Economics 252 – Financial Markets

Spring 2011

Lecture 18: Exchanges, Brokers, Dealers, Clearinghouses

April 13, 2011

Multiple Choice Questions

Question 21.1

What is the definition of a broker?

(a) A broker acts on behalf of others as an agent to earn a commission.
(b) Only agents in the real estate business are legally allowed to carry the title of a broker.
(c) A broker trades for himself or herself, acting as a principal, not an agent, and profits from a markup.
(d) Only agents in the antiques business are legally allowed to carry the title of a broker.

Question 21.2

What is the significance for Jonathan's Coffee House for the history of stock exchanges?

(a) This is the place in New York City, where traders of shares in 1792 signed the Buttonwood Agreement to form the New York Stock Exchange.
(b) In London, people started posting stock prices on the wall at Jonathan's Coffee House by 1698, and the London Stock Exchange grew out of Jonathan's Coffee House.
(c) The first insider trading scandal at the Sao Paolo Stock Exchange was uncovered at Jonathan's Coffee House in Sao Paolo.
(d) The origins of NASDAQ as an over-the-counter exchange can be traced back to the counter at Jonathan's Coffee House in Chicago.

Question 21.3

Suppose that you own 100 shares that are currently worth $50. Assume you want to hold on to your shares, but are worried that the price of your shares might collapse. You definitely want to sell the shares if their price falls to $25. What kind of order should you place?

(a) A sell market order for 100 shares.
(b) A sell limit order for 100 shares at $25.
(c) A stop loss order for 100 shares at $25.
(d) A sell limit order for 100 shares at $50.

Question 21.4

Consider a hypothetical NASDAQ level 1 screen for the shares of a corporation. Suppose the displayed ask is $30.05 for 100 shares and the displayed bid is $30 for 250 shares. What happens if another dealer places a limit order to buy 50 shares for $30.03?

(a) There will be no transaction.
(b) There will be a transaction of 50 shares at $30.05.
(c) There will be a transaction of 50 shares at $30.
(d) There will be a transaction of 100 shares at $30.05.

Question 21.5

On May 6, 2010, the stock market experienced a so-called Flash Crash. Bring the following statement in the correct order, reflecting the order of events surrounding May 6, 2010.

(a) The market was already in a stressed mode, as the market was down 4% and the VIX index had shot up.
(b) Prices quickly rebounded on the same day, so that closing prices do not reflect the severity of the intraday events.
(c) Computers started trading back and forth in milliseconds and the volume of trade just went to an astronomical level, scaring people off.
(d) Although the Flash Crash created a lot of public anger about high frequency trading, it is considered a glitch and not a major fault of the system, which needs to be addressed with new regulation with regard to high frequency trading.

Correct Answers/Orders

21.1: (a)
21.2: (b)
21.3: (c)
21.4: (a)
21.5: 1-(a), 2-(c), 3-(b), 4-(d)