

2018

CFA® EXAM REVIEW



MORNING  
SESSION

LEVEL I CFA®  
MOCK EXAM

WILEY

Copyright © 2018 by John Wiley & Sons Inc  
All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600, or on the Web at [www.copyright.com](http://www.copyright.com). Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>. Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages. For general information on our other products and services or for technical support, please visit [www.efficientlearning.com/cfa](http://www.efficientlearning.com/cfa) or contact our Customer Care Department at [info@efficientlearning.com](mailto:info@efficientlearning.com).

CFA Institute does not endorse, promote, or warrant the accuracy or quality of the products and services offered by Wiley Efficient Learning. CFA Institute, CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

## Mock Exam 6 – Morning Session – Questions

### Questions 1–18 Ethical and Professional Standards

1. Which of the following statements is *most accurate*? The CFA Institute Code and Standards are an example of:
  - A. rule-based standards.
  - B. principle-based standards.
  - C. government-mandated legislation.
  
2. Brian Milton, CFA, works as an equity analyst and has recently taken over the coverage of North American bank research. The previous analyst for the sector has been promoted to VP of equity research and has asked Milton to maintain recommendations for most of the covered banks. As this is common practice in his firm, Milton agrees to this request. In maintaining the recommendations, which of the following statements is *most correct*? Milton has:
  - A. violated CFA standards.
  - B. not violated CFA standards, as he is following company practices.
  - C. not violated CFA standards, as there is a reasonable basis for the recommendation.
  
3. In the bibliography for a manuscript titled *Wealth Management in New Zealand* by May Heung, CFA, the following statements are included:

*Statement 1: Heung has long been one of the premier investment professionals in New Zealand, being one of the first in the country to complete the CFA program.*

*Statement 2: The CFA program is one of the most respected and prestigious investment management designations in the world.*

*Statement 3: As a CFA, Heung has delivered expert investment advice to individuals and institutions for over 20 years.*

Which statement has *most likely* violated CFA standards?

- A. Statement 1
- B. Statement 2
- C. Statement 3

4. Carmichael Ho, CFA, is a broker at Far-West Securities LLC, where he earns a base salary plus a portion of trade commissions above a minimum trade level. After receiving a number of internal reports recommending to sell a particular holding, Ho decides it appropriate to swap this holding with a more favorable company for most of his clients. This trade allows Ho to earn a substantial bonus for the quarter. Which of the following statements is *most accurate*?
- A. Ho has not violated the Code and Standards.
  - B. To remain compliant with the Codes and Standards, Ho should reject the bonus for the quarter.
  - C. To remain compliant with the Codes and Standards, Ho should include only one side of the trade in bonus calculations.
5. Jason Stein, CFA, is the head of trading at Cumulo Asset Management (CAM). To facilitate currency transactions for the various CAM portfolios, Stein currently uses the services of Mountain FX, who consistently provides superior rates and spreads. A competitor company, Go Currency Solutions, has recently sent Stein two box tickets to an major upcoming sporting event. In order to avoid violating CFA Codes and Standards, which of the following actions is *least appropriate*? Stein should:
- A. not accept the tickets.
  - B. disclose the gift to his firm.
  - C. accept the tickets, but refuse to use the services of Go Currency Solutions.
6. Jessica Vine, CFA, works as a portfolio manager for a GIPS-compliant firm in Country X. Investment performance regulations in Country X conflict with GIPS, and Vine is currently preparing a performance presentation for the previous year. Which of the following actions should Vine *most likely* follow? For any specific conflict, Vine should:
- A. follow the stricter of either the local regulations or GIPS.
  - B. present performance figures under both the local regulations and GIPS.
  - C. adhere to local regulations and disclose the conflict in the presentation for GIPS compliance.
7. Benny Mao, CFA, is the compliance officer for Redmiser Wealth Management. New legislation requires all financial service firms to disclose information for all clients who have transacted more than \$1 million in net assets overseas during the past 12 months. Due to the potential cost to the firm of extrapolating out affected clients, and to be safe, Mao provides authorities with information on all existing clients who have had overseas transactions in the past 12 months. Mao has *least likely*:
- A. complied with the CFA standards.
  - B. violated the CFA standards by reporting on more clients than necessary.
  - C. violated the CFA standards by including only existing client information.

8. Mikael Vincheyk, CFA, is the portfolio manager for a strong-performing micro-cap equity fund. Each quarter, Vincheyk receives a 5% performance fee from the fund should it beat its benchmark and hurdle rate. This quarter, the fund is close to achieving its performance bonus, but some poor news just before the end of the quarter about one of its holdings, Evershine LLC, has caused the fund to lose a substantial amount. Vincheyk decides to post on a blog his opinion that the market reaction to this stock has been overblown. On the last day of the quarter, Vincheyk puts in a large buy order for the stock, which is several multiples above the daily trade volume. As a result, the stock price rebounds back to its previous level and he reduces the portfolio's holding in Evershine over the following few weeks. Vincheyk has *most likely*:
- A. complied with CFA standards.
  - B. violated CFA standards relating to his blog post.
  - C. violated CFA standards relating to his trading in Evershine.
9. Regarding GIPS compliance, which of the following statements is *most accurate*? For periods on or after 1 January 2011, reporting on total firm assets:
- A. include all accounts of the firm.
  - B. can exclude non-fee paying accounts.
  - C. can exclude nondiscretionary accounts.
10. Henrietta Jessop, CFA, has received an allocation of shares in a new IPO for her wealth management clients, of which three had requested to participate in the new listing. Due to an oversubscription, the amounts requested cannot be met in full. Due to the popularity of the float, two more clients have also requested some of the IPO allocation. Which of the following actions is *least likely* a violation of CFA standards? Jessop could:
- A. distribute the IPO shares evenly among the five clients.
  - B. allocate the IPO shares to the three initial clients as a pro-rata of their requested allocations.
  - C. allocate the minimum share allotment to the three initial clients and any excess allocation to her personal account.
11. Carrie Phillips, CFA, manages the ABC Diversified Growth Fund, as well as the International equity portfolios for various ABC clients and the model portfolio for international equities, which is used by internal managers and external clients. In preparing GIPS-compliant performance data for the ABC International equity composite, which of the following is *least appropriate*?
- A. The composite may include the ABC model portfolio data.
  - B. The composite must include terminated portfolios in historical performance data.
  - C. The composite may include the international equity segment of the ABC Diversified Growth Fund under strict circumstances.

