

Chapter 4

Basics of Personal Financial Management



Section 4

Stock Trading as an Investment

1. D 2. D 3. C 4. C 5. A 6. B 7. A 8. D 9. B 10. B
11. B 12. B 13. C 14. D 15. D 16. D 17. A

1. **D**

(1) is correct. If the general economic condition is good, customers' demand for all goods tends to rise. Investors then feel more confident in investing in companies as the expected returns seem to be high due to the increase in demand. Demand for shares rises and thus the share prices increase.

(2) is correct. If political stability is not secured, investors see a low continuity of businesses. The lack of investors' confidence in the businesses is likely to lead to low share prices.

(3) is correct. Dividend policies determine the returns of investors. A high rate of return usually attracts more investors and the prices of that share tend to rise.

2. **D**

Internal factors refer to factors which can be controlled by the company while external factors are closely related to and are easily affected by the macro environment.

In this regard, company performance is an internal factor while interest rates, industry prospects and speculation are external factors.

3. **C**

A company has a good business performance if it earns a huge profit. This attracts more investors to invest in the company as they believe that the company can perform well in the future and that they are more likely to get a high return from this investment. Share prices are likely to rise because of the increasing number of investors.

A is incorrect. The cost of investment increases due to an increase in interest rate, i.e., more interests need to be paid. A higher cost of investment discourages individuals to invest and this decreases the amount of investments in the market. As a result, share prices are likely to decrease.

B is incorrect. An unstable political environment discourages individuals to invest because it lowers their confidence in the economy. Thus, share prices are likely to decrease.

D is incorrect. Uncertainty arises when a company changes its senior management officials. They are not sure whether the new officials can lead the company. This causes fluctuations in the share prices.

4. **C**

Speculations cause fluctuations in share prices as investors carry out risky transactions in a bid to earn profits from short term fluctuations in the stock market. These activities cause great and rapid changes in the demand and supply of shares because investors buy and sell the shares quickly.

5. **A**

A good business performance is likely to boost share prices.

6. **B**
- (1) is correct. A decrease in market share implies that the company has poor business performance. This shows that the company is likely to earn lower profits in the future. Therefore, the share prices decrease.
- (2) is incorrect. Launching quality products attracts more customers; the company is then likely to earn higher profits and increase its market share. This will increase the share prices instead.
- (3) is correct. A drop in sales volume shows that the company performance worsens. This lowers the confidence of investors in the company and this will likely lower share prices.
7. **A**
- (1) is correct. An increase in interest rates of borrowing discourages individuals to borrow funds to invest in financial products. Industry prospects deteriorate and the business performance of banks will likely worsen. As a result, their share prices decline.
- (2) is incorrect. There is no direct relationship between the increase in interest rates and the appreciation of Hong Kong dollars. It would not lower the share prices.
- (3) is incorrect. The increase in interest rates is not related to the long-standing poor economic condition.
8. **D**
- (1) is incorrect. A drop in the general income level implies decreases in the disposable income of individuals. They then have less money to invest in the stock market and this discourages investment. In this regard, share prices drop due to a decreasing amount of investments from individuals.
- (2) is correct. The introduction of subsidies encourages investment in this industry. As the industry expands, related industries may also come into place. Despite fiercer competition, the industry as a whole has a better prospect. This may attract investors and result in higher share prices.
- (3) is correct. A better economic growth has a positive impact on the operations of firms. Their businesses prosper and higher profits are expected. Thus, share prices increase.
9. **B**
- From the table, it is shown that the Hang Seng Index has been continuously increasing.
- (1) is incorrect while (2) is correct. Hang Seng Index (HSI) comprises 50 constituent companies. It indicates the overall performance of these 50 companies which represents the general performance of the whole Hong Kong stock market on that day. An increase in HSI does not imply that the share prices of ALL listed companies increase. In fact, some of them may have increasing share prices while others levelling or decreasing. A rising HSI only means that the overall performance of the 50 constituent companies has improved.
- (3) is incorrect. An increase in HSI cannot indicate that a lot of listed companies made profits.

