ECON 160: Midterm 1, Winter 2020

Prof. Saeidinezhad

Your name: ....

Student ID: ....

INSTRUCTIONS:

1. **The exam is worth 50 points in total**
2. **There are 10 multiple choice questions and 3 analytic question.**

Part 1: Multiple Choice Questions

This section has 10 questions. Each question has 2 points.

1. Periodic payments of net earnings to shareholders are known as
   - (a) capital gains.
   - (b) dividends.
   - (c) profits.
   - (d) interest.

2. In the one-period valuation model, the value of a share of stock today depends upon
   - (a) the present value of both the dividends and the expected sales price.
   - (b) only the present value of the future dividends.
   - (c) the actual value of the dividends and expected sales price received in one year.
   - (d) the future value of dividends and the actual sales price.

3. Using the one-period valuation model, assuming a year-end dividend of $1.00, anexpectedsalespriceof 100$, and a required rate of return of 5%, the current price of the stock would be
   - (a) $110.00.
   - (b) $101.00.
   - (c) $100.00.
   - (d) $96.19.

4. In the generalized dividend model, a future sales price far in the future does not affect the current stock price because
   - (a) the present value cannot be computed.
   - (b) the present value is almost zero.
   - (c) the sales price does not affect the current price.
   - (d) the stock may never be sold.

5. A change in perceived risk of a stock changes ....
    (a) the expected dividend growth rate.
    (b) the expected sales price.
    (c) the required rate of return.
    (d) the current dividend.
6. In the generalized dividend model, the current stock price is the sum of
    (a) the actual value of the future dividend stream.
    (b) the present value of the future dividend stream.
    (c) the present value of the future dividend stream plus the actual future sales price.
    (d) the present value of the future sales price.
7. Dealer's inventories .... when traders buy from the dealers, and they .... when traders sell to dealers.
    (a) rise, drop.
    (b) rise, rise
    (c) drop, rise
    (d) remain unchanged, remain unchanged
8. Price discovery process means that dealers quote prices to control their .... and obtain .... order-flow.
    (a) inside spread, one-sided
    (b) inventories, one-sided
    (c) inside spread, two-sided
    (d) inventories, two-sided

9. The adverse selection spread component is higher for .... than ....

   (a) insider spread, outside spread
   (b) outside spread, inside spread
   (c) the answer depends on the riskiness of the securities
   (d) adverse selection is not an important component for any kind of spreads

10. Dealers sell .... which is the ability to buy and sell securities quickly when you want to.

   (a) width
   (b) depth
   (c) immediacy
   (d) funding liquidity

Part 2: Analytic Questions

This section has three questions. Each question has 10 points.

1. Suppose Barbara looks out in the morning and sees a clear sky so decides that a picnic for lunch is a good idea. Last night the weather forecast included a 100% chance of rain by midday but Barbara did not watch the local news program. Is Barbara's prediction of good weather at lunch time rational? Why or why not?

2. Who are dealers?

   Dealers are profit-... traders who allow other traders to ....when they want to. The .... service they sell- called immediacy- is valuable to ....traders.

   Dealers .... when they buy from impatient sellers at low prices and sell to impatient sellers at high prices. The difference in .... compensates them for the cost of providing immediacy.

3. If you understood the discussion of the characteristics of common stocks, you should be able to explain the following statement: One of the benefits from stock ownership is the unlimited upside potential and the limited downside. What does this statement mean?