Finance Core SAMPLE

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1. Which of the following best describes the purpose of a firm's capital structure?

A. To limit equity financing and maximize tax obligations
B. To balance various sources of funding to minimize the overall cost of capital
C. To strictly rely on long-term bonds for raising capital
D. To eliminate risk by avoiding short-term liabilities

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2. When analyzing a company's current ratio, a result significantly below 1.0 typically indicates:

A. Surplus working capital
B. Potential liquidity problems
C. A highly profitable operation
D. A strong balance sheet position

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3. A key difference between venture capitalists (VCs) and angel investors is:

A. Angel investors typically invest larger sums of money than VCs
B. VCs focus on early-stage startups, while angels only invest in established firms
C. VCs often require a board seat and have larger institutional backing
D. Angel investors usually have strict legal structures with pooled funds

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4. In capital budgeting, the internal rate of return (IRR) is best described as:

A. The discount rate that sets net present value (NPV) to zero
B. The minimum acceptable hurdle rate set by the board of directors
C. The prime lending rate offered by major banks
D. The annual percentage yield required by shareholders

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5. A major disadvantage of issuing convertible bonds rather than common stock is:

A. Convertible bonds often carry zero coupon payments
B. They dilute ownership when bondholders convert

C. Interest on convertible bonds is typically non-tax-deductible
D. They cannot be traded on secondary markets

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6. If a firm's inventory turnover ratio is declining over time, it might suggest:

A. Improved relationships with creditors
B. Greater efficiency in cash flow management
C. Excess stock buildup or decreased sales demand
D. Rapid conversion of inventory to sales

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7. When projecting cash flows for a proposed project, which of the following should be excluded?

A. Depreciation of new equipment
B. Sunk costs related to previous feasibility studies
C. Incremental sales revenue
D. Opportunity costs of using existing facilities

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8. A leveraged buyout (LBO) primarily relies on:

A. Substantial use of high-yield debt to acquire a target company
B. Government grants that subsidize corporate takeovers
C. Equity-only financing that avoids long-term liabilities
D. Short-term commercial paper for bridging working capital

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9. If a firm's beta is significantly higher than 1, it indicates:

A. The company is less volatile than the overall market
B. The firm's returns perfectly mirror the market's returns
C. The company's stock price exhibits higher systematic risk
D. The firm is immune to macroeconomic factors

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10. The quick (acid-test) ratio excludes which type of current assets?

A. Cash and marketable securities
B. Accounts receivable
C. Inventory
D. Prepaid expenses

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11. In a forward exchange contract, the agreed-upon exchange rate is established:

A. Retrospectively based on spot market fluctuations
B. At the contract's initiation for future delivery
C. By an international trade commission
D. After the settlement date has passed

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12. From a lender's perspective, a high debt-to-equity ratio suggests:

A. A well-diversified capital structure
B. Elevated financial risk for the firm
C. Low reliance on borrowed funds
D. Strict compliance with bond covenants

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13. One major objective of the Sarbanes-Oxley Act (SOX) is:

A. To set fixed corporate tax rates for multinational companies
B. To streamline the formation of joint ventures
C. To enhance the accuracy and reliability of corporate disclosures
D. To eliminate all forms of insider trading globally

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14. Earnings per share (EPS) can be distorted if:

A. Dividend payments are decreased
B. Companies increase R&D expenditure
C. Firms execute significant share buybacks
D. Management focuses on improving margins

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15. A company seeking to raise capital while maintaining strict control of ownership would likely:

A. Issue common shares to the public
B. Seek debt financing through term loans or bonds
C. Utilize an open market repurchase program
D. Sell majority ownership to strategic investors

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16. The term "commercial paper" refers to:

A. A long-term equity instrument for small startups
B. Short-term, unsecured debt issued by corporations

C. A specialized real estate contract for REITs
D. Corporate bonds with maturity dates over 30 years

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17. In a typical bond indenture, a call provision allows:

A. Bondholders to force the issuer to pay off early
B. The issuer to redeem the bond before maturity
C. Automatic conversion of bonds into equity
D. Underwriters to adjust the coupon rate

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18. The main function of the Securities and Exchange Commission (SEC) in the U.S. is to:

A. Secure patents for innovative technologies
B. Ensure the stability of the banking system
C. Protect investors through regulation and disclosure requirements
D. Set global monetary policy for all capital markets

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19. Which of the following is a systematic risk factor for equity investments?

