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QUESTION 1

Empire Builders is in need of capital to finance its current expansion plans. For this, it has decided not to raise dividends for the next 4 years, maintaining them constant at $2 per share. Analysts expect the growth rate after that to be about 3% per year. If the investors expect a 9% rate of return on the stock, the market price of Empire Builders is ________.

A. $34.33

B. $27.61

C. $30.80

D. $32.23

Correct Answer: C

Since the dividends do not grow at a constant rate, you cannot directly apply the Dividend Discount Model valuation formula. However, note that 4 years from now, looking into the future, you will see a constant growth rate of 3% and the dividend 5 years from now will be $2 * 1.03 = $2.06. Therefore, the stock price 4 years from now, using the required rate of return of 9%, will equal P = 2.06/(9% - 3%) = $34.33. Thus, the current stock price equals $2*(1/1.09 + 1/1.09^2 + 1/1.09^3 + 1/1.09^4) + 34.33/1.09^4 = $30.80.

Note that you must be very careful about the time line. In the Dividend Discount Model valuation formula, the price at time t uses the dividend paid at time (t+1). That\\'s the reason we had to use the dividend paid in year 5 to calculate the price at the end of year 4.

QUESTION 2

A preferred stock has a $100 par value and a dividend payout of $8 per year. What is the value of the preferred stock?

A. not enough information to calculate it

B. $102.61

C. $93.24

D. $89.65

Correct Answer: A

The value of a preferred stock is the stated annual dividend divided by the required rate of return on preferred stock.

The required rate of return in this case is not given.

QUESTION 3

The amount by which a plant asset depreciated is classified as

A. a liability

B. an asset

C. an expense

D. revenue

Correct Answer: C

Depreciation is the periodic allocation of the cost of a tangible, long-term asset over its estimated useful life, and therefore a period expense.

QUESTION 4

Technical analysts would feel that an upside-downside volume ratio with a value of 1.04

A. is bearish.

B. indicates that the market is overbought.

C. indicates that the market is oversold.

D. is neither particularly bullish nor bearish.

Correct Answer: D

Technical analysts may use the ratio of upside-downside volume as an indicator of short-term momentum for the market. They feel that a ratio value of 1.50 or more indicates that the market is overbought, while a ratio of 0.70 or less indicates that the market is oversold.

QUESTION 5

Jefferson Blake invests only in bonds and other fixed-income securities. Blake believes there is a good opportunity to purchase an undervalued 4% annual pay corporate bond with three years left until maturity and a par value of $1,000. Blake observes that 1-year, 2-year, and 3-year Treasury strip rates are currently 4.0%, 4.5%, and 4.75%, respectively. What is the maximum price Blake should be willing to pay for the bond?

A. $1,069.58.

B. $979.93.

C. $958.36.

Correct Answer: B