

FREE SERIES 6 PRACTICE EXAM

We offer an online video Series 6 exam prep course that includes over 16 hours of online video instruction. Our full pdf study manual and over 800 questions are also included. Please go to www.testteachersonline.com/series6 for more information.

1. All of the following are considered to be equity securities EXCEPT:
 - A. Common stock
 - B. Preferred stock
 - C. Convertible preferred stock
 - D. Convertible bond
2. Which of the following types of securities is least risky:
 - A. Common stock
 - B. Preferred stock
 - C. Convertible preferred stock
 - D. Convertible bond
3. Which of the following is not true regarding unrealized appreciation:
 - A. It is taxable
 - B. It is also known as paper profit
 - C. It is also known as unrealized growth
 - D. It is taken into consideration when calculating total return
4. All of the following are true about warrants EXCEPT:
 - A. They are attached to some bonds
 - B. They allow the holder to convert the bond into common stock
 - C. They are issued for a long period of time, often 30 years
 - D. They may be detached from a bond and sold in the market
5. Which of the following yields would be highest on a bond selling in the secondary market at a discount:
 - A. Nominal
 - B. Current
 - C. Yield to maturity
 - D. Coupon
6. What is the current yield on a 5% bond selling in the secondary market at 50:
 - A. 2.5%
 - B. 5%
 - C. 7.5%
 - D. 10%

7. Who sets fiscal policy:
- A. Congress
 - B. Banks
 - C. The Federal Reserve Board
 - D. The Secretary of the Treasury
8. Who sets monetary policy:
- A. Congress
 - B. Banks
 - C. The Federal Reserve Board
 - D. The Secretary of the Treasury
9. Who set the prime rate:
- A. Congress
 - B. Banks
 - C. The Federal Reserve Board
 - D. The Secretary of the Treasury
10. Which of the following is true regarding callable bonds:
- A. They are issued when interest rates are low
 - B. All bonds are callable
 - C. They are callable at their current market price
 - D. Their indenture must state the call date and call price
11. All of the following are true about U.S. Treasury bonds EXCEPT:
- A. Capital gains are not taxable
 - B. Interest is exempt from state income tax
 - C. They are issued in large denominations
 - D. They are directly backed by the U.S. government
12. All of the following are true regarding general obligation municipal bonds EXCEPT:
- A. They are backed by user fees
 - B. Interest is exempt from federal income tax
 - C. They have low rates of return
 - D. They are not suitable for investors in low tax brackets
13. Which of the following is true regarding municipal revenue bonds:
- A. Interest is always exempt from state income tax
 - B. They have less risk than general obligation bonds
 - C. Capital gains are taxable
 - D. They are backed by taxes

14. If an investor is in a 30% tax bracket, a 7% municipal bond would have a corporate equivalent yield of:
- A. 5%
 - B. 7.5%
 - C. 10%
 - D. 12.5%
15. When selling open-end mutual funds, which of the following is true about the prospectus delivery requirements:
- A. A prospectus need not be given to an investor who already owns shares of the fund
 - B. A prospectus must always be given
 - C. A prospectus is not required if an investor is dollar cost averaging
 - D. A prospectus is not required if an investor is buying under a contractual plan
16. All of the following are true about the exchange markets EXCEPT:
- A. They are also known as auction markets
 - B. Market prices are set by supply and demand
 - C. There is more dollar volume on the NYSE than on the OTC market
 - D. Redeemable securities trade there
17. Under Federal Reserve Board Regulation T, when is the latest time to pay:
- A. The next business day
 - B. 3 business days
 - C. 5 business days
 - D. 7 business days
18. Under Regulation T, if a customer does not pay on time and no extension has been granted, the brokerage firm must do all of the following EXCEPT:
- A. Establish a margin account for the customer
 - B. Liquidate the trade
 - C. Freeze the customer's account for 90 days
 - D. Require cash in advance while the account is frozen
19. If the Federal Reserve wants to slow down the economy, they could do all of the following EXCEPT:
- A. Raise the federal funds rate
 - B. Increase the discount rate
 - C. Increase the reserve requirements
 - D. Buy U.S. government securities from member banks and securities dealers

20. Which of the following has the least amount of purchasing power risk:
- A. Corporate bond
 - B. Common stock
 - C. Preferred stock
 - D. Fixed annuity
21. A bond purchased and held to maturity does not have which of the following risks:
- A. Inflation
 - B. Credit
 - C. Interest rate
 - D. Financial
22. Mutual fund dollar cost averaging is a defensive strategy that:
- A. Guarantees a profit
 - B. Has the risk of fluctuating share prices
 - C. May result in an average cost per share that is lower than the average price
 - D. Requires the investor to buy the same number of shares each month regardless of price
23. What is the least important factor in determining an investor's suitability:
- A. Investment objective
 - B. Time horizon
 - C. Attitudes towards risk
 - D. Educational background
24. All of the following are true about growth portfolios EXCEPT:
- A. They are most suitable for investors with short time horizons
 - B. They usually have high price/earnings ratios
 - C. They pay little in dividends
 - D. They are considered to be risky
25. Which of the following would be most suitable for the parents of a high school freshman who is planning on college:
- A. Growth stocks
 - B. Treasury bills
 - C. Corporate bonds
 - D. Common stocks