A. Poor branding strategy within the company
B. A nationwide recession affecting all industries
C. High inventory levels in a single firm’s warehouse
D. Mismanagement by a single company’s executive team

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20. A firm using a just-in-time (JIT) inventory approach primarily aims to:

A. Reduce inventory holding costs by receiving goods only when needed
B. Maximize warehousing capacity and reduce cost of goods sold
C. Stabilize the company’s net income through consistent production levels
D. Overproduce raw materials to guard against stock-outs

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21. If a bank is assessing the 5 Cs of credit for a small business loan, the “Capacity” element refers to:

A. The collateral used to secure the loan
B. The ability to repay the debt from business operations
C. The borrower’s personal credit score
D. The overall loan-to-value ratio

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22. An increase in the Federal Reserve's discount rate generally:

A. Encourages more borrowing by commercial banks
B. Lowers the prime interest rate charged to consumers
C. Restricts money supply and can dampen economic growth
D. Has no effect on the equity markets or bond yields

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23. A major advantage of an interest rate swap is that it allows:

A. Investors to convert common stock to preferred stock
B. Parties to exchange fixed interest payments for floating rates (or vice versa)
C. The elimination of all counterparty risk
D. Businesses to capitalize on convertible debt securities

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24. When a firm uses derivative contracts to hedge currency risk, it is attempting to:

A. Eliminate credit risk in bond financing
B. Lock in a favorable exchange rate for future transactions
C. Increase speculative profits in the forex market
D. Bypass foreign direct investment restrictions

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25. The payback period for a project that costs $500,000 and yields $150,000 in annual net cash inflows is approximately:

A. 2.33 years
B. 3.33 years
C. 4.00 years
D. 5.00 years

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26. In ratio analysis, an abnormally high price-to-earnings (P/E) ratio may signal:

A. Undervaluation of the company's stock
B. Lower market expectations of future growth
C. Potential overvaluation or speculative bubble
D. A consistent dividend payout policy

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27. When calculating the weighted average cost of capital (WACC), the cost of equity is often estimated using:

A. The Consumer Price Index (CPI)
B. The Capital Asset Pricing Model (CAPM)
C. The Federal Reserve's discount rate
D. A standard multiplier of net income

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28. If a currency is freely floating, its exchange rate is primarily determined by:

A. Central bank quotas on exports and imports
B. The fixed peg set by the government
C. Supply and demand dynamics in the forex market
D. Committee decisions at the International Monetary Fund

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29. A firm that raises prices due to strong brand loyalty but sees no drop in demand is benefiting from:

A. Perfectly elastic demand
B. Price elasticity greater than 1
C. Inelastic demand for its products
D. Strict government price controls

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30. When analyzing the DuPont identity, which three components are multiplied to determine return on equity (ROE)?

A. EPS, dividend yield, and net profit margin
B. Net profit margin, total asset turnover, and equity multiplier
C. Operating margin, current ratio, and debt ratio
D. Times interest earned, quick ratio, and payout ratio

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31. In a scenario where a multinational firm repatriates profits from its foreign subsidiary, "repatriation" refers to:

A. The process of converting local currency revenues into U.S. dollars (or home currency)
B. Issuing new equity shares to domestic investors
C. Conducting a leveraged buyout in a foreign market
D. Selling off foreign business units at a discount

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32. A significant reason to pursue a share repurchase program is to:

A. Destroy shareholder value by diluting ownership
B. Boost the supply of outstanding shares in the market
C. Potentially increase earnings per share by reducing the number of shares
D. Force mandatory debt covenants on bondholders

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33. Which of the following is a challenge in valuing intangible assets such as patents and trademarks?

A. They have constant market liquidity
B. Their value remains static over time
C. Valuation heavily depends on future benefits and legal protections
D. They cannot be assigned any monetary worth

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34. The concept of business risk typically involves:

A. The risk of losing money in government bonds
B. Potential variability in returns due to operational factors
C. The inability of a firm to raise additional equity capital
D. Fluctuations in interest rates caused by central bank policies

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35. The overconfidence bias in financial decision-making often leads investors to:

A. Diversify their portfolios extensively
B. Assume lower levels of leverage
C. Trade more frequently than is optimal
D. Seek professional financial advice for complex trades

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36. If a company’s accounts receivable turnover decreases significantly, it could indicate:

A. More efficient credit collection practices
B. Reduced average collection period
C. Stricter credit policies
D. Potential difficulties in collecting payments from customers

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37. In evaluating a capital budgeting project, the modified internal rate of return (MIRR) differs from IRR in that MIRR:

A. Ignores the time value of money
B. Assumes reinvestment of cash flows at the cost of capital rather than the IRR
C. Eliminates the need to estimate a required rate of return
D. Always produces a lower percentage than IRR

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38. A major risk of high-frequency trading (HFT) algorithms is:

