MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Another way to state the efficient markets condition is: in an efficient market,  
   A) unexploited profit opportunities will not exist for long, as market participants will act quickly to eliminate them.  
   B) every financial market participant must be well informed about securities.  
   C) unexploited profit opportunities will never exist as market participants ensure that they are instantaneously dissipated.  
   D) only A and C of the above.

2) Stockholders are residual claimants, meaning that they  
   A) are liable for all of a company’s debts.  
   B) have a higher claim on cash flow than bond holders.  
   C) have the first priority claim on all of a company’s assets.  
   D) receive the remaining cash flow after all other claims are paid.  
   E) will never share in a company’s profits.

3) Expectations play a key role in the theories that attempt to explain the risk and term structure of interest rates. For example, expectations of future _____ interest rates play a central role in the determination of _____ interest rates.  
   A) long-term; short-term  
   B) market; government  
   C) short-term; long-term  
   D) government; market

4) The value of any investment is found by  
   A) computing the future value of all future expenses.  
   B) computing the present value of all future sales.  
   C) computing the present value of all future liabilities.  
   D) computing the future value of all sales.  
   E) computing the present value of all future cash flows.
5) Which of the following statements are true about rational expectations?

A) The evidence from studies using survey data is not as supportive of rational expectations as is the evidence from financial markets.

B) Survey evidence does indicate that if there is a change in the way a variable moves, then the way expectations of this variable are formed will change as well.

C) The stock market crash of 1987 indicates that the efficient markets hypothesis is not a valid theory.

D) All of the above.

E) Only A and B of the above.

6) To say that stock prices follow a "random walk" is to argue that

A) stock prices rise, then fall in a predictable fashion.

B) stock prices are, for all practical purposes, unpredictable.

C) stock prices rise, then fall.

D) stock prices tend to follow trends.

7) In the Gordon growth model, a decrease in the required rate of return

A) increases the future stock price.

B) has no effect on stock prices.

C) increases the current stock price.

D) reduces the future stock price.

E) reduces the current stock price.

8) Dishonest corporate accounting procedures caused stock prices to

A) increase due to higher expected dividend growth and lower required return.

B) remain unchanged.

C) increase due to higher expected dividend growth and higher future sales price.

D) decrease due to lower expected dividend growth and lower required return.

E) decrease due to lower expected dividend growth and higher required return.

9) Which of the following types of information most likely allows the exploitation of a profit opportunity?

A) Hot tips from a stockbroker

B) Financial analysts' published recommendations

C) Insider information

D) All of the above

E) Both B and C of the above
Evidence in support of the efficient markets hypothesis includes:

A) the failure of technical analysis to outperform the market.
B) excessive volatility.
C) the small-firm effect.
D) the January effect.
E) all of the above.
Answer Key
Testname: PRACTICE_CH7

1) A 
2) D 
3) C 
4) E 
5) E 
6) B 
7) C 
8) E 
9) C 
10) A