

ECON 133 – Securities Markets – FALL 2010, UCSC

HOMEWORK # 1 (Due Friday Oct. 1, Beginning of Class)

1. **CH.1.5** What are the differences between real and financial assets?
2. **CH. 1.9** Lanni, a startup firm, currently owns computers equipment worth \$30,000 and has cash on hand of \$20,000 contributed by Lanni's owners. For each of the following transactions, identify the real and/or financial assets that trade hands. Are any financial assets created or destroyed in the transaction?
 - a) Lanni takes out a bank loan. It receives \$50,000 in cash and signs a note promising to pay back the loan over three years.
 - b) Lanni uses the cash from the bank plus \$20,000 of its own funds to finance the development of new financial planning software.
 - c) Lanni sells the software product to Microsoft, which will market it to the public under the Microsoft name. Lanni accepts payment in the form of 5,000 shares of Microsoft stock.
 - d) Lanni sells the share of stock for \$25 per share and uses part of the proceeds to pay off the bank loan.
3. **CH.1.10** Reconsider Lanni from the previous problem.
 - a) Prepare its balance sheet just after it gets the bank loan. What is the ratio of real assets to total assets?
 - b) Prepare the balance sheet after Lanni spends the \$70,000 to develop its software product. What is the ratio of real to financial assets?
 - c) Prepare the balance sheet after Lanni accepts the payment of shares from Microsoft. What is the ratio of real to total assets?
4. **CH.3.6** What are the differences between a stop-loss order, a limit sell order, and a market order?
5. **CH.3.10** Suppose you short sell 100 shares of IBM, now selling at \$120 per share.
 - a) What is your maximum possible loss?
 - b) What happens to maximum loss if you simultaneously place a stop-buy order at \$128?
6. **CH.3.17** You are bearish on Telecom and decided to sell short 100 shares at the current market prices of \$50 per share.
 - a) How much in cash or securities must you put into your brokerage account if the broker's initial margin requirement is 50% of the value of the short position?
 - b) How high can the price of the stock go before you get a margin call if the maintenance margin is 30% of the value of the short position?

7. **CH.3.21** You've borrowed \$20,000 on margin to buy shares in Disney, which is now selling at \$40 per share. Your account starts at the initial margin requirement of 50%. The maintenance margin is 35%. Two days later, the stock price falls to \$35 per share.
- Will you receive a margin call?
 - How low can the price of Disney shares fall before you receive a margin call?
8. **Santa Clara MBA Question¹:** You are given the following trading “book” of bids and offers (asks) in security ABC:

BID	OFFER/ASK
	1000 @ \$102.50
	1500 @ \$102.25
	750 @ \$101.50
	500 @ \$101.00
1750 @ \$99.50	
2500 @ \$99.25	
1000 @ \$99.00	
500 @ 98.75	

The following order: “**BUY 1500 ABC @ \$102.00**” comes in. What trade gets consummated and what is the new inside market (indicate price and volume)?

9. ***The Myth of the Rational Market*, Chapter 1 Question:** What proposal did Irving Fisher make regarding the way stocks should be valued?
10. ***The Myth of the Rational Market*, Chapter 1 Question:** What findings did Edgar Smith report in his 1924 book regarding the long-term returns on stocks and bonds?

¹ Note: Question 5 follows the format of Santa Clara MBA class, Prof. Sury