

Module 3

1. Suppose a mutual fund manager has been investing in value stocks. Given the historical patterns in stock returns in the U.S., would the fund manager prefer to be evaluated by having alpha calculated from the Capital Asset Pricing Model (CAPM) or a Three-Factor Model?
 - A) CAPM
 - B) Three-Factor Model

2. Suppose that a pattern in stock returns, such as value stocks historically yielding higher average returns than growth stocks, is attributable to risk. This would imply in the future that ...
 - A) Value stocks should continue to generate higher average returns than growth stocks
 - B) Value stocks should generate the same average returns as growth stocks
 - C) Value stocks should generate lower average returns than growth stocks

3. Research suggests that the Capital Asset Pricing Model (CAPM) is a ...
 - A) Better predictor of returns on days when macroeconomic news is released than days with no such news released
 - B) Key tool used by chief financial officers (CFOs) to estimate a required return for the firm's stock
 - C) Both of these statements are true
 - D) Neither of these statements is true

4. True or False: Market efficiency means that stock prices should not rise or fall.
 - A) True
 - B) False

5. Suppose that a pattern in stock returns, such as value stocks historically yielding higher average returns than growth stocks, is attributable to data mining (i.e., by random chance). This would imply in the future that ...
 - A) Value stocks should continue to generate higher average returns than growth stocks
 - B) Value stocks should generate the same average returns as growth stocks
 - C) Value stocks should generate lower average returns than growth stocks

6. Research suggests that the stock returns of firms are best explained by a regression model that includes ...
 - A) Domestic factors
 - B) Global (i.e., worldwide) factors

7. The Capital Asset Pricing Model (CAPM) predicts the following should predict returns ...
 - A) Size of the firm
 - B) Value-growth characteristic of the firm
 - C) The past stock return of the firm
 - D) All of these should predict returns

E) None of these should predict returns

8. True or False: One possible motivation for the Three-Factor Model developed by Fama and French is that the size factor and value factor represent types of risk investors care about that are not reflected in the CAPM.

A) True

B) False

9. Historically in the U.S., the average returns of small stocks have been greater than the average returns of large stocks (with firm size measured by the market value of equity). Most of this difference in average returns is explained by ...

A) Differences in risk between small and large stocks (i.e., small stocks having a higher CAPM beta)

B) Small stocks outperforming large stocks after accounting for market-risk in the CAPM (i.e., small stocks having a positive alpha)

10. Which of the following is not accounted for in the Three-Factor Model developed by Fama and French?

A) Market-risk factor

B) Size factor

C) Momentum factor

D) Value factor

E) All are included in the Three-Factor Model developed by Fama and French

11. Suppose a mutual fund manager has been investing in growth stocks. Given the historical patterns in stock returns in the U.S., would the fund manager prefer to be evaluated by having alpha calculated from the Capital Asset Pricing Model (CAPM) or a Three-Factor Model?

A) CAPM

B) Three-Factor Model

12. True or False: If markets are efficient, any positive alpha earned by a mutual fund manager is more likely to reflect good luck rather than good skill.

A) True

B) False

Module 4

1. True or False: Valuing a firm using discounted cash flow techniques (i.e., the income approach) involves adding projected cash flows over a forecast period (such as 5 to 10 years into the future) to an estimated terminal value of the firm at the end of the forecast period and appropriately discounting both to reflect a value today.
 - A) True
 - B) False
2. Which of the following is NOT part of the formula for the required return for equity (assuming you are using a CAPM model)?
 - A) Market risk premium
 - B) Beta of the stock
 - C) Volatility of the stock
 - D) Risk-free rate
3. Suppose debt is 20% of a firm's capital structure and equity is 80%. The required return on the firm's debt is 5% and the required return on the firm's equity is 12%. Suppose there is zero corporate tax. What is the firm's weighted average cost of capital (WACC)?
 - A) 5%
 - B) 5.6%
 - C) 8.5%
 - D) 10%
 - E) 10.6%
 - F) 12%
4. True or False: Empirical research suggests that there is strong persistence in the earnings growth rates of U.S. firms.
 - A) True
 - B) False
5. An asset can have a high price-to-earnings ratio because ...
 - A) It is expected to have a high growth rate in cash flows
 - B) It is viewed as having low risk (i.e., has a low discount rate)
 - C) Both are possible reasons for an asset having a high price-to-earnings ratio
 - D) Neither are possible reasons for an asset having a high price-to-earnings ratio
6. Suppose an asset provides annual risk-free cash flows of \$200 at the end of each year in perpetuity. The risk-free rate is 5%. What is the value of this perpetuity?
 - A) \$200
 - B) \$1,000
 - C) \$2,000
 - D) \$4,000
 - E) \$8,000

- F) \$10,000
 - G) \$20,000
7. An increase in the financial or operating leverage of a firm should ...
- A) Increase the CAPM beta of the firm's stock
 - B) Have no effect on the CAPM beta of the firm's stock
 - C) Decrease the CAPM beta of the firm's stock
8. Market multiple techniques to value a firm ...
- A) Use ratios like price-to-earnings or market-to-book from a competitor to value a firm
 - B) Are useful to obtain an estimate of the potential market value of a private company before its initial public offering (IPO)
 - C) Are only as good as is the match between the firm to value and its comparison firm
 - D) Can result in biased valuation estimates if firms have different accounting conventions
 - E) All of these responses are true
 - F) None of these responses are true
9. True or False: The accounting deduction for depreciation represents actual cash flow leaving the firm.
- A) True
 - B) False
10. Future liabilities or revenues tied to fixed quantities that are known in advance should be discounted at a ...
- A) Low discount rate
 - B) High discount rate
11. The stock betas of individual industries estimated over a five-year period are ...
- A) Exactly the same as those estimated five years earlier (i.e., don't change over time)
 - B) Positively related to what the industry betas were five years earlier, but not perfectly so (i.e., the betas change somewhat over time)
 - C) Unrelated to what the industry betas were five years earlier
12. Suppose an asset provides annual risk-free cash flows at the end of each year in perpetuity. The risk-free rate is 5%. The first cash flow is \$200 and the cash flows grow at 4% per year. What is the value of this perpetuity?
- A) \$200
 - B) \$1,000
 - C) \$2,000
 - D) \$4,000
 - E) \$8,000
 - F) \$10,000
 - G) \$20,000