**Multiple Choice Questions (Chapter 5):**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 1. | The following entities issue bonds to engage in long-term borrowing EXCEPT:     |  |  | | --- | --- | | A. | the federal government |  |  |  | | --- | --- | | B. | state and local governments |  |  |  | | --- | --- | | C. | corporations |  |  |  | | --- | --- | | **D**. | individuals | |

2. Generally, a bond can be valued as a package of:   
(I) annuity, (II) perpetuity, (III) single payment 

|  |  |
| --- | --- |
| A. | I and II only |

|  |  |
| --- | --- |
| B. | II and III only |

|  |  |
| --- | --- |
| **C**. | I and III only |

|  |  |
| --- | --- |
| D. | I, II, and III |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 3. Which of the following statements about the relationship between interest rates and bond prices is true?  I) There is an inverse relationship between bond prices and interest rates. II) There is a direct relationship between bond prices and interest rates. III) The price of short-term bonds fluctuates more than the price of long-term bonds for a given change in interest rates (assuming that the coupon rate is the same for both). IV) The price of long-term bonds fluctuates more than the price of short-term bonds for a given change in interest rates (assuming that the coupon rate is the same for both).    |  |  | | --- | --- | | **A**. | I and IV only |  |  |  | | --- | --- | | B. | I and III only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | II and IV only | |

4. A bond has a face value of $1,000, a coupon rate of 0%, yield to maturity of 9%, and 10 years to maturity. This bond's duration is: 

|  |  |
| --- | --- |
| A. | 6.7 years |

|  |  |
| --- | --- |
| B. | 7.5 years |

|  |  |
| --- | --- |
| C. | 9.6 years |

|  |  |
| --- | --- |
| **D**. | 10.0 years |

5. One can best describe the term structure of interest rates as the relationship between: 

|  |  |
| --- | --- |
| A. | spot interest rates and bond prices |

|  |  |
| --- | --- |
| B. | spot interest rates and stock prices |

|  |  |
| --- | --- |
| **C**. | spot interest rates and time |

|  |  |
| --- | --- |
| D. | yields of coupon bonds and their maturity |

6. As CFO of your corporation, you would prefer (all else equal) to see the price of your corporation's bonds: 

|  |  |
| --- | --- |
| **A**. | increase, indicating that bond investors view your firm as less risky |

|  |  |
| --- | --- |
| B. | decrease, indicating that bond investors view your firm as less risky |

|  |  |
| --- | --- |
| C. | increase, indicating that bond investors view your firm as more willing to take risks |

|  |  |
| --- | --- |
| D. | decrease, indicating that bond investors view your firm as more willing to take risks |

7. Which of the following bonds has the longest duration? 

|  |  |
| --- | --- |
| A. | five-year coupon bond |

|  |  |
| --- | --- |
| B. | five-year, zero-coupon bond |

|  |  |
| --- | --- |
| C. | ten-year coupon bond |

|  |  |
| --- | --- |
| **D**. | ten-year, zero-coupon bond |

8. The interest rate on a one-year risk-free bond is 5%. BAC Company issued a 5% coupon bond with a face value of $1,000, maturing in one year. If the bond is considered risk-free, what is the price of the bond? 

|  |  |
| --- | --- |
| A. | $1,050 |

|  |  |
| --- | --- |
| **B**. | $1,000 |

|  |  |
| --- | --- |
| C. | $985 |

|  |  |
| --- | --- |
| D. | $950 |

9. A corporate bond matures in one year. The bond promises a coupon of $50 and principal of $1,000 at maturity. If the bond has a 10% probability of default and payment under default is $400, calculate the expected payment from the bond. 

|  |  |
| --- | --- |
| A. | $1,050 |

|  |  |
| --- | --- |
| B. | $400 |

|  |  |
| --- | --- |
| **C**. | $985 |

|  |  |
| --- | --- |
| D. | $1,000 |

Expected payment = 1,050 X 0.9 + 400 X 0.1 = 985

10. What is the most important difference between a corporate bond and an equivalent U.S. Treasury bond? 

|  |  |
| --- | --- |
| A. | Corporate cash flow is relatively smooth, whereas U.S. government revenue is more variable. |

|  |  |
| --- | --- |
| B. | Corporate bonds are traded on the floor of the New York Stock Exchange, and Treasury bonds trade in the over-the-counter market. |

|  |  |
| --- | --- |
| **C**. | In the case of corporate bonds, firms have sometimes defaulted whereas the U.S. government has not. |

|  |  |
| --- | --- |
| D. | The beta of corporate bonds is usually less than the beta of a U.S. Treasury bond. |

11. Which of the following rated bonds has the most risk? 

|  |  |
| --- | --- |
| A. | Aaa |

|  |  |
| --- | --- |
| B. | Aa |

|  |  |
| --- | --- |
| C. | Baa |

|  |  |
| --- | --- |
| **D**. | Ba |

12. Bonds rated below BBB (Baa) are called: 

|  |  |
| --- | --- |
| A. | investment-grade bonds. |

|  |  |
| --- | --- |
| **B**. | junk bonds. |

|  |  |
| --- | --- |
| C. | default-free bonds. |

|  |  |
| --- | --- |
| D. | intermediate bonds. |