Chapter Fifteen Exercises

1. The International Bank of Roseau made this offer: For $300, you can receive a short course on international banking and earn the right to sign others up for this course. If you sign up six people, you receive a $1000 "loan" from the bank that does not have to be repaid. Let's say that you sign up six people and each of these sign up six people and so on eight more times. How many people (including yourself) will have taken this course? How much money will the bank have taken in and paid out? Why do you think Florida attorney general shut down this bank?

2. J. David & Co. sent a memo to a bank that had lent it money stating that J. David's cash flow problems were temporary, because its investor requests for withdrawals could soon be satisfied by the arrival of funds from new investors. Why might such a memo suggest fraud? Why might a legitimate business do the same thing, with no fraud whatsoever? If you were a bank officer, how would you tell the difference between a fraud and a legitimate business?

3. Between August 1982 and August 1987, the Dow Jones Industrial Average rose from 777 to 2722. What was the annual percentage rate of increase?

4. In 1997, Nobel laureate William F. Sharpe offered this advice for investors:

    > The first thing is to get some feel for the lessons history might teach us about what may happen in the future. . . . I like to make sure that people take a hard look at 1973–1974. It's terribly important to get people focused on real returns—that is, not only how much you won or lost but how much more it cost you to eat. And '73–'74 was really a shocking time—you lost a lot of money on stocks, and it cost you a whole lot more to eat. That was a disastrous time.

    The nominal return on the S&P500 (dividends plus capital gains) was –14.7 percent in 1973 and –26.4 percent in 1974. Consumer prices increased by 8.7 percent in 1973 and by 12.9 percent in 1974. What was the real return for S&P500 investors over this two- year period?

5. Explain why you either agree or disagree with this statement by a prominent professor: "only if everyone has the same information will price changes reflect a stock's true value."