12. The Haley Kumar Global Fund has been trading for the past 4 years and has recently become GIPS compliant. In regard to presenting and reporting requirements, which of the following is *most correct*?
- A. The firm will have to wait 1 year to present its first GIPS compliant report.
  - B. After 1 year, the firm is required to present only 5 years of performance data ongoing.
  - C. The firm is required to increase the performance data for the fund every year by 1 year, until it reaches 10 years of performance data.
13. Which of the following statements is *most correct*? An ethical decision-making framework:
- A. can help reduce unexpected consequences.
  - B. is a tool to improve compliance with the law.
  - C. is redundant when employees follow the law.
14. Gerard Smoot, CFA, works as an asset consultant and resides in Patania, which is a small island country with laws and regulations considered to be less strict than the CFA Code and Standards. He has recently been hired to assist with fund manager selection for a company in Berenland, a neighboring country with laws and regulations stricter than the CFA Code and Standards. If Berenland law applies to his investment work, which of the following statements is *most correct*? As a CFA member, Smoot must adhere to:
- A. Patania law.
  - B. Berenland law.
  - C. CFA Code and Standards.
15. Monty Wordsmith, CFA, works as a portfolio manager and is currently putting together some marketing material for a new fund strategy. The strategy of the fund is partly based on some new external research into momentum drivers in illiquid securities, and in the material, he uses a number of graphs he finds on a website, which he thinks might have been copied from the external research article. Which of the following statements is *most correct*? To comply with CFA standards, Wordsmith should:
- A. reproduce the graphs with minor changes and make no citations.
  - B. cite only the website if he has not reviewed the original research article.
  - C. cite only the research article if he has found the graphs to be a reproduction from the research article.

16. Ben Sosa, CFA, is an equity analyst for a large fund manager based in Boston. He is currently researching MoreCover LLC, a manufacturer of roofing materials and is due to release an updated recommendation report. Sosa is impressed with the board and its strategy and expects the company to perform well. An industry analysis for the company shows that the construction sector has some strong economic tailwinds with industry growth likely to be above average over the coming 3 years. MoreCover has only one major competitor in North America, New England Rooftops (NER) LLC, which has its main factory close to Sosa's home. In a visit to a local store, Sosa overhears two NER factory workers discussing their concerns about the state of the factory and the overall discontent of the workforce. Sosa finishes his research report the following week and upgrades MoreCover to a "Strong Buy" recommendation. Which of the following statements is *most correct*? Sosa has:
- A. not violated CFA standards.
  - B. violated CFA standards as he has no reasonable basis for his recommendation.
  - C. violated CFA standards as he has utilized nonpublic information in forming his recommendation.
17. Keith Samuels, CFA, works for Beta Investments and Research (BIR) as an asset consultant. BIR has been contracted to provide an independent asset consultant for the Southern Coast Pension Scheme, and Samuels has been appointed as BIR's representative. Which of the following statements regarding his appointment is *most correct*? In his role as an asset consultant to the pension fund, Samuel's ultimate loyalty lies with:
- A. his employer.
  - B. the pension fund.
  - C. the pension fund clients.
18. Veronika Chan, CFA, manages the fixed income portfolios of Poste Lever Investments (PLI), a large fund manager based in London. She has recently been headhunted by a rival firm based in Frankfurt and she is about to resign her position at PLI. Prior to resigning, she downloads the various pricing models that she has created herself, and leaves behind the work of others. She also makes a number of aggressive portfolio transactions in an effort to boost her final bonus payment. While serving her "noncompete" period, she posts a message on her personal social media account, thanking PLI and clients for the opportunity to work with them. In regard to her conduct, Chan has *least likely* violated the CFA standards by:
- A. downloading the pricing models.
  - B. making the portfolio transactions.
  - C. posting the social media message.

## Questions 19–32 Quantitative Methods

19. Terrence Barnes, CFA, has calculated the effective annual yield on a security to be 24.62%. If he has held the asset for 52 days and plans to hold onto it indefinitely, the holding period yield for the past 52 days is *closest to*:
- A. 3.2%
  - B. 3.6%
  - C. 24.6%
20. The probability of a recession in the next 3 years is deemed to be 32% and the probability of both a recession occurring and a localized flood occurring over the next 3 years is estimated to be 26%. If the probability of a recession occurring given that a localized flood has occurred over the next 3 years is 40%, the probability of either a recession or localized flood occurring in the next 3 years is *closest to*:
- A. 71%
  - B. 92%
  - C. 98%
21. Which of the following statements is *most correct*? The ratio of the standard deviation of a set of data to its mean is also known as:
- A. the Sharpe ratio.
  - B. standard error.
  - C. the coefficient of variation.
22. A portfolio of two assets has the following characteristics:

	Weighting	Expected Annual Return	Expected Annual Standard Deviation
Security A	60%	9.70%	10.80%
Security B	40%	14.80%	19.20%

