

## 2019 Level I Mock Exam (C) PM

The afternoon session of the 2019 Level I Chartered Financial Analyst® Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of one and a half minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

Questions	Topic	Minutes
1–19	Ethical and Professional Standards	28.5
20–31	Quantitative Methods	18
32–43	Economics	18
44–61	Financial Reporting and Analysis	27
62–73	Corporate Finance	18
74–80	Portfolio Management	10.5
81–93	Equity	19.5
94–106	Fixed Income	19.5
107–113	Derivatives	10.5
114–120	Alternative Investments	10.5
<b>Total:</b>		<b>180</b>

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**2019 LEVEL I MOCK EXAM (C) PM**

- 1 Which of the following statements *most likely* reflects one of the six components of the CFA Code of Ethics? Candidates must:
  - A place the integrity of the investment profession above their own interests.
  - B promote the viability of the global capital markets for their employer's benefit.
  - C ignore unprofessional conduct displayed by others within the profession.
- 2 Tamorn Mager, CFA, is an analyst at Pyallup Portfolio Management. CFA Institute recently notified Mager that his CFA Institute membership was suspended for a year because he violated the CFA Code. A hearing panel also came to the same conclusion. Mager subsequently notified CFA Institute that he does not accept the sanction or the hearing panel's conclusion. Which of the following actions by Mager is *most* consistent with the CFA Institute Standards of Professional Conduct Program?
  - A Presenting himself to the public as a CFA charterholder.
  - B Providing evidence for his position to an outside arbitration panel.
  - C Using his CFA designation upon expiration of the suspension period.
- 3 Yip Wai Yin, a CFA candidate, is an independent mutual fund sales agent. For every front-end load product she promotes, Yip receives a portion of the front-end fee as commission at the time of sale. For every back-end load fund she sells, Yip receives a smaller commission paid at the end of the year. Yip always informs her clients that she is paid a commission as an agent, but does not provide details of the compensation structure. When pitching her favored front-end load product line she tells clients 20% of her commission is always invested in the same fund as proof of her confidence in the fund she recommends. Which CFA Code and Standards with regard to Conflicts of Interest does Yip *least likely* violate?
  - A Referral Fees.
  - B Disclosure of Conflicts.
  - C Priority of Transactions.
- 4 Lewis McChord, CFA, a research analyst at an investment bank, covers the auto industry. McChord recently read a report on an auto manufacturing company written by Pierce Brown. Brown's report provided extensive coverage of the company's newly launched products indicating that sales volume, not yet publicly available, would raise future profits. Intrigued by the report, McChord called a senior executive at the company whom she has known personally for years. The officer gave her specific details on new vehicle sales, indicating that profits would double in the current quarter. McChord added this data to Brown's report and then circulated it within her firm as her own report. McChord *least likely* violated which of the following CFA Institute Standards of Professional Conduct?
  - A Misrepresentation
  - B Preservation of Confidentiality
  - C Material Nonpublic Information
- 5 Abe Seneca, CFA, supervises a team of analysts who create index funds for institutional investors. When Seneca makes sales demonstrations without his colleagues to potential clients simulating the fund's performance, the scenarios

he prepares show outcomes based on assumptions reflecting upside bias and positive risk assessments. Gail Tremblay, CFA, an analyst in Seneca's group, observes that the actual performance of these index funds is less than indicated in the scenario outcomes shown in the sales meetings. Seneca *least likely* violated which of the following CFA Institute Standards of Professional Conduct?

- A Loyalty
- B Performance Presentation
- C Responsibilities of Supervisors

- 6 Eileen Fisher, CFA, has been a supervisory analyst at SL Advisors for the past ten years. Recently, one of her analysts was found to be in violation of the CFA Institute Standards of Professional Conduct. Fisher has placed limits on the analyst's activities and is now monitoring all of his investment activities. Although SL did not have any compliance procedures up to this point, to avoid future violations, Fischer has put in place procedures exceeding industry standards. Did Fisher *most likely* violate any CFA Institute Standards of Professional Conduct?

