**Investment Principles**

**Homework 3**

Following are 30 questions: each worth 3.3 points. Indicate the answer you think most correct.

**Mutual Funds**

1) Which one of the following statements concerning mutual funds is correct?

A) The selection of individual securities remains with the mutual fund investor.

B) Mutual funds were first created in the 1980s.

C) The mutual fund industry is the largest financial intermediary in the United States.

D) Mutual funds are generally highly concentrated portfolios.

2) Which of the following are advantages offered by mutual funds?

I. professional portfolio management

II. dividend reinvestment

III. consistent returns in excess of the overall market rate of return

IV. modest capital outlay for investors

A) I and II only

B) I and IV only

C) II, III and IV only

D) I, II and IV only

3) One drawback of investing in mutual funds is the

A) annual management fee.

B) lack of liquidity of fund shares.

C) amount required for the initial investment.

D) lack of information on the performance of the fund.

4) Which one of the following statements is correct concerning players in the mutual fund industry?

A) Security analysts and traders work for the management company.

B) Normally a bank serves as the custodian.

C) The management company maintains the shareholder records.

D) The mutual fund shareholders are the owners of the management company.

5) During the 7 year market cycle of 2006-2012, in which category of funds did a majority of funds outperform the market average?

A) large cap funds

B) small cap funds

C) asset allocation funds

D) In no category did a majority of funds outperform the market average.

6) Which of the following statements best describes the legal organization of mutual funds?

A) Funds are organized as a single entity that handles all functions such as custody and investment decisions.

B) Funds split their basic functions such as record keeping and investment decisions among two or more companies.

C) Funds are owned by the company that manages them.

D) A distributor keeps track of investment and redemption requests from shareholders and maintains other shareholder records.

7) To operate as a regulated investment company and enjoy the related tax benefits, a mutual fund must annually distribute to its shareholders

A) half of its realized capital gains, and interest and dividend income.

B) none of its realized capital gains, but all of its interest and dividend income.

C) all of its realized capital gains, and at least 90 percent of its interest and dividend income.

D) all of its realized capital gains and interest and dividend income.

8) A type of fund that invests in real estate and/or mortgages is known as a

A) REIT.

B) ETF.

C) sector fund.

D) hedge fund.

9) Which type of fund is always passively managed?

A) a closed-end fund

B) a growth fund

C) a value fund

D) an index fund

10) An open-end investment company

A) is involved in all trades of its shares.

B) sells shares at a discounted NAV price.

C) trades like a stock on the exchanges.

D) has a set number of shares.

**Options**

1) Purchasers of stock options

A) own a financial asset with benefits of firm ownership.

B) have a claim on the profits of the firm issuing the underlying securities.

C) have the obligation to buy or sell a predetermined amount of shares at the strike price.

D) have the right to buy or sell a certain number of underlying shares.

2) Which one of the following statements concerning options is correct?

A) One option covers 1,000 shares of stock.

B) A put gives the option holder the right to buy a stated amount of securities.

C) The owner of a call is entitled to the dividends paid on the underlying shares of stock.

D) Option holders can profit on movements of the price of the underlying security.

3) An American call option gives the owner

A) the right to buy or sell the stock at the strike price on or before the expiration date.

B) the right but not the obligation to buy the stock at the strike price on or before the expiration date.

C) the right and the obligation to buy the stock at the strike price on or before the expiration date.

D) the right but not the obligation to sell the stock at the strike price on or before the expiration date.

4) Which of the following statements concerning options are correct?

I. Options are derivative securities.

II. The value of an option is dependent upon the value of the underlying security.

III. The seller of the option retains the option premium whether or not the option is exercised.

IV. Options can provide leverage benefits.

A) II and III only

B) I, II and III only

C) I, II and IV only

D) I, II, III and IV

5) Which of the following is true about rights?

A) They are usually attached to bonds as a "sweetener."

B) The owner has several years in which to exercise the option.

C) They are a type of short-lived call option.

D) They are a type of short-lived put option.

6) The maker of a put or call is the

A) company which issued the underlying security.