If the correlation between the two assets is expected be 38%, the annualized standard deviation for the portfolio is *closest to*:

- A. 1.4%
- B. 7.3%
- C. 11.8%



23. Fund manager A claims that it outperforms its relevant benchmark consistently. To test this claim, a sample of 72 monthly excess returns is taken, with the sample producing a mean of 0.92% and a variance of 0.0452%. Using a *t*-test to test this claim, the test statistic is *closest to*:
- A. 3.7
  - B. 31.2
  - C. 172.7
24. Which of the following statements is *most correct*? In technical analysis, the change in polarity principle might refer to:
- A. a price trend changing direction.
  - B. a resistance level becoming a support level.
  - C. a price movement between support and resistance levels.
25. A structured bond product is expected to provide investors with a return of 9.5% per year with a 70% probability, or 3.3% per year with a 30% probability. The likelihood of earning 9.5% every year for at least 4 of the next 5 years is *closest to*:
- A. 36.0%
  - B. 49.0%
  - C. 52.8%
26. The following loan is to be repaid with equal monthly repayments over the next 10 years:
- |               |                     |
|---------------|---------------------|
| Loan amount   | \$20,000            |
| Interest rate | 15.0% p.a.          |
| Payment type  | Monthly, in arrears |
- The monthly repayment for this loan is *closest to*:
- A. \$191.67
  - B. \$276.67
  - C. \$322.67

27. The Delta X Fund has purchased the following equal lots of 2,000 shares over the past month:

Date	Number of Shares	Share Price
1 March	2,000	26.4
5 March	2,000	23.1
8 March	2,000	24.7
20 March	2,000	28.7
26 March	2,000	27.2

The harmonic mean price for the purchase of the shares is *closest to*:

- A. \$25.87
- B. \$26.02
- C. \$26.29

28. The Golden Diversified Fund is invested in the following asset classes:

Asset Class	Weight	Expected Annual Return	Expected Annual Standard Deviation
A	15%	9.7%	10.8%
B	26%	14.8%	19.2%
C	43%	7.2%	8.1%
D	9%	5.5%	4.2%
E	7%	8.9%	8.9%

The expected annual return of the portfolio is *closest to*:

- A. 8.92%
- B. 9.22%
- C. 9.52%

29. Which of the following statements is *least correct*? The lognormal distribution is:

- A. positively skewed.
- B. is unbounded at its lower end.
- C. frequently used to model asset price distributions.

30. Barry Figgins, CFA, is comparing the following projects for his firm:

- Project 1 has a negative NPV.
- Project 2 has a positive NPV.
- Project 3 has a positive NPV and an IRR lower than Project 2.

Given all these projects have the conventional cashflows and the same hurdle rate, which of the following statements is *least correct*?

- A. The IRR for Project 1 is negative.
- B. Project 2's IRR is greater than the hurdle rate.
- C. Proceeding with Project 3 would be expected to increase the value of the firm.

31. Which of the following statements is *most correct*? A discrete random variable can only take:

- A. a countable number of values.
- B. a finite number of integer values.
- C. a finite number of positive values.

32. A certain passive strategy randomly selects five stocks every month from the largest 15 companies on the local stock exchange. The first stock chosen receives the largest allocation of investments with the last chosen receiving the least. Given that the order of selection is important, how many different portfolios are possible each month?

- A. 3,003
- B. 360,360
- C. 759,375

### Questions 33–44 Economics

33. Which of the following statements is *most correct*? A market is *likely* to exhibit perfect competition when:
- A. sellers have market-pricing power.
  - B. each firm is perceived to produce goods or services with unique characteristics.
  - C. the share of each firm's minimum efficient scale is small relative to market demand.
34. Which of the following statements is *least correct*? A limitation of the Consumer Price Index (CPI) as a measure of inflation is:
- A. its failure to adequately account for changes in product quality.
  - B. its bias toward newer products, which are likely to be more expensive.
  - C. that it tends to overestimate inflation where substitutes exist for goods experiencing price rises.
35. A negative cross-price elasticity between two goods indicates that they are *likely* to be:
- A. substitutes.
  - B. complements.
  - C. inferior goods.
36. Which of the following is *least likely* to be a limitation of monetary policy?
- A. Policy transmission through the economy may be unsuccessful where the central banks lack credibility.
  - B. Monetary policy mechanisms cannot easily control the willingness of banks to lend and create credit.
  - C. A liquidity trap situation may form in which banks refuse to pass on interest rate changes to borrowers and savers.
37. Which of the following statements is *least correct*? A government's fiscal deficit can be funded by:
- A. a trade surplus.
  - B. inflows of foreign savings.
  - C. savings from the private sector.

38. Country X has its own currency, \$X, which is pegged to a basket of major currencies. The central bank of Country X holds foreign currency reserves to cover the entire monetary base of the country and it provides short-term liquidity to the monetary system when necessary. However, it cannot act as a lender of last resort. Country X has *most likely* adopted which kind of currency regime?
- A. Fixed parity system
  - B. Managed float system
  - C. Currency board system

39. The concrete industry in Country J has six suppliers with the following market structure:

Concrete Supplier	Market Share (%)
1	39
2	26
3	13
4	12
5	7
6	3

To better compete with Supplier 1, Supplier 2 intends to merge with Supplier 3. Following the merger, the Herfindahl-Hirschman Index (HHI) of the three largest firms is *closest to*:

- A. 0.32
  - B. 0.78
  - C. 0.90
40. Which of the following statements is *most correct*? A leftward shift in the aggregate demand curve may be caused by:
- A. an increase in taxes.
  - B. a decrease in the exchange rate.
  - C. an increase in business confidence.
41. Which of the following criticisms of the Austrian School of Thought is *least accurate*?
- A. The Austrian school does not offer a theory on business cycles.
  - B. The theory attributes economic booms and busts solely to government intervention.
  - C. In times of economic stress, history has shown that economies might not self-adjust back to equilibrium.