- A Yes.
- B No, because she has taken steps to ensure the violations will not be repeated by the analyst.
- C No, because she is taking steps to implement compliance procedures that are more than adequate.

- 7 Elbie Botha, CFA, an equity research analyst at an investment bank, disagrees with her research team's buy recommendation for a particular company's rights issue. She acknowledges that the recommendation is based on a well-developed process and extensive research but feels the valuation is overpriced based on her assumptions. Despite her contrarian view, her name is included on the research report to be distributed to all of the investment bank's clients. To avoid violating any CFA Institute Standards, it would be *least* appropriate for Botha to undertake which of the following?

- A Leave her name on the report.
- B Insist her name is removed from the report.
- C Issue a new report based on her conclusions.

Colleen O'Neil, CFA, manages a private investment fund with a balanced global investment mandate. Her clients insist that her personal investment portfolio replicate the investments within their portfolio to ensure them that she is willing to put her money at risk. By undertaking which of the following simultaneous investment actions for her own portfolio would O'Neil *most likely* be in violation of Standard VI(B)–Priority of Transactions?

- A Sale of a listed US blue chip value stock.
- B Participation in a popular frontier market IPO.
- C Purchase of a UK government bond in the primary market.

Tammi Holmberg is enrolled to take the Level I CFA examination. While taking the CFA examination, the candidate on Holmberg's immediate right takes a stretch break and a piece of paper from his pocket falls onto Holmberg's desk. Holmberg glances at the paper and realizes there is information written on the paper, which includes a formula Holmberg needs for the question she is working on. Holmberg had not memorized this formula and could not complete the question without this information. Holmberg pushes the paper off her desk and uses the formula to complete the question. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, Holmberg *most likely*:

- A compromised her exam.  
B was free to act on the information that fell on her desk.  
C is responsible for notifying exam proctors of her neighbor's violation.
- 10 Praful Chandarana, CFA, is starting a new business to offer investment consulting services to pension fund trustees in response to a new regulation that requires all pension fund Investment Policy Statements (IPS) to be reviewed and approved by an independent CFA charterholder. Prior to starting the new business, he meets with the pension fund regulator to clarify if the CFA charterholder undertaking the IPS review should be a licensed financial advisor by the capital markets regulator. The capital markets regulator requires and grants licenses to those giving investment advice to clients. The pension regulator states that they do not require the CFA charterholder to hold a financial advisor's license, despite financial-related advice being given to the pension funds during any IPS review. Chandarana therefore starts his new business to undertake IPS reviews without obtaining a financial advisor's license from the capital markets regulator. Subsequently, when clients of his former employer contact him he informs them of his new company and the services he offers. Does Chandarana *most likely* violate the CFA Code and Standards?
- A No.  
B Yes, with regard to Professionalism.  
C Yes, with regard to Duties to Employer.
- 11 At the conclusion of the afternoon section of the Level I CFA examination, the exam proctor instructs all candidates to stop writing and put their pencils down immediately. Krishna Chowdary sees other candidates in front of him continue to fill in their answer sheets. Chowdary has two questions left to complete so he randomly fills in one of the ovals on his answer sheet before putting his pencil down on the table. Did Chowdary's actions *most likely* violate the CFA Institute Code of Ethics and Standards of Professional Conduct?
- A Yes.  
B No, because other candidates continued writing.  
C No, because he randomly answered one question.
- 12 Upon receiving notification that he passed his Level III CFA exam, Paulo Garcia updates his educational background on his social media site by adding "completed the CFA course." Does Garcia *most likely* violate the CFA Institute Standards of Professional Conduct?
- A No.  
B Yes, because it could imply he has obtained the charter.  
C Yes, because he doesn't describe the certification process.
- 13 Jackson Barnes, CFA, works for an insurance company providing financial planning services to clients for a fee. Barnes has developed a network of specialists, including accountants, lawyers, and brokers, who contribute their expertise to the financial planning process. Each of the specialists is an independent contractor. Each contractor bills Barnes separately for the work he or she performs, providing a discount based upon the number of clients Barnes has referred. What steps should Barnes take to be consistent with the CFA Institute Standards of Professional Conduct?
- A Have his independent contractors approved by the insurance company  
B List the consideration he receives from the specialists on monthly client invoices

