV of expected dividends; if the discount rate is increased, then PVs will fall)

14. D

15. D (Use the CAPM 🡪 8 + (14-8)\*.9 = 8 + 6\*.9 = 8 + 5.4 = 13.4%

16. ☺

17. B (Exporter will receive foreign currency at a later date –short future allows you to sell foreign currency at a later date)

18. D

19. C

20. D

21. B (will need to buy euros in the future, so buy them now & lock in the price)

22. A

23. B (when buying securities, the FED must pay for them, pumping $ in the economy for an expansionary effect)

24. A

25. C