A. Perfect forecasting of all intraday price movements
B. Complete insulation from market volatility
C. The potential for flash crashes due to rapid, large-volume trades
D. Elimination of the need for compliance oversight

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39. If the yield curve inverts, it may signal:

A. An immediate bull market in equities
B. Higher short-term rates than long-term rates, potentially indicating economic slowdown
C. Elevated expectations of long-term inflation
D. A stable interest rate environment with minimal risk

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40. A primary market transaction in the stock market involves:

A. Investors trading shares among themselves in the secondary market
B. The initial issuance of new shares by the company
C. Converting common shares to preferred shares
D. The repurchase of shares via open market operations

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41. The free cash flow to equity (FCFE) metric is used to assess:

A. Net income minus dividend payments
B. The cash flow available after interest, taxes, and capital expenditures for distribution to shareholders
C. The total revenue recognized under GAAP
D. Gross profit before interest and taxes

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42. Default risk premium in bond yields refers to:

A. The additional yield required for bonds with high credit quality
B. A constant measure applied to all U.S. Treasury securities

C. Extra compensation investors demand for assuming higher probability of issuer default
D. The risk that inflation will erode fixed coupon payments

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43. In an efficient market, the price of a stock should:

A. Always be set by the highest bidder
B. Reflect all publicly available information
C. Be immune to changes in investor sentiment
D. Follow a predictable cyclical pattern

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44. A firm operating under high operating leverage typically experiences:

A. Very low fixed costs relative to variable costs
B. Significant impact on profits from small changes in sales volume
C. Lower business risk in cyclical industries
D. Less sensitivity to economic downturns

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45. A credit default swap (CDS) is a financial derivative that:

A. Protects a lender against the risk of default by transferring the risk to the seller of the CDS
B. Represents an ownership stake in a corporation
C. Converts floating interest rates to fixed interest rates
D. Eliminates currency risk in foreign transactions

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46. Cross-listing a company’s shares on multiple stock exchanges often aims to:

A. Reduce total market liquidity for the stock
B. Avoid compliance with international regulations
C. Broaden the investor base and potentially increase share liquidity
D. Limit the number of analyst coverage reports

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47. To measure the volatility of an investment’s returns, analysts typically use:

A. Discounted cash flow analysis
B. Standard deviation of historical returns
C. Weighted average cost of capital
D. Cash conversion cycle

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48. A major critique of the payback period method in capital budgeting is that it:

A. Requires complex net present value calculations
B. Ignores any cash flows occurring after the cutoff date
C. Focuses excessively on future residual value
D. Accounts for inflation but not for the time value of money

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49. A company may choose to issue a stock dividend instead of a cash dividend if:

A. It wants to reduce the total number of outstanding shares
B. It wishes to conserve cash while still providing a return to shareholders
C. The firm aims to immediately dilute existing shareholders' ownership
D. It has strong short-term liquidity and minimal growth prospects

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50. When discussing the role of the audit committee within corporate governance, one key responsibility is:

A. Setting executive compensation based on daily stock price fluctuations
B. Overseeing the integrity of financial statements and external audits
C. Approving small operational expenses for each department
D. Determining the marketing budget for product launches

Answer Key

1. Answer: B

Explanation: The purpose of capital structure is to create an optimal mix of debt, equity, and other financing sources to minimize the cost of capital while supporting operational goals.

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2. Answer: B

Explanation: A current ratio below 1.0 means the firm's current liabilities exceed its current assets, indicating potential issues in meeting short-term obligations.

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3. Answer: C

Explanation: Venture capitalists usually provide funding with institutional support and often demand significant control, including board representation, unlike angel investors.

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4. Answer: A

Explanation: The IRR is the rate at which the present value of a project's cash inflows equals its outflows, resulting in a net present value of zero.

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5. Answer: B

Explanation: When convertible bonds are converted to equity, the number of shares increases, diluting ownership among existing shareholders.

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6. Answer: C

Explanation: A declining inventory turnover ratio may indicate that inventory is not being sold quickly, potentially leading to excess stock and inefficiencies.

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7. Answer: B

Explanation: Sunk costs, which have already been incurred, are irrelevant to future decisions and should not be included in cash flow projections.

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8. Answer: A

Explanation: LBOs rely on significant debt financing to acquire companies, with the acquired firm's cash flows often used to service the debt.

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9. Answer: C

Explanation: A beta higher than 1 indicates that the stock is more volatile and sensitive to market movements than the average market.

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10. Answer: C

Explanation: The quick ratio excludes inventory because it is less liquid than other current assets like cash and accounts receivable.

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11. Answer: B

Explanation: A forward exchange contract locks in an exchange rate at the time of agreement for a transaction that will occur in the future.

