Question #1 of 15

A U.S. firm is *most likely* to introduce into a simulation a constraint related to negative book value of equity, because if the firm experiences negative book value of equity:

A) the firm will probably have to cease operations and liquidate.

B) loan covenants may allow lenders to gain control of the firm.

C) the firm will be prohibited by law from paying dividends.

Question #2 of 15

In designing a simulation, the step involving identification of probabilistic variables should most likely:

A) maximize the number of variables that are allowed to vary in a simulation.

B) focus attention on a few variables that have a big impact on value.

C) define probability distributions for every input in a valuation.

Question #3 of 15

Which of the following *least accurately* describes one of the common constraints introduced into simulations used in risk analysis?

A) Earnings and cash flow constraints

B) Market value constraints

C) Time horizon constraints

Question #4 of 15

Which of the following would be the *most appropriate* approach to probabilistic risk assessment when risky events have discrete outcomes and risks occur concurrently.

A) scenario analysis.

B) decision tree.

C) simulation.

Question #5 of 15

Which of the following *most accurately* describes one of the key steps in running a simulation? Check for:

A) heteroskedasticity within variables.

B) correlation across variables.

C) serial correlation of residuals.

Question #6 of 15

Which of the following is *best describes* an advantage of simulation? Simulations:

A) produce a simple-to-understand point estimate for expected value.

B) encourage better estimation of inputs.

C) yield a superior estimate of expected value.

Question #7 of 15

Which of the following would be *most appropriate* approach to probabilistic risk assessment when facing risks with continuous (rather than discrete) outcomes:

A) simulation.

B) scenario analysis.

C) decision tree.

Question #8 of 15

Suppose that the different risks that our investment portfolio is exposed to are correlated. The *least* effective method to model these risks would be to use:

A) scenario analysis.

B) decision trees.

C) simulations.

Question #9 of 15

Which of the following is *least likely* to contribute to a meaningful output using simulations?

A) static correlations across inputs.

B) ad-hoc parameter estimates.

C) stationary input distributions.

Question #10 of 15

Which of the following methods *least accurately* describes one of the ways to treat correlation across variables in a simulation:

A) Build the correlation explicitly into the simulation.

B) Select only the input with the bigger impact on value to vary.

C) Calculate and use White-corrected standard errors.

Question #11 of 15

Which of the following *most accurately* describes one of the advantages of using simulations in decision making?

A) Better estimates of expected value.

B) Better decisions.

C) Better estimation of input variables.

Question #12 of 15

Which of the following statements about using simulations in risk assessment is *most accurate*?

A) It is generally straightforward to fit real data to an appropriate statistical distribution.

B) Correlation across input variables can be expected to remain stable.

C) Even when the inputs are random, simulations will yield a better looking output.

Question #13 of 15

Which of the following methods *least accurately* describes one of ways to define the probability distributions for a variable?

A) Statistical distribution and parameters.

B) Exegetical data.

C) Cross sectional data.

Question #14 of 15

Using cross-sectional data to define the probability distribution of a variable in a simulation is *most appropriate* when:

A) reliable historical data is available that covers a long period of time.

B) parameter estimates have low variability across companies.

C) the peer data is representative of the subject.

Question #15 of 15

If the different risks that an investment is exposed to are correlated, the *least appropriate* approach to probabilistic risk assessment would be:

A) scenario analyses.

B) decision trees.

C) simulations.