- C Inform potential clients about his arrangement with the contractors before they agree to hire him
- 14 Linda Chin, CFA, is a member of a political group advocating lower governmental regulation in all aspects of life. She works in a country where local securities laws are minimal and insider trading is not prohibited. Chin's politics are reflected in her investment strategy where she follows her country's mandatory legal and regulatory requirements. Which of the following actions by Chin is *most* consistent with the CFA Institute Standards of Professional Conduct?
- A Follow the CFA Code and Standards.
- B Continue her current investment strategy.
- C Disclose her political advocacy to clients.
- 15 Priscilla Moab, CFA, is the director of marketing at Red Lantern Investments. Red's investment approach uses technical and fundamental analysis as well as portfolio construction to minimize risk. Moab plans to market an online investment newsletter to retail clients. Moab decides to let prospective clients have access to Red's buy and sell recommendation list by posting this information on a social media site. The posting also provides information on Red's basic investment process and logic. To avoid violating the CFA Institute Code of Ethics and Standards of Professional Conduct, Moab should *most likely*:
- A describe the investment approach in detail.
- B update investment process changes annually.
- C indicate that additional information and analysis are available.
- 16 The Global Investment Performance Standards (GIPS) *least likely* require:
- A non-discretionary portfolios to be included in composites.
- B non-fee-paying portfolios to be excluded in the returns of appropriate composites.
- C composites to be defined according to similar investment objectives and/or strategies.
- 17 CFA Institute support of a local country sponsor to drive the adoption of the GIPS standards seeks to:
- A provide a link between the governing body and the local markets.
- B promote the standards as mandatory.
- C translate the standards into the local language for use as the official governing version.
- Under what circumstances could a client possibly win a lawsuit against a financial adviser despite the financial adviser abiding by all regulatory and legal requirements?
- A The adviser benefiting more from the relationship than the client
- B The adviser not being subject to a code of ethics
- C The adviser violating his employer's published code of ethics
- Can an individual *most likely* cause the public to lose confidence in the global financial markets?
- A Yes.
- B No, a negative event would need to be considered systemic.
- C No, a single person does not have enough influence.
- A stock's expected price movement over the next two periods is as follows:

Time = 0	Time = 1	Time = 2
$S_0 = 80$	$S_u = 88$	$S_{uu} = 96.80$
	$S_d = 72$	$S_{ud,du} = 79.20$
		$S_{dd} = 64.80$

The initial value of the stock is \$80. The probability of an up move in any given period is 75%, and the probability of a down move in any given period is 25%. Using the binomial model, the probability that the stock's price will be \$79.20 at the end of two periods is *closest* to:

- A 37.50%.  
 B 56.25%.  
 C 18.75%.
- 21 An equally weighted portfolio is composed of four stocks. An analyst knows the mean and variance for each of the four stocks. In order to estimate the portfolio mean and variance, the analyst will require the stocks':  
 A skewness.  
 B pairwise correlations.  
 C kurtosis.
- 22 If a stock's continuously compounded return is normally distributed, then the distribution of the future stock price is *best* described as being:  
 A normal.  
 B a Student's *t*.  
 C lognormal.
- 23 A US Treasury bill (T-bill) has 90 days to maturity and a bank discount yield of 3.25%. The effective annual yield (EAY) for the T-bill is *closest* to:  
 A 3.29%.  
 B 3.32%.  
 C 3.36%.
- 24 An analysis of US share prices determines that there is consistent underpricing by \$0.02 with a *p*-value of 0.0012. Assuming an average transaction cost of \$0.05, which statement is *most* accurate? The underpricing result is:  
 A statistically significant and indicates a possible arbitrage opportunity.  
 B not economically meaningful.  
 C not statistically significant.
- 25 The total probability rule is used when an analyst is interested in:  
 A all potential outcomes.  
 B a set of events.  
 C a single outcome.
- 26 An analyst develops a set of criteria for evaluating distressed credits. Companies that do not receive a passing score are classed as likely to go bankrupt within the next year. The analyst concludes the following:  
 • Forty percent of the companies tested will go bankrupt within a year:  $P(\text{non-survivor}) = 0.40$ .  
 • Fifty-five percent of companies tested will pass:  $P(\text{pass test}) = 0.55$ .  
 • There is an eighty-five percent probability that a company will pass the test given that it survives a year:  $P(\text{pass test} | \text{survivor}) = 0.85$ .