ANSWERS & RATIONALES

1. **D** Bonds are debt securities, but both common and preferred stocks are considered to be equity securities. Which type of security would a corporation rather offer? Stock, since the investor never has to be repaid and dividends are at the discretion of the board of directors.
2. **D** From a seniority or priority standpoint, even the worst bond is better than the best stock, since bond interest must be paid before dividends and bondholders will receive their money back before the stockholders if the company goes broke.
3. **A** Unrealized appreciation (or growth) is on paper only, and is not taxable. However, if an investor elects to redeem his mutual fund shares for more than he paid, he will have a 'realized' capital gain, which is taxable.
4. **B** Warrants are attached to bonds to make them easier to sell. If the market price of the underlying stock goes up above the subscription price in the warrant, the warrant can be detached and either exercised or sold in the market. However, don't confuse warrants with conversion, which allows a bondholder to exchange a bond for common stock of the same issuer.
5. **C** When a bond is selling at a discount in the secondary market, both its current yield and yield to maturity will be higher than its nominal interest rate. However, the yield to maturity will be higher than the current yield since it also takes into account the difference between the discounted market price and the bonds par value at maturity.
6. **D** Bonds have a par value of \$1,000. If a bond has a nominal yield of 5%, that would be 5% of par, or \$50 a year. If you can buy the bond in the secondary market for \$500, then its current yield would be 10% (\$50 divided by \$500). Obviously, interest rates in the economy have doubled since this bond was issued, which caused to bond to lose half its value.
7. **A** Congress and the President set fiscal policy, such as a change in tax law.
8. **C** The Federal Reserve Board sets monetary policy, such as raising interest rates to slow down the rate of inflation.
9. **B** Although they are influenced by what the FRB does, banks actually set the prime rate, which is their best interest rate available to large commercial customers.
10. **D** Callable bonds are issued when interest rates are high. If rates drop, the issuer may call the bond at par, which of course makes bondholders very unhappy, since the market price of the bond is higher than par. Issuers of callable bonds must disclose the first call date and the call price in the bond's indenture.

11. **A** U.S. Government bonds are directly backed by the federal government and their interest payments are exempt from state income tax, but not exempt from federal tax. However, if the bond is sold in the secondary market for more than its purchase price, a taxable capital gain will occur.
12. **A** Since municipal bond interest is exempt from federal income tax (but not necessarily state income tax), investors are willing to accept a lower rate of return, which makes them unsuitable for investors in low tax brackets. General obligation (or full faith and credit) municipal bonds are backed by taxes, not user fees.
13. **C** Municipal bond interest is only 'double exempt' from both state and federal income tax for investors who live in the same state where the bond was issued. Municipal revenue bonds are backed by 'user' fees (such as from a toll road), so they are slightly more risky than general obligation bonds, which are backed by taxes.
14. **C** To find out what corporate bond nominal rate would be the same (or equivalent) as a municipal bond nominal interest rate, you need to divide the municipal bond nominal rate by the reciprocal of the investor's tax bracket, which may be found by subtracting their tax bracket from 100%. In this case, you would divide .07% by .70% (100% - 30%) to determine that the corporate equivalent would be 10%.
15. **B** Open-end mutual funds are always subject to the prospectus delivery requirements. If the sale is solicited, the prospectus must be given out at or prior to the sale. If unsolicited, the latest time it can be delivered is with the confirmation, which goes out the next business day.
16. **D** Redeemable securities, such as shares of open-end mutual funds, cannot be sold in the secondary market. Upon redemption, they are not re-sold, but instead destroyed. However, closed-end mutual fund shares are marketable, meaning that they can be sold in the secondary market, either on exchanges or OTC.
17. **C** Although 'regular way' settlement is 3 business days after the trade day under the NASD Uniform Practice Code, the latest time an investor may settle a trade is actually 5 business days under FRB Regulation T.
18. **A** If a customer does not settle within 5 business days, under FRB Regulation T, the broker/dealer firm must liquidate the trade (also known as a 'sell out') and freeze the customer's account for 90 days, during which time the customer may still make trades, but they have to pay cash in advance.
19. **D** The Federal Open Market Committee tries to control the money supply by either buying or selling outstanding U.S. Government securities to U.S. Government securities dealers or member banks. When the FOMC buys U.S. Government securities, they would have to pay for them with cash, which would pump money into the economy and cause interest rates to go down. If they want to slow down the economy, they would sell U.S. Government securities instead.
20. **B** Any investment product that has fixed rate of return is subject to inflation or purchasing power risk. However, over a period of time, common stocks have kept pace with the rate of inflation, so investing in a common stock mutual fund or a variable annuity is a way to 'hedge' against inflation.

21. **C** If interest rates go up, bond prices in the secondary market will fall, which is known as 'interest rate' risk. However, regardless of what interest rates do, if you buy a bond at par and hold it to maturity, you can then redeem it at par, so there is no interest rate risk.
22. **C** Dollar cost averaging requires that the investor invest the same amount every month in the same mutual fund regardless of share price. If shares values fluctuate over a period of time, the investor's average cost per share may be lower than his average price. However, DCA does not guarantee a profit.
23. **D** Of the suitability factors listed, the investor's educational background is the least important. Suitability information may be found on the new account form, as completed by the investor. The investor's investment objectives are the most important.
24. **A** Growth portfolios invest in the stocks of newly emerging companies, which are risky, pay little in dividends and have low price/earnings (P/E) ratios. They are most suitable for younger investors with longer time horizons.
25. **B** These parents have a short time horizon, so they are looking for safety and preservation of capital.