

33

MARKET ORGANIZATION AND STRUCTURE

1. An investor buys 1,000 shares of a non-dividend-paying stock for \$18. The initial margin requirement is 40% and the maintenance margin is 30%. After one year the investor sells the stock for \$24 per share. The investor's rate of return on this investment (ignoring borrowing and transactions costs and taxes), and the price at which the investor would receive a margin call, are *closest to*:

	Rate of return	Margin call
(A)	83%	\$21.00
(B)	33%	\$15.43
(C)	83%	\$15.43

2. If an investor buys 100 shares of a \$50 stock on margin when the initial margin requirement is 40%, how much money must she borrow from her broker?
- (A) \$2,000.
(B) \$3,000.
(C) \$4,000.
3. A unique item such as fine art is *most likely to* be exchanged in a(n):
- (A) brokered market.
(B) order-driven market.
(C) quote-driven market.
4. A buy limit order is said to be "inside the market" when:
- (A) the order can be executed.
(B) the limit is between the best bid and the best ask.
(C) the order is entered in the limit book.
5. Financial intermediaries that issue securities which represent interests in a pool of similar financial assets are *best* characterized as:
- (A) arbitrageurs.
(B) block brokers.
(C) securitizers.

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6. In contrast with a typical forward contract, futures contracts have:
- (A) greater counterparty risk.
 - (B) standardized terms.
 - (C) less liquidity.
7. The main functions of the financial system *most likely include*:
- (A) allocating capital to its most productive uses and determining the supply of money.
 - (B) determining equilibrium interest rates and allocating capital to its most productive uses.
 - (C) determining the supply of money and determining equilibrium interest rates.
8. An electronic crossing network is *best* described as:
- (A) a price-driven market.
 - (B) an order-driven market.
 - (C) a quote-driven market.
9. An investor purchases 200 shares of Mertz, Inc. on margin. The shares are trading at \$40. Initial and maintenance margins are 50% and 25%. If the investor sells the stock when the price rises to \$50 at year-end, the return on the investment would be *closest to*:
- (A) 25%.
 - (B) 50%.
 - (C) 20%.
10. Markets for financial assets with maturities of one year or less are *best* characterized as:
- (A) forward markets.
 - (B) primary markets.
 - (C) money markets.
11. Stop loss sell orders are:
- (A) executed on an uptick only.
 - (B) placed to protect a short position.
 - (C) placed to protect the gains on a long position.
12. An investor buys 400 shares of a stock on margin for \$25 a share. The initial margin requirement is 50%, and the maintenance margin requirement is 25%. At what price would the investor receive a margin call?
- (A) \$16.67.
 - (B) \$6.25.
 - (C) \$21.88.

13. Which of the following statements about short sales is *least accurate*?
- (A) The short seller is required to replace the borrowed securities within six months of a short sale.
 - (C) The short seller must pay the lender of the stock any dividends paid by the company.
 - (C) Proceeds from short sales cannot be withdrawn from the account.

14. When using margin to invest in equities, which of the following defines initial margin and what level will the margin be brought back to in the event of a margin call?

	Initial Margin	Margin Call Action
(A)	Amount of borrowed funds in the transactions	A deposit must be made to bring the margin back to the maintenance margin
(B)	Minimum amount of equity required of the investor	A deposit must be made to bring the margin back to the initial margin
(C)	Minimum amount of equity required of the investor	A deposit must be made to bring the margin back to the maintenance margin

15. Toby Jensen originally purchased 400 shares of CSC stock on margin at a price of \$60 per share. The initial margin requirement is 50% and the maintenance margin is 25%. CSC stock price has fallen dramatically in recent months and it closed today with a sharp decline bringing the closing price to \$40 per share. Will Jensen receive a margin call?
- (A) Yes, he does not meet the minimum maintenance margin requirement.
 - (B) No, he meets the minimum maintenance margin requirement.
 - (C) No, he meets the minimum initial margin requirement.
16. The prospectus for the Horizon Fund states that it invests only in real assets. Which of the following would the Horizon Fund *most likely include* in its portfolio?
- (A) An apartment complex.
 - (B) Common stock of a technology company.
 - (C) Foreign currencies.
17. Mark Ritchie purchased, on margin, 200 shares of TMX Corp. stock at a price of \$35 per share. The margin requirement was 50%. The stock price has increased to \$42 per share. What is Ritchie's return on investment before commissions and interest if he decides to sell his TMX holdings now?
- (A) 10%.
 - (B) 20%.
 - (C) 40%.

