**Characteristics That Affect Security Yields**

Identify the relevant characteristics of any security that can affect the security’s yield.

**Impact of Liquidity on Yield**

What effect does a high credit risk have on securities?

**Tax Effects on Yields**

Do investors in high tax brackets or those in low tax brackets benefit more from tax-exempt securities? Why? Do municipal bonds or corporate bonds offer a higher before tax yield at a given point in time? Why? Which has the higher after tax yield? If taxes did not exist, would Treasury bonds offer a higher or lower yield than municipal bonds with the same maturity? Why?

**Pure Expectations Theory**

Explain how a yield curve would shift in response to a sudden expectation of rising interest rates, according to the pure expectations theory.

**Liquidity Premium Theory**

Explain the liquidity premium theory.

**Segmented Markets Theory**

If a downward-sloping yield curve is mainly attributed to segmented markets theory, what does that suggest about the demand for and supply of funds in the short-term and long-term maturity markets?

**Yield Curve**

What factors influence the shape of the yield curve? Describe how financial market participants use the yield curve.

**Yield Curve**

If liquidity and interest rate expectations are both important for explaining the shape of a yield curve, what does a flat yield curve indicate about the market’s perception of future interest rates?

**Global Interaction among Yield Curves**

Assume that the yield curves in the United States, France, and Japan are flat. If the U.S. yield curve then suddenly becomes positively sloped, do you think the yield curves in France and Japan would be affected? If so, how?

**After-Tax Yield**

You need to choose between investing in a one-year municipal bond with a 7 percent yield and a one-year corporate bond with an 11 percent yield. If your marginal federal income tax rate is 30 percent and no other differences exist between these two securities, which one would you invest in?

**The Fed**

Briefly describe the origin of the Federal Reserve System. Describe the functions of the Fed district banks.

**FOMC**

What are the main goals of the Federal Open Market Committee (FOMC)? How does it attempt to achieve these goals?

**Open Market Operations**

Explain how the Fed increases the money supply through open market operations.

**Effect on Money Supply**

Why do the Fed’s open market operations have a different effect on the money supply than transactions between two depository institutions?