Finance 2302 – Sample Exam #3

T F 1. Past information can be extrapolated into the future to provide an accurate forecast

T F 2. An economic forecast will usually start with an analysis of the government's economic plan.

T F 4. Coincident indicators are of major importance to investors because they accurately predict the timing of business cycle changes.

T F 5. The most positive long-term sign of economic growth is probably slow, steady, predictable growth in the money supply.

T F 6. The valuation process begins with an industry analysis.

T F 7. A federal deficit will always expand the money supply.

T F 8. Monetary policy can be implemented very quickly to reinforce fiscal policy or, when necessary, to offset the effects of fiscal policy.

T F 9. If the Fed buys securities, the money supply goes down, along with interest rates.

10. Which of the following industries will in general do better than other industries during a recession? [

A) the durable goods industry

B) television and radio

C) housing and construction

D) Food and energy

11. Fiscal policy concerns the implementation of the government's

A) spending and taxing plans

B) money supply and interest rate strategy

C) foreign trade policy

D) attitude towards business investment

12. Which of the following are true statements:

    A) When a country's economy is healthy, its citizens will spend more in general.

    B) When a country's economy is healthy, its citizens will import more high priced luxury goods.

    C) When a country's economy is health, its currency rises against its trading partners.

    D) a and b are both correct

T F 13. The last step to the top-down approach is to analyze the overall health of the economy.

T F 14. Industry life cycles predict an industry's sensitivity to the economy.

T F 15. Firms in the development stage are typically publicly owned.

T F 16. The presence of cash dividends increases the ability of some institutional investors to invest in companies.

T F 17. The growth rate of the companies that make up the S&P 500 is an excellent proxy for the growth of mature companies.

T F 18. If an industry is in the mature phase, this means that all companies in that industry will also be in the mature phase.

T F 19. It is always a safe bet to invest in companies in growing industries.

T F 20. Oligopolistic industries are characterized by many competitors and few barriers to entry.

T F 21. Pure competition in manufacturing is common in the United States.

T F 22. When monopolies exist, they are almost always found in mature industries.

T F 23. Growth firms generally pay higher cash dividends than mature firms.

24. Which of the following four industry sectors would benefit the most from rising inflation?

    A) Consumer cyclical

    B) Basic materials

    C) Household durable goods

    D) Consumer non-cyclical

25. In which stage in the industry life cycle are companies likely to be privately owned

A) Development

B) Maturity

C) Decline

D) Expansion

26. Which of the following sources of capital is not likely to be used by companies in the development stage?

A) Family loans

B) Bank loans

C) Venture capital

D) Corporate bonds

T F 27. All dividend valuation models are based on the present value of a future income stream.

T F 28. Under the constant dividend growth model, it is possible for a negative stock value to result.

T F 29. The final value calculated in dividend valuation models is typically very accurate.

T F 30. Dividend valuation models are best suited for firms in the expansion or maturity phase of their life cycle.

T F 31. Every valuation method has its limitations.

T F 32. Mathematically, the price-earnings ratio (P/E) is simply the price per share divided by earnings per share.

T F 33. All things being equal, the less debt that a firm has, the more likely it is to be highly valued in the marketplace.

34. One basic problem with the application of the Capital Asset Pricing Model when computing K_e is that

A) (K_m – R_f) is not observable in the market

B) the analyst needs to forecast dividends for next year

C) beta is a historical number

D) the risk-free rate changes every day

35. The primary difference between dividend valuation models and earnings valuation models is.

A) selecting the appropriate discount rate.

B) dividends are not considered in earnings models.

C) whether the investor's income stream or the firm's income stream is measured.

D) more than one of the above.

36. Short-term speculators would probably NOT use _________ to develop a stock value.

A) dividend growth rates

B) discount rates

C) a stream of earnings or dividends

D) any of the above

37. A high P/E ratio for any individual stock may be misleading

A) in an inflationary economy.

B) if the firm is in a cyclical industry like automobiles.

C) if the firm has a strong future growth rate.

D) more than one of the above.

38. The value of the price-earnings ratio is affected by

A) the earnings period used for it's calculation

B) expected growth in earnings per share

C) overall conditions in the stock market

D) all of the above

39. A good example of an industry that has a lot of growth companies in it is:

A) the automobile industry.

B) the computer industry.

C) the food and beverage industry.

D) the television industry.

Answer Key -- ex3

1. False
2. True
4. False
5. True
6. False
7. False
8. True
9. False
10. D
11. A
12. D
13. False
14. False

15. False
16. True
17. True
18. False
19. False
20. False
21. False
22. True
23. False
24. B
25. A
26. D
27. True
28. False
29. False
30. True
31. True
32. True
33. True
34. A
35. D
36. D
37. B
38. D

39. B

Stock Valuation using the PE Ratio and Dividend Yield Methods:

We practiced in class, valuing a stock using these two valuation tools. In each case, we are solving for PRICE. PE Ratio and Dividend Yield are two simple ratios that we need to set equal to the market to see if our stocks are over or under valued. Listed in the table below are 6 stocks with their financial information: Stock ticker, price per share, annual dividend, earnings per share (EPS), PE ratio (all values taken on 4/7/14). I preformed valuation analysis on these companies, using 15 as a market PE and 1.6% (0.016) as a market dividend yield.

In each case, pose these two questions: IF a stock was to reflect the market PE ratio, what would be the price? IF a stock was to reflect the market dividend yield, what would be the price?

Under the word VALUATION (below) are the answers:

Given stock information						VALUATION	
Stock Symbol	Stock Price	Annual Dividend	Earnings per Share	PE Ratio		PE METHOD	DIV YLD METHOD
GE	25.85	0.88	1.26	20.44		18.90	55.00
F	16.01	0.50	1.76	9.08		26.40	31.25
IBM	194.06	3.80	14.94	12.99		224.10	237.50
DD	67.03	1.80	5.18	12.94		77.70	112.50
BAC	16.48	0.04	0.90	18.26		13.50	2.50
AAPL	526.60	12.20	40.32	13.06		604.80	762.50

The Capital Asset Pricing Model (CAPM), calculates the required rate of return of a risky asset (a stock). Given the following information, calculate Ke:

Risk Free Rate	Beta	Required Return of the Mkt (Km)	Equity Risk Premium		ANSWER
1%	1.5		7%		0.115
3%	0.65	8%			0.0625
5%	1.7		5%		0.135
2%	0.5	10%			0.06
4%	2.35		9%		0.2515
6%	0.35	11%			0.0775