

NAME: _____

Cooleconomics.com
Financial Markets and Institutions

Final Exam

You have 180 minutes to complete this 200 point exam. Please write clearly and legibly. Show your calculations for partial credit. Good luck!

1. (30 Points). Match each finance term below with the 1 letter preceding its correct definition.

___ market maker	___ principal agent problem
___ usury	___ PPP
___ Penny Benny	___ rational expectations
___ Regulatory forbearance	___ spot interest rate
___ Edge Act	___ perpetuity

- A. An infinitely-lived corporation.
- B. Pension Benefit Guarantee Corporation.
- C. Using net worth as collateral for debt.
- D. Theory of Purchasing Power Performance saying that a dollar should buy a fixed basket of world goods.
- E. Securities dealer.
- F. Act allowing a U.S. bank to form a subsidiary for international banking.
- G. A bond with no maturity date that makes coupon payments forever.
- H. Taxes imposed specifically on imported goods.
- I. People make decisions based on unbiased forecasts of the future.
- J. Financial innovator who introduces new financial products.
- K. Use of regulatory power by government to close insolvent institutions.
- L. Problem that arises when borrowers engage in risky behavior with borrowed funds.
- M. Act repealing prohibition against commingling of investment and commercial banking.
- 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. People make decisions expecting past trends to continue.
- R. Deferring enforcement of regulations to prevent closure of financial institutions.
- S. Charging illegally higher interest rates.
- T. Theory of Purchasing Power Parity stating that changes in exchange rates should reflect relative changes in national price levels.
- V. Daughter of Benny Hill and June Robinson.

2. (60 Points) Choose 10 of the 12 statements below. Indicate whether each of the 10 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.

A money market mutual fund is a basket of stocks that an individual investor may purchase.

The Fed Funds rate is legally fixed by the Fed; veering from it is a violation of law.

Mean reversion supports efficient markets theory.

Pure expectations theory is a theory of stock market performance.

A *best efforts* offering occurs when an investment bank buys the entirety of a firm's newly-issued securities and resells them.

A balloon loan helps to finance circuses.

Federal law requires that pension plans be fully funded.

The Glass-Steagal Act prohibited branch banking.

The *mutual form of ownership* is the term that describes indirect ownership of stock through purchases of mutual fund shares.

The United States was one of the last nations to have a central bank because Teddy Roosevelt shot his big toe off while hunting hamsters.

3. (10 points) Trump is in the 28% tax bracket and itemizes deductions on his tax return, and boy, does he have a lot of deductions. His mortgage has an 8% annual percentage interest rate.

Calculate Trump's tax-adjusted mortgage annual percentage interest rate.

4. (10 points) Describe *factoring* in three or four sentences.

5. (10 points) You purchase a new 182-day Treasury bill with an annualized yield of 6%. When it matures it will be worth \$10,000.

How much did you pay for the bond?.

6. (10 points) Describe the most important attribute of the Graham-Leach-Bliley Act in a couple of sentences.

7. (10 points) Describe *floor plan financing* in three or four sentences

8. (10 points) Describe the historical origins of thrift institutions in the United States.

9. (10 points) Describe *term life and whole life* insurance policies.

10. (40 points) Today you buy a bond that matures exactly 2 years from now. You will receive two annual coupon payments, the first exactly one year from now. The bond has a par value of \$500 and a coupon rate of 5%. The yield to maturity of your bond is 4.5%. Today the yield to maturity on 1-year coupon bonds is 4%. The risk premium today for holding 2-year coupon bonds is .35%.

a) How much did you pay for the bond?

b) Use liquidity premium theory to forecast the 1-year forward rate on 1-year coupon bonds.

c) Calculate the duration of your bond.

d) Calculate your rate of return if you sell your bond exactly 1 year from now (immediately after receiving a coupon payment) for \$525.