42. Which of the following statements is *most appropriate* regarding fiscal tools available to a government?
- A. Direct taxes can be adjusted very quickly.
  - B. Capital spending has a bigger impact on spending than income tax cuts and is quick to implement.
  - C. Tax cuts to the wealthy are likely to have a bigger impact on spending than transfer increases to the poor.
43. Which of the following statements is *least correct*?
- A. Gross domestic product (GDP) excludes goods produced by citizens outside of the country.
  - B. Gross national product (GNP) includes services produced by foreigners within the country.
  - C. Gross domestic product (GDP) is generally preferred by analysts over gross national product (GNP).
44. Vernon Wallace, CFA, is based in Singapore and is looking to buy CAD in order to settle a transaction with a Canadian supplier. The following rates are offered by Bank A and Bank B:

Currency Pair	Bank A	Bank B
USD-CAD	1.2076	1.2107
USD-SGP	1.3166	1.3195

If Wallace can only use separate banks for each currency pair, the cross-rate that Wallace should transact at is *closest to*:

- A. 1.0875
- B. 1.0899
- C. 1.0927

## Questions 45–68 Financial Reporting and Analysis

45. Which of the following is *not* a mandatory financial statement under International Financial Reporting Standards (IFRS)?
- A. Income statement
  - B. Statement of cash flows
  - C. Statement of changes in equity
46. Which of the following is *most accurate*? Financial assets that are measured at cost or amortized cost include:
- (i) loans
  - (ii) derivatives
  - (iii) unlisted instruments
  - (iv) held-to-maturity investments
- A. (i) and (ii) only
  - B. (iii) and (iv) only
  - C. (i), (iii), and (iv) only
47. Georgia Snow, CFA, is conducting research into GenCom LLC, a large company in the telecommunications industry. In so doing, she compares the level of days receivables across similar-sized companies in the industry across a number of years. Snow is *most likely* undertaking which kind of company analysis?
- A. Trend analysis
  - B. Common-size analysis
  - C. Cross-sectional analysis
48. Carrywell LLC, a luggage producer based in Dayton, Ohio, is preparing its annual financial reports under US GAAP. There is concern that an older assembly line might need to be repaired and the following information is produced:
- Cost = \$1,400,000
  - Accumulated depreciation = \$ 920,000
  - Estimated net sale value = \$ 460,000
  - Expected future net cash flow = \$ 55,000 p.a.
  - Life of equipment = 9 years
  - Salvage value = \$ 0

Based on this information, the impairment loss to be recognized by Carrywell is *closest to*:

- A. \$0
- B. \$20,000
- C. \$30,000

49. Victory Construction LLC leases a crane that would likely be in use for another 15 years. Under which of the following circumstances might the lease *most likely* be classified as an operating lease under US GAAP?
- A. The lease term is 5 years.
  - B. A bargain purchase option exists.
  - C. The lessor gains ownership of the asset at the end of the lease.
50. Which of the following strategies might be used if a company wanted to reduce the level of revenues it recognizes in the current period?
- A. Increasing its allowance for sales returns
  - B. Reclassifying inventory as “sold but held”
  - C. Setting shipping terms as “FOB destination”
51. Which of the following statements regarding types of audit opinions is *least correct*?
- A. An unqualified audit opinion states that the financial statements of the subject company have been presented fairly.
  - B. An adverse audit opinion states that the financial position of the subject company is either unsustainable or insolvent.
  - C. A disclaimer of opinion is issued when the auditor is not able to issue an opinion on the financial statements of the subject company.
52. Bell Engines, a UK-based manufacturer has recently concluded the following transactions:
- Issued GBP 30 million in new bonds
  - Purchased new factory for GBP 20 million
- These transactions might *best* be described as:
- A. financing activities only.
  - B. operating and investing activities, respectively.
  - C. financing and investing activities, respectively.
53. Constraints in meeting fundamental and supplementary qualitative characteristics of financial report are *least likely* to include:
- A. cost-benefit constraints.
  - B. conflicts between characteristics.
  - C. indifference of the users of financial information.



54. In regard to nonrecurring items, which of the following statements is *most accurate*? Income and expense items that are unusual in nature, but that are likely to reoccur:
- A. should be ignored when considering forecasts.
  - B. should be recorded as a separate line item under IFRS.
  - C. should be recorded as a separate line item under US GAAP.

55. Mizuho Machines has the following balance sheet items:

	¥ Millions
Cash and cash equivalents	23
Accounts receivables	38
Accounts payables	30
Inventories	39
Short-term debt	12
Long-term debt	86
Equipment	140

Based on this information, Mizuho Machines' quick ratio is *closest to*:

- A. 0.55
  - B. 1.45
  - C. 1.88
56. In regard to the Statement of Cash Flows, which of the following statements is *most correct*? Dividends received are classified as:
- A. investing cash flows under both IFRS and US GAAP.
  - B. operating or financing cash flows under IFRS and financing cashflows under US GAAP.
  - C. operating or investing cash flows under IFRS and operating cashflows under US GAAP.
57. In the most recent year, Becker Superstores LLC produced net income of \$356,000 and earnings before interest and tax (EBIT) of \$582,000. It had an EBIT margin of 12.7%, an asset turnover of 0.94 times, and leverage of 3.20. Based on this information, Becker Superstores' return on assets is *closest to*:
- A. 7.3%
  - B. 19.5%
  - C. 23.4%

