

## Chapter Six Exercises

1. The *Wall Street Journal* awarded its tongue-in-cheek 1986 “Charity Begins at Home Award”:

To Merrill Lynch Capital Markets, for its underwriting of Home Shopping Network. Merrill priced the stock at \$18 a share. The day it began trading, the stock more than doubled to \$42.625 . . . By June the stock had more than doubled again to \$100.

Why is the price, \$42.625, given to three decimal places? The creators of Home Shopping Network sold 2 million shares to the public and kept 10 million shares for themselves. What was the total market value of the company at a price of \$18? At \$42.625? At \$100? At \$5, the price one year later? Did it really make any difference to anyone whether the two million shares were initially sold at \$18 or \$42?

2. Explain how stop-loss orders could do the damage described here:

A friend of mine who was out in the Far East in 1963 had stop-loss orders on all his stocks. When President Kennedy was assassinated . . . the market took a fierce immediate plunge . . . The market then recovered its nerves, turned around almost immediately and went right up past its previous level. But by the time the news reached my unfortunate friend, all he could do was get back in with 80 shares where he had formerly had 100.

3. Bonds can be bought on margin—30 percent for corporate bonds and as little as 5 percent for Treasury bonds. Why would anyone want to buy Treasury bonds on margin, since the loan rate charged by the broker is presumably higher than the interest rate on Treasury bonds?
4. In 1929, many speculators bought stocks with a 10 percent margin. Assuming a very short period of time, so that dividends and interest costs are negligible, how much do stock prices have to increase to double the speculator’s equity? How much do stock prices have to fall to wipe the speculator out?
5. Below are the closing prices on Friday, October 16, 1987 and on Monday, October 19, 1987. Do these data indicate that stock prices fell more on this Black Monday for large established companies or for smaller, more speculative firms?

	Friday	Monday
Dow Industrials	2246.74	1738.74
NYSE Composite	159.13	128.62
Nasdaq	406.33	360.21