Using the total probability rule, the probability that a company passed the test given that it goes bankrupt can be determined. The  $P(\text{pass test} | \text{non-survivor})$  is closest to:

- A 0.22.
- B 0.35.
- C 0.10.

27 The sampling error is *best* described as the:

- A sample standard deviation divided by the square root of the sample size.
- B difference between the observed value of a statistic and the quantity it is intended to estimate.
- C sum of squared deviations from the mean divided by the sample size minus one.

28 Use the following values from a student's  $t$ -distribution to establish a 95% confidence interval for the population mean given a sample size of 10, a sample mean of 6.25, and a sample standard deviation of 12. Assume that the population from which the sample is drawn is normally distributed and that the population variance is not known.

Degrees of Freedom	$p = 0.10$	$p = 0.05$	$p = 0.025$	$p = 0.01$
9	1.383	1.833	2.262	2.821
10	1.372	1.812	2.228	2.764
11	1.363	1.796	2.201	2.718

The 95% confidence interval is *closest* to a:

- A lower bound of  $-2.20$  and an upper bound of  $14.70$ .
- B lower bound of  $-0.71$  and an upper bound of  $13.21$ .
- C lower bound of  $-2.33$  and an upper bound of  $14.83$ .

29 Which of the following statements is *most* accurate? The first quintile generally exceeds the:

- A first quartile.
- B median.
- C first decile.

The process of looking for inflection points in one market that may signal a trend change in a related market is *best* described as:

- A capital market cycle analysis.
- B relative strength analysis.
- C momentum analysis.

Assume the following:

- The real risk-free rate of return is 3%.
- The expected inflation premium is 5%.
- The market-determined interest rate of a security is 12%.

The sum of the default risk premium, liquidity premium, and maturity premium for the security is *closest* to:

- A 10%.
- B 4%.
- C 8%.

- 32 Given stable aggregate supply, which of the following changes in aggregate demand is *most likely* to cause economic expansion?

A An increase in corporate income tax  
 B An increase in foreign currency per unit of domestic currency  
 C An increase in capacity utilization

- 33 Assume the percentage increases in each of the following listed items:

	Percentage Increase
Real domestic exchange rate (USD/EUR)	5
Eurozone price level	2
US price level	1.5

The predicted change in the nominal US spot exchange rate is *closest* to:

A 4.5%.  
 B -0.5%.  
 C 5.5%.

- 34 The production capabilities of two countries for computers and phones is as follows:

Country	Output per Worker per Year	
	Computers	Phones
X	600	900
Y	400	800

Country X is *best* described as having a comparative advantage over Country Y for producing:

A computers.  
 B phones.  
 C phones and computers.

- 35 A country's international transactions accounts data for last year are presented in its domestic currency:

Transaction	Amount
Exports of goods and services	10,000
Import of goods and services	14,216
Investment income payments made to foreigners	2,519
Investment income received from foreigners	3,409
Net change in assets owned abroad	1,548
Net change in foreign-owned assets domestically	4,989
Unilateral current transfers received	346
Unilateral current transfers paid	1,107
Statistical discrepancy	646

The current account balance is *closest* to:

A -4,087.  
 B -4,216.  
 C -4,345.