58. Charter Bien Asia (CBA) has accounted for inventories and sales over the past quarter as follows:

Month	Units Purchased	Purchase Price	Units Sold	Sale Price
1	180	\$54	200	\$90
2	240	\$50	160	\$105
3	120	\$58	210	\$85

If there were 120 units of inventory at the start of the quarter that was valued at \$6,000, the gross profit for the quarter under the weighted average cost method is *closest to*:

- A. \$22,470  
B. \$22,700  
C. \$23,190
59. Pure Health Diagnostics (PHD) has recently acquired a new MRI machine from a similar business by exchanging with them two X-ray systems that are no longer in use. It costs PHD EUR 2,000 to ship and install the secondhand MRI machine to make it ready for use. The cost of the X-ray systems was EUR 120,000 each and one has accumulated depreciation of EUR 20,000 and the other has accumulated depreciation of EUR 15,000. If the fair value of the secondhand MRI machine is EUR 204,000, which of the following statements is *most correct*?
- A. PHD's net assets will decrease.  
B. PHD will recognize a gain on the income statement.  
C. PHD will not recognize any gain or loss on the income statement.
60. Keamba Dockyards has purchased \$240,000 worth of solar panels for their storage yards. The solar panels are thought to have useful life of 10 years, after which they will be sold for \$80,000. The corporate tax rate in the country is 25% and the government is incentivizing such industrial scale purchases by allowing companies to expense the entire cost of renewable energy assets immediately. If Keamba Dockyards uses straight-line depreciation for such assets, and in relation to the solar panel asset, which of the following statements is *least correct*?
- A. Keamba Dockyard's deferred tax liability at the end of 10 years will be \$20,000.  
B. Keamba Dockyard's deferred tax liability in the first year will increase by \$56,000.  
C. Keamba Dockyard's deferred tax liability in the second year will decrease by \$56,000.
61. Phoenix Water issues \$4 million par worth of 3-year bonds at a market rate of 8.5% p.a. The interest expense from the bond for the company in Year 3 is *closest to*:
- A. \$266,189  
B. \$289,456  
C. \$313,364

62. Which of the following is *least likely* to be a benefit of conservatism in regard to applying accounting standards?
- A. Protection for regulators.
  - B. Reduction in potential litigation.
  - C. Reduction in total income tax expense over time.
63. Company L's total equity on the balance sheet at the end of the year is \$3,200,000. Retained earnings at the start of the year was \$1,750,000 and the net profit for the year \$400,000. If the company retains 20% of earnings each year, the total amount of contributed capital for the company is *closest to*:
- A. \$1,113,000
  - B. \$1,370,000
  - C. \$1,450,000
64. Company P's net profit for the year is \$38.5 million and it has the following shares outstanding:
- Ordinary shares
    - 2,125,000 weighted average shares outstanding
    - Dividend payout ratio of 75%
  - Preference shares
    - 52,000 preference shares outstanding
    - Dividend of \$45 per share
    - Convertible into ordinary shares at a ratio of 20:1
- Based on this information, the diluted earnings per share (EPS) for the year for Company P is *closest to*:
- A. 9.1
  - B. 12.2
  - C. 17.0
65. If using the direct method, which of the following items is *most likely* to appear in the cash flows from operating activities section of the Statement of Cash Flows?
- A. Depreciation
  - B. Cash paid for interest
  - C. Decrease in tax payable

66. MKF Designer House has recently had to write down the value of its handbag inventory due to low sales and poor market conditions. As a result of the write-down, which of the following financial ratios for MKF is *most likely* to improve?
- A. Current ratio
  - B. Asset turnover
  - C. Gross profit margin
67. Which of the following statements is *most correct*? The cost of an intangible asset with an indefinite life is:
- A. amortized over its useful life.
  - B. expensed in the year of purchase.
  - C. tested at least annually for impairment.
68. Which of the following is *not* one of the “4 Cs” of credit analysis?
- A. Capital
  - B. Capacity
  - C. Covenants

## Questions 69–77 Corporate Finance

69. Company D sells only one product and in the most recent quarter made sales of 15,000 units at \$260 each. The total variable costs for the quarter were \$2,625,000 and total fixed costs were \$560,000. Furthermore, total financial costs for the quarter were \$317,000 and the corporate tax rate was 40%. Based on this information, Company D's degree of operating leverage is *closest to*:
- A. 1.78
  - B. 1.80
  - C. 3.20
70. Which of the following stakeholder groups is *least likely* to have operational influence of a company?
- A. Creditors
  - B. Managers
  - C. Regulators
71. Kelly Brokers (KB) is looking to raise GBP 480 million in new capital to finance a new joint venture. If KB has a target debt-to-equity ratio of 60% for the project, the value of equity in the new capital raising would be *closest to*:
- A. GBP 192 million
  - B. GBP 288 million
  - C. GBP 300 million
72. Galaxy Hardware has average accounts payable for the year of \$34,000, which corresponds to supplier purchases of \$480,000 for the year. If the number of days receivables for the year was 52.7 and the number of days of inventory was 27.6, the cash conversion cycle for Galaxy Hardware was *closest to*:
- A. 54.4 days
  - B. 80.3 days
  - C. 106.2 days
73. Which of the following is *least likely* to be considered a nonmarket factor affecting stakeholder relationships and corporate governance?
- A. Media
  - B. The legal environment
  - C. Competition and takeover