18. Which of the following statements regarding primary and secondary markets is *least accurate*?
- (A) New issues of government securities can be sold on the primary market.
 - (B) Prevailing market prices are determined by primary market transactions and are used in pricing new issues.
 - (C) Secondary market transactions occur between two investors and do not involve the firm that originally issued the security.
19. Becky Kirk contacted her broker and placed an order to purchase 1,000 shares of Bricko Corp. stock at a price of \$60 per share. Kirk wishes to buy on margin. Assuming the margin requirement is 40%, how much money does Kirk have to pay up front to make the purchase?
- (A) \$36,000.
 - (B) \$24,000.
 - (C) \$60,000.
20. The initial margin is the:
- (A) amount of cash that an investor must maintain in his/her margin account.
 - (B) minimum amount of funds that must be supplied when purchasing a security on margin.
 - (C) equity represented in the margin account at any time.
21. An investor sells a stock short. To protect against a large loss on this position, the investor is *most likely to*:
- (A) set a limit price on the order to sell short.
 - (B) placing a stop buy order.
 - (C) buy a put option.
22. Which of the following assets are *best* characterized as contracts?
- (A) Commercial paper.
 - (B) Currency swaps.
 - (C) Depository receipts.
23. Which of the following statements about securities exchanges is *most accurate*?
- (A) Call markets are markets in which the stock is only traded at specific times.
 - (B) Continuous markets are markets where trades occur 24 hours per day.
 - (C) Setting a negotiated price to clear the market is a method used to set the closing price in major continuous markets.

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24. An order to sell a security at the best price available is a:
- (A) limit order.
 - (B) market order.
 - (C) stop order.
25. A financial system in which transactions have low costs is said to exhibit:
- (A) allocational efficiency.
 - (B) informational efficiency.
 - (C) operational efficiency.
26. Evelyn Stram, CFA, places a good-till-cancelled limit buy order at 86 for a stock. Stram's order specifies:
- (A) clearing and validity instructions.
 - (B) validity and execution instructions.
 - (C) execution and clearing instructions.
27. A trader pays \$100 per share to buy 500 shares of a non-dividend-paying firm. The purchase is done on margin, and the leverage ratio at purchase is 3.0X. Three months later, the trader sells the shares for \$90 per share. Ignoring transaction costs and interest paid on the margin loan, the trader's 3-month return was *closest to*:
- (A) -10%.
 - (B) -40%.
 - (C) -30%.
28. An investor buys 200 shares of ABC at the market price of \$100 and posts the required initial margin of \$8,000. The maintenance margin requirement is 25%.
At what share price will the investor's account balance be reduced to the maintenance margin level?
- (A) \$80.
 - (B) \$48.
 - (C) \$112.
29. Austin Bruno, CFA, places a fill or kill, limit buy order at 92 for a stock. Bruno's order specifies:
- (A) clearing and validity instructions.
 - (B) execution and clearing instructions.
 - (C) validity and execution instructions.

30. A short seller:
- (A) does not receive the dividends.
 - (B) loses if the price of the stock sold short decreases.
 - (C) often also places a stop loss sell order.
31. Which of the following limit orders is *least likely* to be filled?
- (A) Behind-the-market limit buy order.
 - (B) Aggressively priced limit buy order.
 - (C) Inside-the-market limit sell order.
32. An investor bought a stock on margin. The margin requirement was 60%, the current price of the stock is \$80, and the stock price was \$50 one year ago. If margin interest is 5%, how much equity did the investor have in the investment at year-end?
- (A) 60.6%.
 - (B) 73.8%.
 - (C) 67.7%.
33. An investor buys 200 shares of ABC at the market price of \$100 on full margin. The initial margin requirement is 40% and the maintenance margin requirement is 25%. If the shares of stock later sold for \$200 per share, what is the rate of return on the margin transaction?
- (A) 100%.
 - (B) 250%.
 - (C) 400%.
34. Which of the following statements about selling a stock short is *least likely* accurate?
- (A) The short seller may withdraw the proceeds of the short sale.
 - (B) The seller must inform their broker that the order is a short sale before completing the transaction.
 - (C) The seller must return the securities at the request of the lender.
35. An investor purchases 100 shares at \$75 per share with an initial margin of 50%. Assume there is no interest on the call loan and no transactions fees. If the stock price rises to \$112.50, the rate of return to the investor is:
- (A) 100%.
 - (B) 200%.
 - (C) 50%.

36. Equity securities *most likely* include:

- (A) common stock and warrants.
- (B) exchange-traded funds.
- (C) preferred stock and certificates of deposit.

37. Using the following assumptions, calculate the rate of return on a margin transaction for an investor who purchases the stock and the stock price at which the investor would have received a margin call.

