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Financial Markets and Institutions

Study Questions: Introduction (set 2) (Answers on the Next Page)

Determine where each of the following transactions occurs:

- in a primary debt market
 - in a secondary debt market
 - in a primary stock market
 - in a secondary stock market
 - in a foreign exchange market
 - in none of these
- a) You buy 1000 shares of IBM stock on the New York Stock Exchange
b) You trade \$100 for 450 francs at your bank
c) You pay \$400 for a Tiger Woods rookie card
d) You buy a newly-issued municipal bond from the City of Houston
e) You buy a 30-year Treasury bond today that was issued in 1996
f) You get a \$200,000 mortgage to buy your dream house
g) You buy 1,000,000 shares of newly-issued AMD stock
h) You pay your professor \$1,000 for an A

Determine whether each of these events depicts

- adverse selection
 - moral hazard
 - neither one
- a) You buy a \$1,000,000 life insurance policy; then your spouse kills you (making it look like an accident).
b) Two dudes want to borrow money from you, and both promise to repay with interest, but you are unsure.
c) The PGA Tour announces that it will insure pro golfers if they bean someone with a golf ball; then Tiger Woods purposely beans that idiot announcer, Johnny Miller.
d) A truck on the side of the road is selling shrimp cheap, but you can't tell if they are edible or laden with bacteria.

Determine where each of the following transactions occurs:

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 - in a secondary debt market
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- a) You buy 1000 shares of IBM stock on the New York Stock Exchange
secondary stock
 - b) You trade \$100 for 450 francs at your bank
foreign exchange
 - c) You pay \$400 for a Tiger Woods rookie card
none
 - d) You buy a newly-issued municipal bond from the City of Houston
primary debt
 - e) You buy a 30-year Treasury bond today that was issued in 1996
secondary debt
 - f) You get a \$200,000 mortgage to buy your dream house
primary debt
 - g) You buy 1,000,000 shares of newly-issued AMD stock
primary stock
 - h) You pay your professor \$1,000 for an A
none

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Adverse selection
 - c) The PGA Tour announces that it will insure pro golfers if they bean someone with a golf ball; then Tiger Woods purposely beans that idiot announcer, Johnny Miller.
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 - d) A truck on the side of the road is selling shrimp cheap, but you can't tell if they are edible or laden with bacteria.

Adverse selection