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12. Answer: B

Explanation: A high debt-to-equity ratio suggests greater reliance on debt, which increases financial risk due to higher fixed obligations.

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13. Answer: C

Explanation: SOX aims to improve financial transparency and accountability in corporations, primarily through stricter disclosure and auditing requirements.

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14. Answer: C

Explanation: Share buybacks reduce the number of outstanding shares, artificially inflating EPS even if earnings remain unchanged.

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15. Answer: B

Explanation: Debt financing allows firms to raise capital without giving up ownership or control, unlike issuing common equity.

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16. Answer: B

Explanation: Commercial paper is a form of short-term financing used by corporations to cover immediate liabilities.

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17. Answer: B

Explanation: A call provision allows issuers to buy back bonds before maturity, usually to refinance at a lower interest rate.

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18. Answer: C

Explanation: The SEC's primary role is to ensure fair and transparent markets by regulating disclosures and investor protections.

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19. Answer: B

Explanation: Systematic risk affects the entire market or economy, as opposed to firm-specific risks like poor management.

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20. Answer: A

Explanation: JIT minimizes holding costs by synchronizing inventory supply with production schedules.

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21. Answer: B

Explanation: Capacity assesses a borrower's ability to generate sufficient cash flow to meet repayment obligations.

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22. Answer: C

Explanation: Raising the discount rate makes borrowing more expensive, reducing the money supply and slowing economic activity.

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23. Answer: B

Explanation: Interest rate swaps allow parties to hedge against interest rate risk by exchanging different types of interest payments.

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24. Answer: B

Explanation: Hedging with derivatives helps firms mitigate the risk of unfavorable currency fluctuations.

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25. Answer: B

Explanation: Payback period is calculated as $500,000 ÷ $150,000 = 3.33 years.

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26. Answer: C

Explanation: A high P/E ratio often indicates overvaluation, particularly if the firm's growth prospects do not justify the valuation.

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27. Answer: B

Explanation: CAPM is commonly used to estimate the cost of equity by factoring in risk-free rates, market returns, and the firm's beta.

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28. Answer: C

Explanation: Freely floating exchange rates are determined by market forces of supply and demand.

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29. Answer: C

Explanation: Strong brand loyalty can lead to inelastic demand, where consumers are less sensitive to price increases.

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30. Answer: B

Explanation: The DuPont identity breaks ROE into these three components to analyze financial performance.

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31. Answer: A

Explanation: Repatriation refers to transferring profits earned abroad back to the home country, often involving currency conversion.

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32. Answer: C

Explanation: Reducing outstanding shares through repurchase increases EPS if net income remains constant.

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33. Answer: C

Explanation: Intangible assets are challenging to value because their worth often depends on future cash flows and legal enforceability.

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34. Answer: B

Explanation: Business risk is linked to operational uncertainties that affect a firm's returns.

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35. Answer: C

Explanation: Overconfidence bias often leads investors to trade excessively, potentially reducing returns due to higher transaction costs.

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36. Answer: D

Explanation: A decrease in accounts receivable turnover may indicate inefficiencies in collecting payments.

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37. Answer: B

Explanation: MIRR provides a more realistic measure of a project's profitability by assuming reinvestment at the cost of capital.

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38. Answer: C

Explanation: HFT's reliance on speed can amplify market instability, leading to flash crashes.

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39. Answer: B

Explanation: An inverted yield curve is often viewed as a leading indicator of a recession.

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40. Answer: B

Explanation: A primary market transaction occurs when a company issues new securities directly to investors.

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41. Answer: B

Explanation: FCFE represents the cash flow remaining after all obligations, available for equity holders.

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42. Answer: C

Explanation: Default risk premium compensates investors for the risk that the bond issuer may fail to meet obligations.

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43. Answer: B

Explanation: In an efficient market, stock prices incorporate and reflect all known information.

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44. Answer: B

Explanation: High operating leverage amplifies the effect of changes in sales on profitability due to high fixed costs.

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45. Answer: A

Explanation: A CDS acts as insurance, transferring the risk of borrower default to the CDS seller.

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46. Answer: C

Explanation: Cross-listing enhances market access and liquidity by making shares available to investors in multiple regions.

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47. Answer: B

Explanation: Standard deviation measures the dispersion of investment returns, indicating volatility.

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48. Answer: B

Explanation: The payback period focuses solely on the time required to recover the initial investment, neglecting later cash flows.

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49. Answer: B

Explanation: Stock dividends are used when firms want to reward shareholders without reducing cash reserves.

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50. Answer: B

Explanation: The audit committee ensures that financial reporting is accurate and compliant with regulations.