74. Following the basic principles of capital budgeting, which of the following items is *most likely* to be included in the cash flow analysis of a project?
- A. Sunk costs
  - B. Opportunity costs
  - C. Before-tax cash flows
75. Jamestown Telecommunications (JT), based in the island nation of South Sensia, is in the process of establishing the country's first broadband network. JT has a debt-to-equity ratio of 0.90 and a marginal rate of tax 15%. A nearby broadband provider, MegaZone (MZ), has an equity beta of 1.20, with a debt-to-equity ratio of 1.40 and a marginal rate of tax 25%. Based on this information, the equity beta for JT's broadband project is *closest to*:
- A. 0.59
  - B. 1.03
  - C. 1.20
76. Company Y sells one product and has the following expected sales and costs information for the following year:
- |                      |                 |
|----------------------|-----------------|
| Sale price           | \$1.80 per unit |
| Contribution margin  | \$0.36 per unit |
| Fixed sales costs    | \$42,000        |
| Fixed nonsales costs | \$66,000        |
- Based on this information, the breakeven level of revenues is *closest to*:
- A. \$300,000
  - B. \$432,000
  - C. \$540,000
77. Pentahex Solutions (PS) decides to issue \$3 million in commercial paper at 7.5% for one month. The dealer's commission on the issue is 0.3% and it has a backup line of credit cost of 0.4%. The cost of the commercial paper in % p.a. is *closest to*:
- A. 8.20%
  - B. 8.25%
  - C. 8.31%

## Questions 78–85 Portfolio Management and Wealth Planning

78. The annual change in Country V's level of GDP and currency (\$V) against a basket of trade-weighted currencies is given below.

Year	$\Delta \text{GDP}$	$\Delta \$$	$\text{GDP} - \overline{\text{GDP}}$	$\$V - \overline{\$V}$
1	4.70%	-2.50%	1.40%	-3.72%
2	3.60%	8.70%	0.30%	7.48%
3	-1.30%	4.30%	-4.60%	3.08%
4	6.40%	-8.60%	3.10%	-9.82%
5	3.10%	4.20%	-0.20%	2.98%

Given this information, the sample covariance between the change in GDP and the change in \$V is *closest to*:

- A. -61.85%
  - B. -0.12%
  - C. 1.95%
79. Which of the following is *least likely* to be a constraint for an investment trust that has been established for an infant for the strict use of buying their first home?
- A. Liquidity
  - B. Tax concerns
  - C. Unique circumstances
80. Which of the following statements is *least correct*? Bond index construction can be more difficult than equity index construction because:
- A. there are more equity issues.
  - B. the bond price discovery process is less effective.
  - C. specific bonds are likely to move between different indexes.
81. Which of the following statements is *most correct*? Exchange-traded funds (ETFs) differ from index mutual funds as:
- A. ETFs are more tax-effective.
  - B. mutual funds have lower fees.
  - C. mutual funds pay out all dividends received.

82. Good risk governance practices in an organization should:

- (i) focus on enterprise risk management
- (ii) provide for the appointment of a chief risk officer
- (iii) provide for a risk management committee
- (iv) give clear guidance to management.

- A. Only (i), (ii), and (iv) are correct.
- B. Only (ii), (iii), and (iv) are correct.
- C. (i), (ii), (iii), and (iv) are all correct.

83. Ingrid Jolley, CFA, has put together a constrained efficient frontier (no short sales) of five risky assets based on expected returns, volatility, and correlations of the risky assets. Asset E has the highest expected return and standard deviation of returns of 13.5% p.a. and 16.2% p.a. However, Jolley wishes to put together a portfolio with an expected return greater than 13.5% p.a. but with an expected volatility of no more than 13.5% p.a. This objective might *best* be achieved by:

- A. borrowing and investing in Asset E.
- B. including a long position in the risk-free asset.
- C. borrowing and investing in a portfolio of the risk assets.

84. Company X, Company Y, and Company Z have the following expected return characteristics:

	<b>Expected Return (p.a.)</b>	<b>Variance (p.a.)</b>	<b>Correlation with Market</b>
X	13.60%	2.27%	0.52
Y	7.90%	1.28%	0.68
Z	9.40%	1.41%	0.65

If the market has a variance of 1.54%, the company with the highest market beta is:

- A. Company X.
- B. Company Y.
- C. Company Z.

85. Which of the following markets is *most likely* to exhibit semi-strong form efficiency?

- A. Stock market in a country with no laws against insider trading
- B. Corporate bond market where all issuers are required to have a credit rating
- C. Commodity futures market where most trading is based on technical analysis



## Questions 86–97 Equity Investments

86. Regarding current industry classification systems, which of the following statements is *most accurate*? Industry Classification Benchmark (ICB):
- A. classifies companies based on their primary sources of revenues.
  - B. classifies industries according to their principal business activity.
  - C. classifies industries on the basis of goods and/or services produced.
87. Power Build Constructions (PCB) has just declared an annual dividend of EUR 4.86 per share, with dividends expected to grow at 3.9% p.a. indefinitely. PCB has a beta of 1.3 and the risk-free rate is currently 2.3%. If the required rate of return for investors in PCB shares is 11.2% p.a., the intrinsic value of PCB per share is *closest to*:
- A. EUR 56.74
  - B. EUR 66.58
  - C. EUR 69.17
88. Which of the following is *not* a common type of publicly traded preference share?
- A. Noncumulative
  - B. Nonredeemable
  - C. Nonparticipating
89. Which of the following statements is *most accurate*? Market share stability:
- A. decreases as barriers to entry increase.
  - B. decreases as industry competition decreases.
  - C. decreases as frequency of new products into the market increase.
90. An investor is considering the purchase of stock in Company H and expects the following dividends at the end of each of the next 3 years:
- |        |                   |
|--------|-------------------|
| Year 1 | \$10.50 per share |
| Year 2 | \$11.00 per share |
| Year 3 | \$11.50 per share |
- He expects to sell the stock for \$306 per share in 3 years' time and he requires a required rate of return of 12% p.a. to invest in the company. If Company H's shares are currently trading at \$259, the investor will *most likely* consider the stock to be:
- A. overvalued.
  - B. undervalued.
  - C. fairly valued.

