1. Assuming g will remain constant, the dividend yield is a good measure of the required return on a common stock under which of the following circumstances?

a. $g = 0$.
b. $g > 0$.
c. $g < 0$.
d. Under no circumstances.
e. Answers a and b are both correct.

2. An increase in a firm's expected growth rate would normally cause the firm's required rate of return to

a. Increase.
b. Decrease.
c. Fluctuate.
d. Remain constant.
e. Possibly increase, possibly decrease, or possibly remain unchanged.

3. If the expected rate of return on a stock exceeds the required rate,

a. The stock is experiencing supernormal growth.
b. The stock should be sold.
c. The company is probably not trying to maximize price per share.
d. The stock is a good buy.
e. Dividends are not being declared.

4. One of the basic relationships in interest rate theory is that, other things held constant, for a given change in the required rate of return, the ____ the time to maturity, the ____ the change in price.

a. longer; smaller
b. shorter; larger
c. longer; greater
d. shorter; smaller
e. Answers c and d are both correct.

5. If the model below is to give a "reasonable" valuation of a stock, which of the following is ***not*** a valid assumption for the model?

$$\hat{P}_0 = \frac{D_0(1+g)}{r_s - g}$$

a. Growth, g, is negative.
b. There will be no growth, i.e., g is zero.
c. The growth rate exceeds the required rate of return.
d. The required return is exceptionally high ($r_s > 30\%$).
e. All of the above are workable assumptions and are valid in the sense that the model can be used even if they hold true.

6. You have just purchased a 10-year, $1,000 par value bond. The coupon rate on this bond is 8 percent annually, with interest being paid each 6 months. If you expect to earn a 10 percent simple rate of return on this bond, how much did you pay for it?

a. $1,122.87
b. $1,003.42
c. $875.38
d. $950.75
e. $812.15

7. You intend to purchase a 10-year, $1,000 face value bond that pays interest of $60 every 6 months. If your simple annual required rate of return is 10 percent with semiannual compounding, how much should you be willing to pay for this bond?

a. $826.31
b. $1,086.15
c. $957.50
d. $1,431.49
e. $1,124.62

8. Assume that you wish to purchase a 20-year bond that has a maturity value of $1,000 and makes semiannual interest payments of $40. If you require a 10 percent simple yield to maturity on this investment, what is the maximum price you should be willing to pay for the bond?

a. $619
b. $674
c. $761
d. $828
e. $902

9. Suppose that you read in *The Wall Street Journal* that a bond has a coupon rate of 9 percent, a price of 71 3/8, and pays interest annually. Rounded to the nearest whole percent, what would be the bond's "current" yield?

a. 11%
b. 13%
c. 15%
d. 17%
e. 20%

10. A share of perpetual preferred stock pays an annual dividend of $6 per share. If investors require a 12 percent rate of return, what should be the price of this preferred stock?

a. $57.25
b. $50.00
c. $62.38
d. $46.75
e. $41.64

11. A share of preferred stock pays a quarterly dividend of $2.50. If the price of this preferred stock is currently $50, what is the simple annual rate of return?

a. 12%
b. 18%
c. 20%
d. 23%
e. 28%

12. The last dividend on Spirex Corporation's common stock was $4.00, and the expected growth rate is 10 percent. If you require a rate of return of 20 percent, what is the highest price you should be willing to pay for this stock?

a. $44.00
b. $38.50
c. $40.00
d. $45.69
e. $50.00

13. A share of common stock has a current price of $82.50 and is expected to grow at a constant rate of 10 percent. If you require a 14 percent rate of return, what is the current dividend on this stock?

a. $3.00
b. $3.81
c. $4.29
d. $4.75
e. $6.13

14. Which of the following will generally result in a higher price for a bond?

a. Higher coupon rate.
b. Longer maturity.
c. Shorter maturity.
d. Higher required rate of return.

15. The ____ yield is the percentage change in the value of an investment.

a. interest
b. total
c. current
d. capital gains

16. The total expected future yield on a bond consists of a(n) ____ yield which is usually positive and a(n) ____ yield which can be positive or negative.

a. current; interest
b. capital gain; current

c. interest; current
d. interest; capital gain