- 36 Which of the following statements regarding the characteristics of money is correct?
- A Compared to a barter economy, an economy in which money is the medium of exchange has more prices.
  - B Money as a medium of exchange depends on shared beliefs about its value.
  - C Money's low value relative to its weight enhances wealth portability.
- 37 If a central bank reduces the money supply, this move will *most likely* lead to a:
- A rise in nominal interest rates and a decline in aggregate price level.
  - B rise in nominal interest rates and a rise in aggregate price level.
  - C decline in nominal interest rates and a rise in aggregate price level.
- 38 According to the Fisher effect, an increase in expected inflation will *most likely* increase:
- A the real interest rate.
  - B both nominal and real interest rates.
  - C the nominal interest rate.
- 39 The primary monetary policy goal of most major central banks is *best* characterized as:
- A maintaining price stability.
  - B stimulating economic growth.
  - C maintaining low interest rates.
- 40 Assume that two firms in a duopoly enter into a collusive agreement in an attempt to form a cartel and restrict output, raise prices, and increase profits. According to the Nash equilibrium, a low price is *most likely* charged by:
- A only one firm.
  - B both firms.
  - C neither firm.
- 41 Assume the following consumption basket and prices over 2011 and 2012 (in US dollars):

Item	2011		2012	
	Price	Quantity	Price	Quantity
Meat	\$12/kg	30 kg	\$12.2/kg	35 kg
Rice	\$1/kg	55 kg	\$1.1/kg	50 kg
Milk	\$1.5/liter	65 liters	\$1.6/liter	65 liters
Fuel	\$1/liter	95 liters	\$1.2/liter	85 liters

The Fisher index is *closest* to:

- A 106.1.
- B 105.4.
- C 105.8.

Cost-push inflation is *least likely* to be affected by an increase in:

- A employee wages.
- B finished goods prices.
- C commodity prices.

All else remaining equal, a decline in the average duration of unemployment *most likely* indicates that an economic:

- A upturn is beginning.  
 B upturn has already occurred.  
 C downturn is forthcoming.
- 44 The following table provides selected ratios for a company's two main operating segments during the past two years:

Segment	Asset Growth (%)	Profit Margin (%)		EBIT/Assets		Asset Turnover		Debt/Assets	
		Current	Prior	Current	Prior	Current	Prior	Current	Prior
1	12	18.0	19.0	64.8	76.0	3.6	4.0	0.55	0.43
2	15	23.0	26.0	66.7	88.4	2.9	3.4	0.62	0.51

- Which of the following statements is *most* appropriate? The segment:
- A that is currently most efficient is also financed the most conservatively.  
 B that had the lowest profit margin experienced the most aggressive expansion.  
 C that earned the most per dollar invested last year failed to do so again in the current year.
- 45 Operating segments are *most likely* reportable if they constitute 10% or more of the total for all operating segments of which financial metrics?
- A Assets, profit/loss, or revenue  
 B Capital expenditures, liabilities, or profit/loss  
 C Amortization expense, assets, or revenue
- 46 Accounting choices within GAAP that decrease reported performance in the current period and may increase performance in later periods are most likely examples of:
- A aggressive accounting.  
 B conservative accounting.  
 C earnings that are not sustainable.
- 47 Which of the following items is a non-GAAP financial measure?
- A Net income after taxes  
 B Income from operations  
 C EBITDA
- 48 Which of the following *best* describes a responsibility of the SEC?
- A Overseeing the Public Companies Accounting Oversight Board (PCAOB)  
 B Prosecuting analysts who disseminate conclusions based on non-material non-public information  
 C Promoting the adoption of global financial reporting standards
- 49 The convergence of global accounting standards has advanced to a degree that the Securities and Exchange Commission in the United States now mandates that foreign private issuers who use IFRS may report under:
- A US GAAP or under IFRS with a reconciliation to US GAAP.  
 B US GAAP or under IFRS.  
 C US GAAP with voluntary supplemental reporting under IFRS.

