**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. |