Reading 46: Market Efficiency

Question #1 of 34

Question ID: 415241

Which of the following statements *least likely* describes the role of a portfolio manager in perfectly efficient markets? Portfolio managers should:

A) construct diversified portfolios that include international securities to eliminate unsystematic risk.

B) quantify client's risk tolerance, communicate portfolio policies and strategies, and maintain a strict buy and hold policy avoiding any changes in the portfolio to minimize transaction costs.

C) construct a portfolio that includes financial and real assets.

Question #2 of 34

Question ID: 415232

Which of the following statements about market efficiency is *least* accurate?

A) The strong-form EMH assumes cost free availability of all information, both public and private.

B) The weak-form EMH suggests that fundamental analysis will not provide excess returns while the semi-strong form suggests that technical analysis cannot achieve excess returns.

C) The semi-strong form EMH addresses market and non-market public information.

Question #3 of 34

Question ID: 415238

Which of the following statements concerning market efficiency is *least* accurate?

A) Market efficiency assumes that individual market participants correctly estimate asset prices.

B) If weak-form market efficiency holds, technical analysis cannot be used to earn abnormal returns over the long-run.

C) Tests of the semi-strong form of the EMH require that security returns be risk-adjusted using a market model.

Question #4 of 34

Question ID: 415251

The idea that uninformed traders, when faced with unclear information, observe the actions of informed traders to make decisions, is referred to as:

A) information cascades.

B) herding behavior.

C) narrow framing.

Question #5 of 34

Question ID: 415228

Which of the following statements on the forms of the efficient market hypothesis (EMH) is *least* accurate?

A) The semi-strong form EMH addresses market and non-market public information.

B) The weak-form EMH states that stock prices reflect current public market information and expectations.

C) The strong-form EMH assumes perfect markets.

Question #6 of 34

Question ID: 415230

The strong-form efficient market hypothesis (EMH) asserts that stock prices fully reflect which of the following types of information?

A) Public and private.

B) Public, private, and future.

C) Market.

Question #7 of 34

Question ID: 415234

Which of the following forms of the EMH assumes that no group of investors has monopolistic access to relevant information?

A) Weak-form.

B) Both weak and semistrong form.

C) Strong-form.

Question #8 of 34

Question ID: 598995

An investor who is more risk averse with respect to potential negative outcomes than potential positive outcomes *most likely* exhibits:

A) loss aversion.

B) mental accounting.

C) conservatism.

Question #9 of 34

Question ID: 415221

The measure of an asset's value that can *most likely* be determined without estimation is its:

A) intrinsic value.

B) fundamental value.

C) market value.

Question #10 of 34

Question ID: 415218

The implication of efficient capital markets and a lack of superior analysts have led to the introduction of:

A) futures options.

B) index funds.

C) balanced funds.

Question #11 of 34

Question ID: 415240

In a perfectly efficient market, portfolio managers should do all of the following EXCEPT:

A) quantify their risk and return needs within the bounds of the client's liquidity, income, time horizon, legal, and regulatory constraints.

B) diversify to eliminate systematic risk.

C) monitor their client's needs and circumstances.

Question #12 of 34

Question ID: 415243

David Farrington is an analyst at Farrington Capital Management. He is aware that many people believe that the capital markets are fully efficient. However, he is not convinced and would like to disprove this claim. Which of the following statements would support Farrington in his effort to demonstrate the limitations to fully efficient markets?

A) Stock prices adjust to their new efficient levels within hours of the release of new information.

B) Processing new information entails costs and takes at least some time, so security prices are not always immediately affected.

C) Technical analysis has been rendered useless by many academics who have shown that analyzing market trends, past volume and trading data will not lead to abnormal returns.

Question #13 of 34

Question ID: 415244

The opportunity to take advantage of the downward pressure on stock prices that result from end-of-the-year tax selling is known as the:

A) end-of-the-year effect.
B) January anomaly.
C) end-of-the-year anomaly.

Question #14 of 34

Question ID: 415235

The semi-strong form of the efficient market hypothesis (EMH) asserts that stock prices:

A) fully reflect all relevant information including insider information.
B) fully reflect all historical price information.
C) fully reflect all publicly available information.

Question #15 of 34

Question ID: 415226

An increase in which of the following factors would *most likely* improve a market's efficiency?

A) Number of participants.
B) Restrictions on short selling.
C) Bid-ask spreads.

Question #16 of 34

Question ID: 415219

In an informationally efficient market:

A) buying and holding a broad market portfolio is the preferred investment strategy.
B) share prices adjust rapidly when companies announce results in line with expectations.
C) the conditions exist for active investment strategies to achieve superior risk-adjusted returns.

