Equity Research (EQR)

Individual Assignment 1

Master in Finance (Elective Course Unit)

2017/2018, 1st Semester

NAME: _____ NUMBER: _____

Grading for Multiple-Choice Questions (1 to 8):

Each correct multiple-choice answer is worth +2.0 points. Each incorrect multiple-choice answer penalizes -0.25 points. No answer in a multiple-choice question is worth zero.

The Firm and Market Structures

1) A market structure with relatively few sellers of a homogeneous or standardized product is *best described* as:

   A. oligopoly.

   B. monopoly.

   C. perfect competition.

   Solution: A is correct.

2) In an industry consisting of three companies that are small-scale manufacturers of an easily replicable product unprotected by brand recognition or patents, the *most representative model* of company behavior is:

   A. oligopoly.

   B. perfect competition.

   C. monopolistic competition.

   Solution: B is correct. The credible threat of entry (easily replicable product; unprotected brands or patents) holds down prices and multiple incumbents are offering undifferentiated products.

3) Aquarius, Inc. is the dominant company and the price leader in its market. One of the other companies in the market attempts to gain market share by undercutting the price set by Aquarius. The market share of Aquarius will *most likely*:

   A. increase.

   B. decrease.

   C. stay the same.

   Solution: A is correct. As prices decrease, smaller companies will leave the market rather than sell below cost. The reason is that smaller companies do not have financial cushion and scale to enter into price wars. The market share of Aquarius, the price leader, will increase.

Understanding Business Cycles

4) The inventory-to-sales ratio is most likely to be rising:

     A. as a contraction unfolds.

     B. partially into a recovery.

     C. near the top of an economic cycle.

Solution: C is correct. Near the top of a cycle, sales begin to slow before production is cut, leading to an increase in inventories relative to sales. At this stage, inventories growth rate is higher than sales growth.

5) An economic peak is *most closely* associated with:

     A. accelerating inflation.

     B. stable unemployment.

     C. declining capital spending.

Solution: A is correct. Inflation is rising at economic peaks.

6) In a recession, companies are *most likely* to adjust their stock of physical capital by:

     A. selling it at fire sale prices.

     B. not maintaining equipment.

     C. quickly canceling construction activity.

Solution: B is correct. Physical capital adjustments to downturns come through aging of equipment plus lack of maintenance.

Currency Exchange Rates

7) Over the past month, the Swiss franc (CHF) has depreciated 12 percent against pound sterling (GBP). How much has the pound sterling appreciated against the Swiss franc?

     A. Exactly 12 percent

     B. Less than 12 percent

     C. More than 12 percent

Solution: C is correct. The appreciation of sterling against the Swiss franc is simply the inverse of the 12 percent depreciation of the Swiss franc against sterling: $[1/(1-0.12)]-1=(1/0.88)-1=0.1364$, or 13.64%.

8) An exchange rate between two currencies has increased to 1.4500 \$/€. If the base currency has appreciated by 8 percent against the price currency, the initial exchange rate between the two currencies in terms of indirect currency quote was closest to:

     A. 0.7496.

     B. 0.7448.

     C. 1.3426.

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9) (4 points) Consider the following statement from the paper "Economic Growth and Equity Investing" – *Financial Analyst Journal:*

> *"The performance of equity investments is inextricably linked to economic growth."*

Comment on how the findings of the paper can be included in the forecast of financial statements and valuation of stocks (maximum of 150 words):

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