62 CREDIT RISK

1. The risk of receiving less than market value when selling a bond is referred to as:
   (A) recovery rate risk.
   (B) loss severity risk.
   (C) market liquidity risk.

2. Which component of traditional credit analysis includes evaluation of industry structure, industry fundamentals, and company fundamentals?
   (A) Capacity.
   (B) Covenants.
   (C) Collateral.

3. The "four Cs" of credit analysis include:
   (A) capacity and character.
   (B) circumstances and covenants.
   (C) collateral and capital.

4. Fraud and malfeasance, soundness of strategy, and prior treatment of bondholders are criteria to evaluate a borrower's:
   (A) covenants.
   (B) character.
   (C) capacity.

5. Which of the following is the most appropriate strategy for a fixed income portfolio manager under the anticipation of an economic expansion?
   (A) Purchase corporate bonds and sell Treasury bonds.
   (B) Sell lower-rated corporate bonds and buy higher-rated corporate bonds.
   (C) Sell corporate bonds and purchase Treasury bonds.

6. If a U.S. investor is forecasting that the yield spread between U.S. Treasury bonds and U.S. corporate bonds is going to widen, then which of the following is most likely to be CORRECT?
   (A) The economy is going to contract.
   (B) The economy is going to expand.
   (C) The U.S. dollar will weaken.

7. Analysis of a firm's intellectual capital, equity market capitalization, depreciation, and intangible assets is associated with which aspect of credit analysis?
   (A) Capacity.
   (B) Collateral.
   (C) Covenants.

8. Loss severity is most accurately defined as the:
   (A) amount a bondholder will lose if the issuer defaults.
   (B) percentage of a bond's value a bondholder will receive if the issuer defaults.
   (C) probability that a bond issuer will default.

9. The yield spreads between corporate bonds and government bonds are most likely to decrease if:
   (A) investors increase their estimates of the recovery rate on the corporate bonds.
   (B) a credit rating downgrade on the corporate bonds becomes more likely.
   (C) liquidity decreases in the market for the corporate bonds.

10. What is the most likely effect on yield spreads when demand for bonds is high and supply of bonds is low?
    (A) The effect on yield spreads will depend on whether supply or demand is the stronger influence.
    (B) Yield spreads are likely to narrow.
    (C) Yield spreads are likely to widen.

11. Yield spreads tend to widen when equity market performance is:
    (A) weak.
    (B) strong.
    (C) stable.

12. The factors that must be considered when estimating the credit risk of a bond include:
    (A) only the bond rating and the recovery rate.
    (B) only the bond rating.
    (C) the bond rating, the recovery rate, and the yield volatility.

13. An 8% annual coupon, 5-year corporate bond has a yield spread of 275 basis points to its benchmark bond. The bond's bid and offer prices are 98.25 and 98.75. The yield spread is best described as being composed of:
    (A) 8% liquidity risk and 92% credit risk.
    (B) 12% liquidity risk and 88% credit risk.
    (C) 5% liquidity risk and 95% credit risk.

14. If investors expect greater uncertainty in the bond markets, yield spreads between AAA and B rated bonds are most likely to:
    (A) narrow.
    (B) widen.
    (C) slope downward