

# EE431 Economics of Financial Markets and Institutions

## Financial Assets and Overview of Financial Market

### 1. Fill in the blanks.

- (a) Those financial markets that facilitate the flow of short-term funds are known as .....  
(Hint: capital market or money market)
- (b) Funds are provided to the initial issuer of securities in the ..... (Hint: primary market or secondary market)
- (c) A five year security was purchased two years ago by an investor, who plans to resell it. The security will be sold by the investor in the ..... (Hint: primary market or secondary market)
- (d) Securities are ..... (Hint: assets or liabilities) for the person who buys them, but are ..... (Hint: assets or liabilities) for the individual or firm that issues them.
- (e) With ..... finance (Hint: direct or indirect) , borrowers obtain funds from lenders by selling them securities in the financial markets.
- (f) With direct finance funds are channeled through the financial market from the ..... (Hint: savers or spenders) directly to the ..... (Hint: savers or spenders) .
- (g) When I purchase ..... (Hint: bonds or stocks), I own a portion of a firm and have the right to vote on issues important to the firm and to elect its directors.
- (h) ..... (Hint: Debt or Equity) holders are a corporation 's residual claimants. That means the corporation must pay all of its ..... (Hint: debt or equity) holders before it pays its .....(Hint: debt or equity holders).
- (i) ..... (Hint: A bondholder or A shareholder) benefits directly from any increase in the corporation 's profitability.
- (j) A financial market in which previously issued securities can be resold is called a ..... (Hint: primary or secondary) market.
- (k) A corporation acquires new funds only when its securities are sold in the ..... (Hint: primary or secondary) market.
- (l) The higher a security 's price in the secondary market the ..... (Hint: more or less) funds a firm can raise by selling securities in the ..... (Hint: primary or secondary) market.
- (m) A financial market in which only short-term debt instruments are traded is called the ..... (Hint: money or capital) market.
- (n) Equity instruments are traded in the ..... (Hint: money or capital) market.
- (o) The total collection of pieces of property that serve to store value is a person 's ..... (Hint: wealth, money or credit).
- (p) ..... (Hint: wealth, money or income) is a flow of earnings per unit of time.

### 2. The following can be described as involving direct finance or indirect finance. Specify.

- (a) You take out a mortgage from your local bank.  
..... (direct finance or indirect finance)
- (b) You borrow \$2500 from a friend to buy a car.  
..... (direct finance or indirect finance)

- (c) You buy shares of common stock in the primary market.  
..... (direct finance or indirect finance)
- (d) A corporation takes out loans from a bank to expand its business.  
..... (direct finance or indirect finance)
- (e) You buy a newly issued U.S. Treasury bill from the U.S. Treasury.  
..... (direct finance or indirect finance)
- (f) You make a deposit at a bank.  
..... (direct finance or indirect finance)

3. Is the following statement true or false and why?

- (a) Both debt and equity instruments can be long-term financial instruments.  
(True or False.) Reason. ....
- (b) Both debt and equity instruments involve a claim on the issuer's income.  
(True or False.) Reason. ....
- (c) Both debt and equity instruments enable a corporation to raise funds.  
(True or False.) Reason. ....
- (d) The income from bonds is typically more variable than that from equities.  
(True or False.) Reason. ....
- (e) A bond is a long-term security that promises to make periodic payments called dividends to the firm's residual claimants.  
(True or False.) Reason. ....

4. Corporations receive funds when their stock is sold in the primary market. Why do corporations pay attention to what is happening to their stock in the secondary market?

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