- 50 The joint conceptual framework project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) guides the development of standards that are *best* described as:
- A integrated with local legal and economic norms.
  - B comprehensive, complex rules designed to increase uniformity.
  - C based on principles that limit the range of acceptable approaches.
- 51 A cell phone manufacturer has switched to high-margin premium-priced products with the most innovative features as part of its product differentiation strategy. Which of the following other changes is *most* consistent with this strategy?
- A An increase in inventory levels
  - B A decrease in research and development expenditures
  - C An increase in advertising expenditures
- 52 A credit rating agency uses "scale and diversification" as one of its metrics to assess credit risk. Which of the following would *most likely* be included in that category?
- A Purchasing power with suppliers
  - B Cost structure
  - C Operating cash flow less dividends
- 53 A company purchased equipment in 2013 for £25,000. The year-end values of the equipment for accounting purposes and tax purposes are as follows:

Year Ending:	2014	2013
Carrying amount for accounting purposes	£20,000	£22,500
Tax base for tax purposes	£16,000	£20,000
Tax rate	25%	30%

Which of the following statements *best* describes the effect of the change in the tax rate on the company's 2014 financial statements? The deferred tax liability:

- A decreases by £800.
- B increases by £250.
- C decreases by £200.

One reason that the last-in, first-out (LIFO) inventory valuation method is widely used in the United States is *most likely* that it:

- A results in higher reported gross profit.
- B is available under both US GAAP and International Financial Reporting Standards.
- C results in higher operating cash flows.

Depreciation expense under which of the following methods is *least likely* affected by the estimate of the useful life of the asset?

- A Double declining balance method
- B Straight-line method
- C Units-of-production method

A company that reports in accordance with IFRS does not use the cost model to value its investment properties and property, plant, and equipment. Information related to an investment property and a plant is as follows:

€ thousands	End of Year	
	Carrying Value	Fair Value
Investment property	1,000	1,100
Plant	1,000	1,200

The impact on its net income for the year will *most likely* be a gain (in thousands) of:

- A €100.
- B €300.
- C €200.

- 57 The following is selected balance sheet data for a company along with information about its financial and operating lease obligations.

As of 31 December 2014	(€ millions)
Long-term debt	1,347
Total shareholder's equity	11,268
Total assets	20,097

#### Note 18. Finance and Operating Leases

##### A. Finance Leases

The implicit interest rate on finance leases for 2014 was 6.0%.

##### B. Operating Lease Commitments as of 31 December 2014 (€ millions)

Due 1 January 2015	130
Due 1 January 2016	130
Due 1 January 2017	130
Due 1 January 2018	130
Due 1 January 2019	80
Total of future lease payments thereafter*	240
Total commitments	840

\* After 2019, all lease payments are assumed to be the same as in 2019.

If the company were to capitalize its long-term leases, its adjusted long-term debt-to-assets ratio as of the end of December 2014 would be *closest* to:

- A 9.9%.
- B 10.2%.
- C 10.4%.

- 58 A company that provides cruise ship vacations uses term loans to finance the acquisition of new cruise ships. Which of the following is *most likely* a negative covenant for the loans? The company must:

- A ensure the ships are insured.
- B seek lender approval to pay dividends.
- C maintain a minimum level of working capital.

- 59 A company issued bonds in 2012 that mature in 2022. The measurement basis that will *most likely* be used on the 2012 balance sheet for the bonds is:
- A amortized cost.
  - B market value.
  - C historical cost.
- 60 A firm reports sales of €50,000 for the year ended 31 December 2012. Its accounts receivable balances were €6,000 at 1 January 2012 and €7,500 at 31 December 2012. The company's cash collections from sales for 2012 is *closest* to:
- A €48,500.
  - B €51,500.
  - C €42,500.
- 61 Which of the following *best* describes a component of the income statement?
- A Amounts that a company owes its vendors for purchases of goods and services
  - B Outflows or depletions of assets in the course of a business's activities
  - C Obligations from past events that are expected to result in an outflow of economic benefits
- 62 The post-audit performed as part of the capital budgeting process is *least likely* to include the:
- A provision of future investment ideas.
  - B rescheduling and prioritizing of projects.
  - C indication of systematic errors.
- 63 Which of the following is *most* consistent with good corporate governance practices?
- A All stakeholders should have the right to participate in the governance of the firm.
  - B An audit committee that benefits from the direct guidance of management.
  - C Appropriate controls and procedures to effectively manage the firm should be in place.
- Based on good corporate governance practices, independent board members *most likely*:
- A are pre-approved by management before being nominated.
  - B have a "lead" director when the board chair is not independent.
  - C hold large equity positions but have never worked at the company.
- Given the following information about a firm:
- debt-to-equity ratio (D/E) of 50%
  - tax rate of 40%
  - cost of debt of 8%
  - cost of equity of 13%
- the firm's weighted average cost of capital (WACC) is *closest to*:
- A 8.9%.
  - B 7.5%.
  - C 10.3%.
- Which of the following is *most likely* considered an example of matrix pricing when determining the cost of debt?

