

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 05

EXERCISE 3: Six Questions (8 Points Total) DUE: Tuesday, September 13, 2005, 2:10pm

****IMPORTANT REMINDER: LATE ASSIGNMENTS WILL NOT BE ACCEPTED – NO EXCEPTIONS****

EXERCISE INSTRUCTIONS:

- (1) Please **fill in your name and student ID number** on Side 1 of your bubble sheet and write **353 Exercise 3** in the top margin of Side 1.
- (2) Use a number 2 pencil to **mark your answers** on Side 1 of the bubble sheet to the first five questions Q1 through Q5, below, which are in multiple choice format.
- (3) The sixth question Q6 is a Web Exercise that asks you to research and provide information about the Chicago Board of Trade. Please put your **name and student ID number** at the top of your answer sheet for Q6 along with **353 Exercise 3**, and **separately** hand in this answer sheet for Q6 in addition to your answer bubble sheet for questions Q1 through Q5.
- (4) Each question Q1 through Q5 is worth 1 point, and Q6 is worth 3 points.

Q1 (1 point). By definition, instances of DIRECT FINANCE include:

- A. You sell an IBM stock share to your classmate.
- B. You take out a loan at the First National Bank.
- C C. You buy a newly issued share of Google.
- D. You buy a life insurance policy.
- E. All of the above.

Q2 (1 Point). Corporations acquire new funds when their securities are sold in a ____ market but NOT when they are sold in a ____ market.

- A. intermediated financial market; stock market
- B. stock market; bond market
- C. secondary; primary
- D D. primary; secondary

Q3 (1 Point). Which of the following are instances of SECONDARY markets:

- A. The Nasdaq.
- B. Used car dealerships.
- C. U.S. Treasury bond auctions conducted by the Treasury.
- D. All of the above.
- E E.** Only A and B above.

Q4 (1 Point). Which of the following properties characterize DEBT securities:

- A. Debt holders do not usually participate in the management of the affairs of debt issuers except under conditions of duress.
- B. In case of bankruptcy, debt claims are paid before the claims of common stock holders.
- C. Debt payments are conditional on the profits earned by the debt issuer (borrower), except when the issuer declares bankruptcy.
- D. All of the above.
- E E.** Only A and B above.

Q5 (1 Point). A key DISTINCTION between common and preferred stock shares is

- A. preferred stock holders do not normally have voting rights with regard to corporate management issues, but common stock holders do;
- B. preferred stock claims are prior to common stock claims if bankruptcy occurs;
- C. purchasers of common stock shares are legally entitled to receive dividend payments on their shares, whereas purchasers of preferred stock shares are not;
- D. all of the above;
- E E.** only A and B above.

**SEE THE FOLLOWING PAGE FOR
Q6: WEB EXERCISE**

Q6: Web Exercise (3 Points Total). The Chicago Board of Trade (CBOT, www.cbot.com) is a leading futures and futures-option exchange. This exercise asks you to use your textbook and web research to answer six queries (A-F) about the CBOT. The answer to each query is worth half a point.

QUERY A. According to Mishkin, what is meant by a “futures contract”?

Remark: Don’t forget that Mishkin provides a Glossary of Terms at the end of his text on pages G-1 through G-11.

ANSWER TO QUERY A: In the Glossary provided at the end of his textbook, Mishkin defines a *futures contract* to be any contract in which the seller agrees to provide a certain standardized commodity to the buyer on a specific future date at an agreed-upon price.

QUERY B. When was the CBOT established, and for what primary purpose?

ANSWER TO QUERY B: 1848, for the primary purpose of trade in futures contracts on agricultural commodities such as corn, wheat, oats, and soybeans.

QUERY C. In what year did the CBOT initiate the trading of *financial futures contracts*, i.e., futures contracts in which the standardized commodity is a particular type of financial instrument (security)? Name a type of financial futures contract that can currently be traded at the CBOT.

ANSWER TO QUERY C. 1975. One of the most widely traded financial futures contracts at the CBOT is for U.S. Treasury bonds.

QUERY D. For its first 150 years, what method of trading (i.e., what type of market organization) did the CBOT use?

ANSWER TO QUERY D. For its first 150 years, the primary method of trading at the CBOT was the (open) auction.

QUERY E. What new type of market organization did the CBOT launch in 1994? Is the CBOT still using this new type of market organization?

ANSWER TO QUERY E. In 1994 the CBOT launched its first electronic trading system. CBOT continues to use electronic trading and indeed has upgraded its electronic trading system several times.

QUERY F. What does the CBOT currently perceive to be its primary role?

ANSWER TO QUERY F. As stated on the CBOT website, “the CBOT’s primary role is to provide transparent and liquid contract markets for its members and customers to use for price discovery, risk management, and investment purposes.”