B) person who facilitates the trade on the floor of the exchange.

C) party who writes the option.

D) party who decides whether or not the option is exercised.

7) Writers of option contracts

A) have a limited liability specified in the contract.

B) hope to exercise the option on favorable terms.

C) earn a commission no matter what subsequently happens to the contract.

D) earn a profit when the option expires without being exercised.

8) One reason that writing options can be a viable and profitable investment strategy is that

A) the option writer collects the quarterly dividends.

B) most options expire unexercised.

C) an option writer determines when the option is exercised.

D) an option writer can exercise the option to avoid a potential loss.

9) The ability to obtain a given equity position at a reduced capital investment, and therefore magnify returns, is known as

A) leverage.

B) straddling.

C) hedging.

D) triple witching.

10) LEAPS are a special type of option

A) that must be exercised within six months.

B) that can only be exercised on the expiration date.

C) that cannot be exercised for at least a year after it is is purchased.

D) that may have an expiration date as long as three years.

**Futures**

1) The seller of a futures contract

A) has the option of canceling the contract the following day if the price is not acceptable to him/her.

B) is legally bound to make delivery of the specified item on the specified day.

C) receives the entire contract amount at the time the contract is made.

D) must make delivery before receiving any monies on the contract.

2) A futures contract

I. obligates the buyer of the contract to buy a specified amount of a commodity.

II. grants the buyer the right to either buy or sell a specified amount of a commodity.

III. uses specified settle prices that vary with the type of commodity.

IV. establishes the delivery price based on the selling price of the futures contract.

A) I and III only

B) I and IV only

C) II and III only

D) II and IV only

3) Which of the following features are shared by futures contracts and options?

I. They have specified expiration dates.

II. Their value is derived from changes in the value of some other asset

III. unprofitable futures or options can simply be allowed expire unexercised.

IV. futures and options specify a specific price at which the underlying asset can be bought or sold.

A) I and III only

B) I and IV only

C) II and III only

D) I, and II only

4) The amount paid at the time a futures contract is sold

A) represents the maximum loss for the buyer of the contract.

B) represents the maximum profit for the buyer of the contract.

C) is simply a refundable security deposit.

D) is the total value of the goods being traded in the future.

5) With futures contracts, the price at which the commodity must be delivered is

A) set when the futures contract is sold.

B) set when the contract expires.

C) is equivalent to the strike price for an options contract.

D) changes frequently during the life of the contract.

6) Which of the following characteristics apply to futures contracts?

I. Futures contracts are an important tool to control risk.

II. Futures contracts are highly risky and involve speculation.

III. Futures contracts specify both the quantity and the quality of the item.

IV. The buyer must hold the contract until maturity.

A) I and II only

B) II and IV only

C) I, II and III only

D) I, II, III and IV

7) Which of the following are specifically stated in futures contracts?

I. the quantity of the commodity to be delivered

II. the quality of the commodity to be delivered

III. the exact price at which the commodity must be delivered

V. the time and place at which the commodity must be delivered

A) I and II only

B) II and IV only

C) I, II and III only

D) I, II and IV only

8) A farmer who grows soy beans can hedge against the risk that bad weather will damage her crop by

A) buying soy bean futures for delivery near the time of harvest.

B) selling soy bean futures for delivery near the time of harvest.

C) buying contracts in alternative crops for delivery near the time of harvest.

D) buying contracts in unrelated commodities for delivery near the time of harvest.

9) Which of the following is(are) correct statements about the buyer of a futures contract?

I. The contract buyer is short on the position.

II. The contract buyer wants the price of the item to increase.

III. The buyer can liquidate the position with an offsetting transaction.

IV. The majority of the buyers actually take delivery of the item.

A) II only

B) I and II only

C) I and IV only

D) II and III only

10) In the futures markets, gains and losses in a contract's value are calculated every day and added to or subtracted from the trader's account. This procedure is called

A) checking the maintenance margin.

B) checking the maintenance deposit.

C) settling.

D) mark-to-the-market.