10. **B**
Uncertainty gives no confidence to the investors. Returns of investment cannot be estimated. Investors are likely to cash their shares and invest in stabler products. Following this, share prices decrease.
A is incorrect. Good industry prospects are likely to cause an increase in share prices instead. Good industry prospects can improve investors' confidence in companies in those industries and more individuals are willing to invest in them. This increases the share prices in general.
C is incorrect. We cannot draw any conclusion on how the appreciation of the country's currency affects the share prices because they are not closely related. In other words, the appreciation of the country's currency has no direct relationship with the share prices.
D is incorrect. An expectation of a decrease in profits tax rate will lead to a rise in share prices because the profits are expected to be higher and companies are likely to have better business performance.
11. **B**
(1) is correct. Fixed deposit interest rates can be regarded as the cost of investment because as you invest in shares, you forgo the interest to be earned. A fall in interest rates lowers the cost of investment. In light of this, more investors tend to invest in the stock market. As a result, share prices increase.
(2) is incorrect. An increase in stamp duty has a negative impact on the operations of firms. Lower profits are expected because firms are required to pay a higher amount of stamp duties to the government. This lowers the share prices due to the lower return.
(3) is correct. A decrease in the income tax rate boosts the amount of disposable incomes of individuals. The money in turn is channelled into investments in financial products; therefore share prices tend to increase.
12. **B**
(1) is incorrect. The Hang Seng Index indicates the performance of the Hong Kong stock market only, not the global market.
(2) is correct. It shows the price movements of major sectors like Commerce and Industry, Finance, Properties and Utilities.
(3) is incorrect. HSI is important because it is a benchmark of the general stock market performance. Individuals can manage and evaluate investments accordingly.
13. **C**
(1) is incorrect. HSI reveals the performance of the stock market on a daily basis, however, it cannot reflect the profits of the constituent companies. It is because it does not show the actual amount of profits earned by the constituent companies.
(2) is correct. HSI acts as an indicator of the performance of the Hong Kong stock market. In light of this, investors and investment agents can evaluate and manage investment choices.
(3) is correct. The Hang Seng Index is a value-weighted index, which can show the trend of price changes of shares traded in the Hong Kong stock market.

14. **D**

(1) is correct. By analysing the trend of the Hang Seng Index, the economy of Hong Kong can be predicted.

(2) is correct. As a matter of fact, the number of constituent companies in the index is 50 currently.

(3) is correct. Being a sector representative and having good performance are criteria for a company to be a constituent company.

15. **D**

Operating history and management is a requirement for listing on the Main Board but not related to finance.

Financial requirements include: profit attributable to shareholders, market capitalisation, revenue and cash flow.

16. **D**

(1) is correct. The requirements for listing on the Main Board are stricter than on GEM as the former is a market for established companies to raise funds. From the data, Platform B requires higher standards, so it is the Main Board.

(2) is correct. Listed companies listed on the Main Board have better reputation and business performance than those listed on GEM. They have passed the profit requirement and demonstrated a good financial position before getting listed. Thus, investing in the Main Board listed companies is undoubtedly less risky than investing in the GEM listed companies.

(3) is correct. As a matter of fact, the number of listed companies in the GEM is lower than that in the Main Board. As of 2016, there are around 200 companies listed on GEM and about 1,500 listed on the Main Board.

17. **A**

(1) is correct. Given that the listing requirements for the Main Board are higher, it is expected that they should have a good reputation and company performance. Otherwise, they won't be able to get listed on it.

(2) is correct. GEM provides companies which do not meet the listing requirement of the Main Board a way to raise capital. Achieving a record of profitability is not a condition of listing for the GEM.

(3) is incorrect. Being a constituent company, a company is implied to be renowned for its satisfactory financial performance. Investors are more interested in investing in these companies. It is easier for the constituent companies to raise capital.