Question #17 of 34

Question ID: 415222

A stock is said to be undervalued if its market price is:

A) less than its book value.
B) greater than its intrinsic value.
C) less than its intrinsic value.

Question #18 of 34

Question ID: 415246

Which of the following statements *best* describes the overreaction effect?

A) Low returns over a three-year period are followed by high returns over the following three years.

B) High returns over a one-year period are followed by low returns over the following three years.

C) High returns over a one-year period are followed by high returns over the following year.

Question #19 of 34

Question ID: 415242

Which of the following is a limitation to fully efficient markets?

A) The gains to be earned by information trading can be less than the transaction costs the trading would entail.

B) There are no limitations to fully efficient markets because the trading actions of fundamental and technical analysts are continuously keeping prices at their intrinsic value.

C) Information is always quickly disseminated and fully embedded in a security's prices.

Question #20 of 34

Question ID: 415249

Investor overreaction that has been documented in securities markets is *most likely* attributable to investors exhibiting:

A) loss aversion.

B) conservatism.

C) risk aversion.

Question #21 of 34

Question ID: 415237

If the efficient markets hypothesis is true, portfolio managers should do all of the following EXCEPT:

A) Spend more time working on security selection.

B) Minimize transaction costs.

C) Work more with clients to better quantify their risk preferences.

Question #22 of 34

Question ID: 415223

The value of an asset that a rational investor with full knowledge about the asset's characteristics would willingly pay is *best* described as the asset's:

A) theoretical value.

B) intrinsic value.

C) market value.

Question #23 of 34

Question ID: 415239

Under the efficient market hypothesis (EMH), the major effort of the portfolio manager should be to:

A) achieve complete diversification of the portfolio.

B) minimize systematic risk in the portfolio.

C) follow a strict buy and hold strategy.

Question #24 of 34

Question ID: 415247

If the momentum effect persists over time, it would provide evidence against which of the following forms of market efficiency?

A) Weak form only.

B) Both weak form and semistrong form.

C) Semistrong form only.

Question #25 of 34

Question ID: 415220

Hume Inc. announces fourth quarter earnings per share of $1.20, which is 15% higher than last year. Hume's earnings are equal to the consensus analyst forecast for the quarter. Assuming markets are efficient, the announcement will *most likely* cause the price of Hume's stock to:

A) increase.

B) remain the same.

C) decrease.

Question #26 of 34

Question ID: 415231

The semi-strong form of efficient market hypothesis (EMH) asserts that:

A) all public information is already reflected in security prices.

B) both public and private information is already incorporated into security prices.

C) past and future prices exhibit little or no relationship to another.

Question #27 of 34

Question ID: 415250

In behavioral finance theory, how is loss aversion *most accurately* defined? For gains and losses of equal amounts, investors:

A) like gains more than they dislike losses.

B) dislike losses more than they like gains.

C) dislike for losses and like for gains are proportionate.

Question #28 of 34

Question ID: 415236

Which of the following forms of the EMH assumes that no group of investors has monopolistic access to relevant information?

A) Strong-form.

B) Both weak and semistrong form.

C) Weak-form.

Question #29 of 34

Question ID: 415229

The statement, "Stock prices fully reflect all information from public and private sources," can be attributed to which form of the efficient market hypothesis (EMH)?

A) Strong-form EMH.

B) Weak-form EMH.

C) Semistrong-form EMH.

Question #30 of 34

Question ID: 415245

Which of the following would provide evidence *against* the semistrong form of the efficient market theory?

A) Trend analysis is worthless in determining stock prices.

B) All investors have learned to exploit signals related to future performance.

C) Low P/E stocks tend to have positive abnormal returns over the long run.

Question #31 of 34

Question ID: 415224

Which of the following would be *inconsistent* with an efficient market?

A) Stock prices adjust rapidly to new information.

B) Price changes are independent.

C) Price adjustments are biased.

Question #32 of 34

Question ID: 415217

An efficient capital market:

A) does not fully reflect all of the information currently available about a given security, including risk.

B) fully reflects all of the information currently available about a given security, excluding risk.

C) fully reflects all of the information currently available about a given security, including risk.

Question #33 of 34

Question ID: 415225

A market's efficiency is *most likely* to negatively affected by:

A) a ban on short selling.

B) a high amount of trading activity.

C) substantial analyst coverage of the exchange listed companies

---

Question #34 of 34

Question ID: 485804

Octagon Advisors believes that the market is semi-strong efficient. The firm's portfolio managers *most likely* will use:

A) an enhanced indexing strategy that relies on trading patterns.

B) passive portfolio management strategies.

C) active portfolio management strategies.