NAME:____________________________________

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Financial Markets and Institutions

Second Midterm Exam

You have 70 minutes to complete this 100 point exam. Please write clearly and legibly. Show your calculations for partial credit. Good luck!

1. (20 Points). Match each finance term below with the 1 letter preceding its correct definition.

____ discount rate
____ bearer instrument
____ call provision
____ tariffs
____ free rider problem
____ principal agent problem
____ PPP
____ TIPS
____ LIBOR
____ open market operations

A. Occurs when the primary owner of a stock quickly sells it on secondary markets.

B. Provision allowing a bondholder to convert her bond into stock.

C. Buying and selling of equities by market makers on secondary markets.

D. Buying and selling of Treasury securities by the Fed.

E. Problem that arises when some benefit from information without having to pay for it.

F. Whoever owns the bond at maturity receives the principal and interest.

G. London interbank offer rate.

H. Taxes imposed specifically on imported goods.

I. A financial security that guarantees its holder ownership in a business.

J. Rate at which a junk bond must be discounted in order to attract buyers.

K. Theory of Price Performance Parity stating that stocks ultimately earn the same risk-adjusted return.

L. Problem that arises when borrowers engage in risky behavior with borrowed funds.

M. Toronto Interbank Preferred Securities.

N. Provision allowing bond issuer to force redemption of a bond prior to its maturity date

O. When a firm's management engages in practices detrimental to shareholder value.

P. London International Bond Offer Rate.

R. Treasury Inflation-Protected Securities

S. Interest rate charged by the Fed to banks for short term loans.

T. Theory of Purchasing Power Parity stating that changes in exchange rates should reflect relative changes in national price levels.

V. Limits placed on the quantity of a product that can be imported.

2. (30 Total Points on this Page) Choose FIVE of the six statements below. Indicate whether each of the five is **true** or **false**. Explain each of your indications in one or two sentences each. (Your scores depend entirely upon your explanations; do not repeat or slightly reword the statements in your explanations.)

According to the law of one price, if an ounce of silver costs $500 in the U.S and 5 Marks in Germany then the mark/dollar exchange rate must be 100 Marks per dollar.

Purchasing power parity theorizes that foreign exchange rates fluctuate due to changes in interest rates, technology, and trade barriers among countries.

The difference between common stock and preferred stock is that one pays a dividend and the other does not.

A 20-year Treasury security with 45 days left 'til its maturity date is traded in a money market.

Indirect finance is a smaller source of external funds for firms than is direct finance.

The Fed fights inflation by buying Treasury securities in the open market.

3. (10 points) Trump is in the 30% tax bracket. He can buy either a risk-free municipal bond with a 5% yield or a risk-free Treasury bond with an 8% yield. Both bonds have the same time 'til maturity.

Which bond should Trump buy? Support your answer with calculations.

4. (10 points) Describe a "bankers acceptance" in three or four sentences.

5. (10 points) You purchase a new 182-day Treasury bill with an annualized yield of 5%. When it matures it will be worth $10,000.

How much did you pay for the bond?.

6. (10 points) A share of Reliant Energy stock pays a dividend of $3 (per year), expected to grow at a rate of 6% per year. The discount rate is 11%

Calculate the current fair price of Reliant energy stock according to the Gordon model.

7. (10 points) A 1-year U.S. bond has a yield of 4% (payable in dollars). A 1-year bond with identical attributes in France has an 9% yield (payable in Francs). The 1-year forward franc/dollar exchange rate is 5 francs per dollar.

Calculate today's franc/dollar exchange rate.