91. The following financial information relates to Company Q:

Net assets	\$53,400,000
Debt	\$19,700,000
Common stock (\$)	\$10,800,000
Common stock outstanding	10,000,000
Preference shares (\$)	\$2,500,000
Preference shares outstanding	50,000

If the current share price is \$11.65 per share, Company Q's price to book value is *closest to*:

- A. 2.4
  - B. 2.5
  - C. 4.0
92. Max Spiller, CFA, is the portfolio manager for a large private equity firm based in Vancouver, Canada. Most of Spiller's transactions involve investing in public companies at significant discounts and gaining significant influence over the business operations. Spiller and his firm are *most likely* to attract which type of private equity investor?
- A. Leveraged buyout fund
  - B. Management buyout fund
  - C. Private investment in public equity fund
93. Which of the following is *not* one of Porter's "five forces" framework?
- A. Intensity of rivalry
  - B. Macroeconomic influences
  - C. Bargaining power of suppliers
94. May Johansson, CFA, is considering an investment in Best Sell Technologies LLC (BST), an online retailer based in San Diego, California. BST has recently started to pay dividends with a payout ratio of 30%. The company is expected to grow rapidly over the next 5 years before earnings are expected to moderate. If Johansson intends to hold shares in BST indefinitely, which of the following share valuation models would be *most appropriate*?
- A. Two-stage dividend discount model
  - B. Gordon (constant) growth dividend discount model
  - C. Multiple-year holding period dividend discount model

95. Consider the following companies:

- Company G, a gold mining company with known reserves
- Company H, a hotelier that has grown predominantly through acquiring smaller hotel chains
- Company I, an internet provider that is currently being liquidated

For which of these companies would an asset-based valuation be *least appropriate*?

- A. Company G
- B. Company H
- C. Company I

96. Company Z has just paid their annual dividend and its shares are trading on a P/E ratio of 17.7. Next year's dividend is expected to be \$16.89 per share, which is expected to grow at 3.4% indefinitely. If the current share price is \$245.25, the market required rate of return for the stock is *closest to*:

- A. 10.1%
- B. 10.3%
- C. 10.5%

97. The EV/EBITDA metric is a common input of which type of valuation model?

- A. Multiplier model
- B. Present value model
- C. Asset-based valuation model

## Questions 98–109 Fixed Income

98. Company R has just issued a new 3-year bond, which pays an annual 6% coupon with par value of \$100 per bond. If it is priced at yield of 7.8% p.a, the bond's Macauley duration is *closest to*:
- A. 2.8
  - B. 3.0
  - C. 3.4
99. Which of the following statements is *most correct*? Sovereign bonds:
- A. are backed by the sovereign's banking industry.
  - B. can be issued only in the sovereign's domestic currency.
  - C. are issued in different forms including floating-rate and inflation-linked.
100. Mark Bael, CFA, calculates a spread of the yield on an international corporate issuer over its Government's bond yield by using individual spot rates to discount each of the bond's expected cash flows. Bael is *most likely* calculating:
- A. a G-spread.
  - B. a Z-spread.
  - C. an I-spread.
101. Which of the following is *least likely* to be included in a bond indenture?
- A. Collaterals
  - B. Issue price
  - C. Credit enhancements
102. The government of Santaria has recently issued 7-year bonds that pay a semi-annual coupon of 10% p.a. The par value of the bonds is \$S 100 and they have a maturity value of \$S 120 each. If the market discount rate for the bonds at issue is 11.5% p.a., the issue price of the bonds is *closest to*:
- A. \$S 92.920
  - B. \$S 102.063
  - C. \$S 111.503

103. Bond D, which pays a quarterly coupon of \$24 per bond, will mature at its par value of \$1,000 in 4 years' time. If the current price is \$1,087 per bond, the effective annual yield on the bond is *closest to*:
- A. 7.1%
  - B. 7.3%
  - C. 9.6%
104. Regarding asset-backed securities (ABS) made up of a portfolio of loans, which of the following statements is *most correct*? The issuer of the ABS:
- A. buys the loans.
  - B. services the loans.
  - C. originates the loans.
105. Which of the following statements is *most correct*? An investor's realized rate of return on a corporate bond that is expected to be held to maturity and not expected to default will equal the bond's yield to maturity if:
- A. interest rates remain stable.
  - B. the bond is bought at par value.
  - C. the bond is a zero-coupon bond.
106. Makken Hellmut (MH) is a large Austrian manufacturer who is looking at issuing bonds to expand its operations in Europe and the UK. To do so, MH issues bonds denominated in GBP in both the Eurobond market and the UK domestic bond market. These bonds would *best* be described as:
- A. global bonds.
  - B. foreign bonds.
  - C. euro sterling bonds.
107. Country R issues a series of inflation-linked bonds that do not pay a coupon, but instead pay an annual amount to bond holders that represents both payment of interest and repayment of principal. This type of bond is *best* specified as a(n):
- A. capital-indexed bond.
  - B. indexed-annuity bond.
  - C. zero-coupon-indexed bond.