- Market Price Per Share: \$32
- Number of Shares Purchased: 1,000
- Holding Period: 1 year
- Ending Share Price: \$34
- Initial Margin Requirement: 40%
- Maintenance margin: 25%
- Transaction and borrowing costs: \$0
- The company pays no dividends

	Margin Return	Margin Call Price
(A)	6.3%	\$25.60
(B)	15.6%	\$17.07
(C)	15.6%	\$25.60

38. The main functions of the financial system *least likely* include:

- (A) allocating financial resources to their most productive uses.
- (B) bringing together savers and borrowers.
- (C) preventing investors from generating abnormal profits by trading on information.

39. An order placed to protect a short position is called a:

- (A) protective call.
- (B) stop loss buy.
- (C) stop loss sell.

40. Which of the following statements regarding secondary markets is least accurate? Secondary markets are important because they provide:

- (A) investors with liquidity.
- (B) regulators with information about market participants.
- (C) firms with greater access to external capital.

41. An investor purchases stock on 25% initial margin, posting \$10 of the original stock price of \$40 as equity. The position has a required maintenance margin of 20%. The investor later sells the stock for \$45. Ignoring transaction costs and margin loan interest, which of the following statements is *most accurate*?
- (A) Leverage ratio is 3:1.
 - (B) Margin call price is \$36.
 - (C) Return on investment is 50%.
42. An investor purchased 725 shares of stock at \$40 per share and posted initial margin of 60%. He subsequently sold the shares at \$50 per share. Based only on this information, the investor's holding period return is *closest to*:
- (A) 20%.
 - (B) 25%.
 - (C) 40%.
43. A securities exchange where traders buy and sell long-term government bonds from and to other traders would *best* be described as part of the:
- (A) capital market.
 - (B) money market.
 - (C) primary market.
44. Lynne Hampton purchased 100 shares of \$75 stock on margin. The margin requirement set by the Federal Reserve Board was 40%, but Hampton's brokerage firm requires a total margin of 50%. Currently the stock is selling at \$62 per share. What is Hampton's return on investment *before* commission and interest if she sells the stock now?
- (A) -17%.
 - (B) -35%.
 - (C) -40%.
45. Regarding the technical points affecting the short sales of a stock, which of the following statements is most accurate?
- (A) Stocks can only be shorted in a down market.
 - (B) The lender must deposit margin to guarantee the eventual return of the stock.
 - (C) The short seller must pay all dividends due to the lender of the shorted stock.
46. Among the classifications of investment assets, "real assets" *most likely* include:
- (A) industrial stocks.
 - (B) durable equipment.
 - (C) foreign currencies.

47. Shares in a publicly traded company that owns gold mines and mining operations are considered:
- (A) financial assets.
 - (B) physical assets.
 - (C) real assets.
48. A primary market transaction involves:
- (A) investment-grade bonds or preferred stocks.
 - (B) the sale of new securities to investors.
 - (C) direct trading of securities between institutional investors.
49. Which of the following statements regarding margin accounts is *most accurate*?
- (A) Maintenance margin refers to the amount of funds the investor can borrow.
 - (B) Margin accounts can be used to purchase securities by borrowing part of the purchase price.
 - (C) The total equity in the margin account cannot fall below the initial margin requirement.
50. Which of the following conditions is *most likely* necessary for capital to be allocated to its most valuable uses?
- (A) Financial markets are frictionless (i.e., free of taxes or transactions costs).
 - (B) Investors are well informed about the risk and return of various investments.
 - (C) There are no barriers to the flow of complete information to the financial markets.
51. An objective of financial market regulation is to:
- (A) ensure that inside information is made public in a timely manner.
 - (B) prevent uninformed investors from participating in financial markets.
 - (C) reduce information gathering costs by requiring common financial reporting standards.
52. A market that directs capital to its most productive use is *best* described as:
- (A) allocationally efficient.
 - (B) operationally efficient.
 - (C) informationally efficient.

53. Which of the following statements about the maintenance margin requirement is *least accurate*?
- (A) The purpose of the maintenance margin requirement is to protect the broker in the event of a large stock decline.
 - (B) Generally the maintenance margin requirement is lower than the initial margin requirement.
 - (C) The Federal Reserve sets the maximum maintenance margin.
54. With respect to a well-functioning securities market, a market that exhibits operational efficiency will have:
- (A) price continuity.
 - (B) low transaction costs.
 - (C) rapid price reactions to new information.
55. Which of the following is *most likely an* objective of market regulation?
- (A) Limit downside risk to investors.
 - (B) Preserve trust in financial markets.
 - (C) Educate unsophisticated investors.
56. Which of the following orders is said to be "behind the market"?
- (A) Limit sell order at 38 when the best ask is 39.
 - (B) Market sell order when the best bid is 38 and the best ask is 39.
 - (C) Limit buy order at 38 when the best bid is 39.

