FIN 366: INVESTMENTS
EQUITIES
CRITICAL THINKING & CONCEPTUAL QUESTIONS

1. You put $10 in a slot machine and immediately win $300. Why is this not considered an investment?
2. You pay $300 for a stock that falls in value to $10. Why is this considered an investment?
3. How are financial assets “claims on real assets and income”? Do real or financial assets represent the material wealth in a society?
4. What is a residual claim, and how can one determine the book and market values of a residual claim on a firm?
5. What does *limited liability* imply for shareholders of a public firm if the firm liquidates but is unable to pay its lenders in full?
6. Why might limited liability be attractive in encouraging entrepreneurship?
7. Why might a younger firm decide to not pay dividends to shareholders?
8. In what way are large institutional investors holding millions of shares of a company more likely to be better monitors of firm management than small investors?
9. How might large institutional investors help to mitigate the agency problem through their voting power?
10. If you expect a stock to soon beat its 52-week high, are you bullish or bearish on the stock?
11. A stock’s volume on a given day is twice as high as its average volume. What does this mean? What might have cause higher volume?
12. What are the differences between common stock and preferred stock? Which of these types of stock are entitled to receive all dividends that the firm “skips”?
13. What is an ADR and why might an ADR be an easier way for you to hold stock of an international firm?
14. Is it possible for a stock to simultaneously sell for two different prices to two different investors at the same point in time?
15. If the ask price for a security is for 3 lots of shares, do you expect the ask price of a 4^{th} lot to be greater or less than the price of the first 3 lots? Why do you expect this is the case?
16. If the bid price for a security is for 3 lots of shares, do you expect the bid price of a 4^{th} lot to be greater or less than the price of the first 3 lots? Why do you expect this is the case?
17. Go to the Cboe Book Viewer during market hours and look up any stock. What does it show? (It might help you answer the two previous questions.)
18. Identify each of the following market or price contingent orders:
    a. MSY is currently trading at $6 per share. You want to wait to purchase MSY until it reaches $8 because you think it’ll rise much higher, but only after it reaches $8.
    b. You are looking to sell SEVL that is currently trading at $10 per share, but you want to receive at least $12 per share.

c. You own HON that currently trades at $20 per share. Your goal is to make at least $5 per share if the price were to drop. You create an order to sell at $15.
d. You submit an order to purchase shares of CHN as quickly as possible at the best possible price.
e. FWND is currently trading at $10 per share. You are interested in purchasing shares, but you only want to pay $8 per share at most.

19. How can buying on margin offer greater upside potential than investing in stocks without borrowing? How can it amplify risks?
20. Define the initial and maintenance margins. What are the levels that they must be, and who establishes each level? What might cause the initial margin to fall to a point where a margin call occurs?
21. Describe the mechanism for how you can sell short shares if you don't own them. What does "covering the short" mean?
22. Why does the value of your liability when buying on margin remain a constant dollar amount while the value of your liability when short selling fluctuates?
23. What makes a *short* position in a stock riskier than a *long* position in a stock? Assuming no margin, how much can your losses be if you are short a stock?
24. How might you use a *buy stop* in conjunction with a short position to protect yourself from unlimited losses? (*Hint:* Assume you short 1 share of DNLE at $100 but set a buy stop for 1 share at $105 prior to the shares rising to $200 and before you cover the short.)
25. How might you use a *sell stop* in conjunction with a long position to protect yourself from the stock falling? Would this protect against unlimited losses?
26. CHALLENGE A **short squeeze** occurs when a stock's price rapidly rises forcing short sellers to cover their positions to prevent increasing losses. How might a short squeeze further help investors who are *long* a stock?
27. CHALLENGE **Market depth** refers to the ability of a stock to "absorb" large orders without moving the stock's price significantly. What types of firms are likely to have greater depth? Where might we observe a stock's depth?
28. CHALLENGE **Short interest** is the number of shares or percentage of shares of a stock that has been sold short relative to the shares outstanding. How might investors use a stock's short interest as a signal for sentiment?
29. CHALLENGE **Dual class stocks** are stocks that offer two or more "classes" of shares that may differ in their voting rights. For example, Alphabet Class A shares are entitled to 1 vote per share, Class B shares are entitled to 10 votes per share (and are held only by insiders), and Class C shares have no voting power. What might this mean for the agency problem? Which share class, A or C, do we expect to trade at a higher price (B doesn't trade publicly)?
30. CHALLENGE **Cumulative voting** allows an investor to have greater flexibility in their allocation of votes for the board of directors. For example, with "regular" voting, if you have 300 shares of a company and there are 4 board seats up for election, you can vote a maximum of 300 times per board seat. With cumulative voting, you can choose to split your 1200 total votes (300 times 4) in any combination across board seats (i.e., 800 votes for one director, 200 votes for the second and third directors, and no votes for the last open board seat). How is this valuable for investors? Which type of investors (big or small) does this benefit?

31. CHALLENGE **Staggered boards** are boards where only a few of the directors at the firm are up for election at a time rather than the full slate of directors up for election all at once. For example, on a nine-person board, three may be up for election in one year, three the next year, and the last three in the third year. How might this prevent corporate takeovers by powerful voters? What might some disadvantages of this system be?
32. CHALLENGE **Stock repurchases** (or **stock buybacks**) occur when a firm uses cash to "buy back" its own shares and remove them from the market. For example, suppose a firm executive owns 49 thousand shares of their company that has 100 thousand total shares outstanding, and they direct the company to repurchase 10 thousand shares from the market. This reduces outstanding shares to 90 thousand. If the executive still personally owns the same 49 thousand shares after the company repurchased shares from other investors, what does this buyback mean for the executive's level of ownership interest in the firm? What about their voting power? How might this protect a firm from being taken over?