Question #1 of 60

Question ID: 1646353

Lurry Corporation executives are considering the purchase of a factory that produces after-market parts for classic cars. The purchase price is $38 million. They have estimated the after-tax cash flows from operating the factory to be $3 million at the end of Year 1, $4 million at the end of Years 2 and 3, and $5 million at the end of Years 4 and 5. After five years, they expect to be able to sell the factory for $40 million. Based on the company's 9.5% estimate of its weighted average cost of capital, the net present value (NPV) for the factory is:

A) $0.98 million.

B) $3.18 million.

C) $4.12 million.

Explanation

The cash flows (in millions) are –38 at Year 0, 3 at Year 1, 4 at Years 2 and 3, 5 at Year 4, and 45 at Year 5. The NPV of the factory purchase, using a 9.5% discount rate, is $3.1855 million.

(Module 24.1, LOS 24.b)

Question #2 of 60

Question ID: 1587863

Using a money-weighted return to evaluate an investment manager's performance is appropriate if the manager:

A) controls the cash flows into and out of the portfolio.

B) holds investments denominated in multiple currencies.

C) actively trades with an average holding period less than one year.

Explanation

If a manager controls the cash flows into and out of the portfolio, a money-weighted return is appropriate for evaluating the manager's performance. Otherwise, a time-weighted return is more appropriate.

(Module 1.2, LOS 1.c)

Question #3 of 60

Question ID: 1587864

An investor holds a bond that matures one year from today. When the bond matures, he will take the proceeds and purchase 1,000 shares of XYZ stock. If he assumes constant dividend growth, which of the following values will he need to estimate to determine the intrinsic value of the stock upon purchase?

A) The value of the bond on the maturity date.

B) The dividend expected to be paid two years from today.

C) A required return that must be less than the growth rate.

Explanation

The constant growth (Gordon growth) dividend discount model is used to calculate the intrinsic value of a stock. This value is a by-product of the dividend in the next period, the required return on common equity, and the constant growth rate of dividends. To determine the value one year from today, the investor will need to determine the dividend two years from today (the dividend used in the equation must always be one year beyond the date of the valuation), the required return (which must exceed the growth rate), and the growth rate itself. The value of the bond on the maturity date is presumed to be its face value.

(Module 2.1, LOS 2.a)

Question #4 of 60

Question ID: 1587887

The one-year interest rate in Minova (MNO) is 6% and the one-year interest rate in Piquar (PQR) is 8%. If the spot MNO/PQR exchange rate is 3.4500, the no-arbitrage one-year forward rate is *closest* to:

A) 3.3860.

B) 3.5150.

C) 3.6440.

Explanation

The no-arbitrage relationship may be stated as:

forward MNO/PQR = spot MNO/PQR ×

= 3.45 × (1.06 / 1.08) = 3.3861.

Notice this question can be answered without performing the calculation. Because the MNO interest rate is less than the PQR interest rate, the no-arbitrage forward MNO/PQR exchange rate must be less than the spot MNO/PQR, and only one of the answer choices is less than 3.4500.

(Module 2.2, LOS 2.c) and (Module 19.1, LOS 19.b)

Question #5 of 60

Question ID: 1587868

Raymond Green has created a pricing model for estimating future returns on high volume, large capitalization stocks. To keep the model relatively simple, Green has assumed that all returns are both identically and independently distributed. The assumptions of Green's model implies that:

A) stationarity is not factored into the model.

B) previous returns are helpful in forecasting future returns.

C) the mean and variance of returns are constant over time. ✓

Explanation

For returns to be identically distributed, the mean and variance of returns are assumed to be constant over time (which is called stationarity). Independent distribution implies that past returns are *not* useful for predicting future returns.

(Module 6.1, LOS 6.a)

Question #6 of 60

Question ID: 1587871

Using a sample size of 58, an analyst determines that a sample correlation coefficient for two random variables is 0.21. The hypothesis at a 10% significance level is that the population coefficient is equal to zero. If the test statistic is 1.571 and the critical value is 1.6725, the analyst should:

A) fail to reject the null hypothesis. ✓

B) reject the null hypothesis and determine the populations are correlated.