108. Company JKL issues a 5% coupon, 10-year callable bond, which has a single call date at the end of year 5. The issue price of the bond is \$978.25 and it has a par value of \$1,000. If the call price in % terms is 106.550, the call premium at the year-5 call date is *closest to*:
- A. \$42.22
  - B. \$65.50
  - C. \$106.55
109. Which of the following statements regarding repurchase agreements is *most correct*?
- A. Only the seller faces counterparty credit risk.
  - B. Only the buyer faces counterparty credit risk.
  - C. Repo rates increase as the level of credit risk in the collateral increases.

## Questions 110–115 Derivatives

110. Colleen O’Farrell, CFA, sells 4,000 equity index futures contracts at a price of EUR 224 per contract. She is required to provide an initial margin of EUR 20 per contract and meet margin calls when her margin balance falls below the maintenance margin level of EUR 12 per contract. In the event of a margin call, the exchange requires additional margin to be contributed up to the maintenance margin level. The price of the contract over the first, second, and third days is as follows:

Day	Beginning Price	Closing Price
1	224	234
2	234	248
3	248	230

Based on this information, the balance in O’Farrell’s margin account at the end of Day 3 is *closest to*:

- A. EUR 56,000
  - B. EUR 104,000
  - C. EUR 120,000
111. Which of the following statements is *least correct*? A credit default swap is a:
- A. credit derivative.
  - B. contingent claim.
  - C. forward commitment.
112. Which of the following is *least likely* to be the reason for an arbitrage opportunity to remain unexploited?
- A. Significant transaction costs
  - B. Difficulty in entering short positions
  - C. Ethical objections to taking advantage of mispricings
113. Satoshi Takada, CFA, takes a long position in a 9-month equity forward contract with a forward price of JPY 1684.20 per share. After four months, the share price has increased to JPY 2087.54 and the annual risk-free rate is currently 1.44%. Based on this information the value of the forward contract to Takada is *closest to*:
- A. JPY 0.00
  - B. JPY 413.34
  - C. JPY 433.23

114. Company XYZ has a \$40 million, 3-year debt on which it pays a fixed rate of interest at 7.6% p.a. As it is expecting rates to drop significantly over the coming few years it enters into a swap contract with a fixed leg of 4.0% p.a. and a floating leg at 90-day LIBOR + 1.8% p.a. The notional value of the swap contract is \$40,000,000 and it is based on a 360-day year. If LIBOR on Day 360 is 1.3% p.a., which of the following statements is *least correct*? The 90-day LIBOR rate on Day 360 corresponds with a swap payment:
- A. of \$690,000.
  - B. made on Day 450.
  - C. to Company XYZ.
115. An investor is considering purchasing 1-year call options in dallanium, which is currently trading at \$566.20 per oz. The price of dallanium after one year will be either up by 20% or down by 10% and the only available call option has a strike price of \$600 per oz. If the risk-free rate is 3.2% p.a., the value of the call option is *closest to*:
- A. \$0.00
  - B. \$33.87
  - C. \$79.44



## Questions 116–120 Alternative Investments

116. Which of the following statements is *least correct*? In addition to management fees, a leveraged buyout (LBO) firm may also charge:
- A. incentive fees.
  - B. underwriting fees.
  - C. a fee if the deal falls through.
117. Missy Cohen, CFA, is a portfolio manager for a small hedge fund based in Phoenix, Arizona. Using internally developed data sets and models, Cohen looks to invest in the securities of companies that are engaged in restructuring activities. The type of hedge fund strategy employed by Cohen is *best* described as:
- A. macro.
  - B. event-driven.
  - C. relative value.
118. Which of the following is *not* a common characteristic of alternative investments?
- A. Large investment size
  - B. Limited historical return data
  - C. Broad manager specialization
119. Which of the following is *not* a common risk measurement tool employed by managers of illiquid assets?
- A. Sortino ratio
  - B. Value at risk
  - C. Systematic risk
120. Joel Kelly, CFA, is the portfolio manager for the SureWall Direct Property Fund and is currently reviewing several properties owned by the fund. The largest property in the fund is a three-story security facility near Lisbon, Portugal, which is leased by a large technology company to house data servers and records. The property is unique in that most other technology companies in Europe own their server centers. Which of the following valuation approaches would be *least appropriate* for Kelly to use in valuing this property?
- A. Replacement cost
  - B. Comparable sales
  - C. Discounted cash flow

# WILEY

## CFA® Mock Exam Answer Key

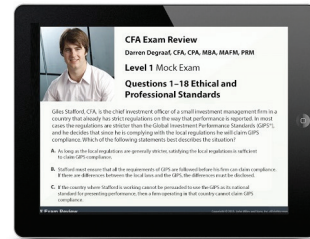
# Congratulations on completing Wiley's CFA® Mock Exam!

**Candidates who take one or more CFA mock exams can exponentially increase their chances of passing.**

To check your answers and obtain full solutions to this mock, visit [www.efficientlearning.com/cfa/mock-exam](http://www.efficientlearning.com/cfa/mock-exam)



## Level I Mock Exam Review Seminar - Free



**9am - 11am ET / 2pm - 4pm BT on Saturday November 24, 2018**

To help you make the most of your Mock Exam experience with Wiley, we are offering to walk through how to answer 20 of the most typical and toughest questions on this mock exam in an online webcast. This live online class will be highly interactive with plenty of Q&A.

Delivered by a top CFA instructor who has helped thousands of candidates to pass the CFA exam, the 20 questions will be voted for by you!

**Vote for your questions and register  
to join the live webcast at:**

**[www.efficientlearning.com/cfa/mock-exam-review-webcast](http://www.efficientlearning.com/cfa/mock-exam-review-webcast)**

Voting closes Tuesday November 20, 2018.

Can't attend live? We will also record the class so you will be able to watch it later on demand.

**Best wishes for your studies.**



WILEY