1. From an investor’s perspective, if the foreign exchange market is efficient, information about expected changes in exchange rates should be widely known and thus reflected in a firm’s market value. Only __________ in exchange rates or an __________ foreign exchange market, should cause market value to change.
   (a) expected changes; efficient (b) unexpected changes; efficient
   (c) expected changes; inefficient (d) unexpected changes; inefficient

2. Translation exposure may also be called __________ exposure.
   (a) transaction (b) operating
   (c) accounting (d) currency

3. Historical exchange rates may be used for __________, while current exchange rates may be used for __________.
   (a) fixed assets and current assets; income and expense items
   (b) equity accounts and fixed assets; current assets and liabilities
   (c) current assets and liabilities; equity accounts and fixed assets
   (d) equity accounts and current liabilities; current assets and fixed assets

   (a) Securities and Exchange Commission (SEC)
   (b) Federal Reserve System (Fed)
   (c) Financial Accounting Standards Board (FASB)
   (d) General Agreement on Tariffs and Trade (GATT)

5. What characteristics of foreign securities lead to diversification benefits for American investors?

6. A fully diversified domestic portfolio has a beta of
   (a) 0.0. (b) 1.0. (c) -1.0.
   (d) Not enough information to answer this question.

7. Portfolio diversification can eliminate 100% of risk.
   (a) True (b) False
8. A well-diversified portfolio is only about ________ as risky as the typical individual stock.
   (a) 8%     (b) 19%
   (c) 27%    (d) 52%

9. Who is more likely to gain from investing in another country, a resident of the Germany or a resident of Thailand? Briefly explain your answer.

10. The theory that suggests specialization by country can increase worldwide production is ________.
    (a) the theory of comparative advantage
    (b) the theory of foreign direct investment
    (c) the international Fisher effect
    (d) the theory of working capital management

11. Of the following, which would NOT be considered a way that government interferes with comparative advantage?
    (a) Tariffs  (b) Managerial skills
    (c) Quotas    (d) Other non-tariff restrictions

12. Comparative advantage shifts over time as less developed countries become more developed and realize their latent opportunities.
    (a) True     (b) False

13. The O in OLI refers to an advantage in a firm’s home market that is ________.
    (a) operator independent (b) owner-specific
    (c) open-market    (d) official designation

14. FDI is
    (a) investment in real assets in foreign countries.
    (b) foreign direct investment.  (c) influenced by behavioral factors.
    (d) all of the above.

15. Local partners in a foreign country and in a joint venture with an MNE are likely to make decisions that maximize the value of the subsidiary. Such actions probably will not maximize the value of the entire firm.
    (a) True     (b) False

16. The traditional financial analysis applied to projects, foreign or domestic, to determine the project’s value to the firm is called ________________.
    a. cost of capital analysis
    b. capital budgeting
    c. capital structure analysis
    d. agency theory
17. The _______ is defined as the present value of future cash flows discounted at the project’s cost of capital minus the initial net cash outlay for the project.
   a. net present value  b. equity-adjusted present value
   c. cost of capital    d. value additivity principle

18. There are no important differences between domestic and international capital budgeting methods.
   a. True                  b. False

19. Generally speaking, a firm wants to receive cash flows from a currency that is _______ relative to their own, and pay out in currencies that are _______ relative to their home currency.
   a. appreciating; depreciating
   b. depreciating; depreciating
   c. appreciating; appreciating
   d. depreciating; appreciating

20. A tax that is effectively a sales tax at each stage of production is defined as a/an _______ tax.
    (a) flat  (b) equitable  (c) value-added tax  (d) none of the above

21. A _______ is a direct reduction of taxes whereas a _______ reduces the taxable income before taxes.
    (a) foreign tax credit; domestic tax credit  (b) tax deduction; tax credit
    (c) tax credit; tax deduction  (d) none of the above

22. Which of the following is NOT a characteristic of “international offshore financial centers” also known as tax havens.
    (a) A low tax on foreign investment.
    (b) An unstable currency to discourage investment in the local economy.
    (c) Infrastructure and workforce to support financial services.  (d) Government stability.
Use the following information to answer questions 1 – 4.
In August 2005 a U.S. investor chooses to invest $500,000 in German equity securities at a then current spot rate of $1.18/€. At the end of one year the spot rate is $1.02/€.

1. (4 points) How many euros will the U.S. investor acquire with his initial $500,000 investment?

2. (4 points) At an average price of €60/share, how many shares of stock will the investor be able to purchase?

3. (4 points) At the end of the year the investor sells his stock that now has an average price per share of €63. What is the investor’s average rate of return before converting the stock back into dollars?

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5. (4 points) Meryl Janicky, a mutual fund manager, is evaluating the recent performance of the shares of Thames Boats International, a publicly traded company in Great Britain. Ms Janicky’s firm has $200,000 invested in Thames Boats and she has gathered the information presented in the following table. What was the return on the security in dollars?

<table>
<thead>
<tr>
<th>Element</th>
<th>January 1 Purchase</th>
<th>December 31 Sale</th>
<th>Distributions Per Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>£88.00</td>
<td>£93.50</td>
<td>£4.00</td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>$1.75/£</td>
<td>$1.83/£</td>
<td></td>
</tr>
</tbody>
</table>
6. (3 points each) two countries, the United States and Italy, produce only one good, widgets. Suppose the price of widgets in the U.S is $15.90 and the price of widgets in Italy is 157,000 lira.
   a. According to the law of one price, what should the $: Lira exchange rate be?

   b. Suppose the price of widgets is expected to fall in the U.S. to $15.50 and increase to 193,000 Lira over the next year. What should the one year $:Lira forward rate be?

   c. Based on the difference between the spot and forward rates, who has the higher inflation rate? What is the differential in inflation between the Italy and the U.S.?

Spot rate is $1=.59 British pounds.
The one-year futures price is $1= .57 British pounds

The 1-year British Treasury rate is 5.9%
Inflation in the United States is expected to be 1.8%.

Answer the following questions? (2 points for each blank)

7. A British person investing 10,000 pounds in the United States expects to invest
   ________ Dollars today in United States Treasury Bonds. They would earn _______%
on their United States Treasury Bonds. At the end of one year, they would redeem their
   bond for ________ dollars and convert their $ back into _________ pounds. During
   this period, the pound appreciated/depreciated ________________% against the $.

Homework: 5% of course grade, Turn in any 6 Questions and Problems,