- A Debt-rating approach only.  
 B Yield-to-maturity approach only.  
 C Both the yield-to-maturity and the debt-rating approaches.
- 67 A company recently issued a 10-year, 6% semiannual coupon bond for \$864. The bond has a maturity value of \$1,000. If the marginal tax rate is 35%, the after-tax cost of debt (%) is *closest* to:  
 A 3.9%.  
 B 5.2%.  
 C 2.6%.
- 68 A company has an equity beta of 1.4 and is 60% funded with debt. Assuming a tax rate of 35%, the company's asset beta is *closest* to:  
 A 0.98.  
 B 1.01.  
 C 0.71.
- 69 Which of the following situations is the *least likely* reason why the marginal cost of capital schedule for a company rises as additional funds are raised?  
 A The company seeks to issue less senior debt because it violates the debt incurrence test of an existing debt covenant.  
 B The cost of additional funds from various sources rises as higher levels of financing are achieved.  
 C The company deviates from its target capital structure because of the economies of scale associated with flotation costs and market conditions.
- 70 An inventory system that reduces average inventory without affecting sales will *most likely* reduce the:  
 A quick ratio.  
 B inventory turnover.  
 C cash conversion cycle.

Income Statement	Millions (\$)
Revenues	10.2
Variable operating costs	4.6
Fixed operating costs	2.0
Operating income	3.6
Interest	1.2
Taxable income	2.4
Tax	1.0
Net income	1.4

- 71 The degree of financial leverage (DFL) is *closest* to:  
 A 2.6.  
 B 1.5.  
 C 1.7.
- 72 If a 90-day \$10,000 US Treasury security is selling for \$9,870, the discount-basis yield is *closest* to:  
 A 5.27%.  
 B 5.34%.  
 C 5.20%.

- 73 The annual cost of trade credit assuming a 365-day year for terms 3/10 net 40 is *closest* to:
- A 43.3%.
  - B 44.9%.
  - C 32.0%.
- 74 Which of the following types of investment clients *most likely* have the lowest liquidity needs?
- A Insurance companies
  - B Banks
  - C Endowments and foundations
- 75 ABC Company has an obligation to pay a certain amount each month to each of its employees after they retire. This obligation is *most likely* known as a(n):
- A endowment.
  - B defined-contribution pension plan.
  - C defined-benefit pension plan.
- 76 With respect to the portfolio management process, the execution step *most likely* includes:
- A portfolio monitoring.
  - B asset allocation.
  - C developing the investment policy statement.
- 77 If Investor A has a lower risk aversion coefficient than Investor B, on the capital allocation line, will Investor B's optimal portfolio *most likely* have a higher expected return?
- A Yes
  - B No, because Investor B has a higher risk tolerance
  - C No, because Investor B has a lower risk tolerance
- 78 A portfolio contains equal weights of two securities having the same standard deviation. If the correlation between the returns of the two securities was to decrease, the portfolio risk would *most likely*:
- A increase.
  - B remain the same.
  - C decrease.

Information for Stock A and the market appear in the following table:

standard deviation of Stock A's return	40%
standard deviation of the market's return	20%
correlation of Stock A with the market	85%

The beta of Stock A is *closest* to:

- A 1.70.
- B 2.35.
- C 0.43.

Which of the following portfolio performance measures are the *most* appropriate for an investor who holds a fully diversified portfolio?

- A Sharpe ratio and Treynor ratio.
- B Treynor ratio and Jensen's alpha.
- C *M*-Squared and Sharpe ratio.

- 81 Which of the following dates in the dividend chronology can fall on a weekend?  
The
- A payment date.
  - B record date.
  - C ex-date.
- 82 An investor gathers the following information about a company:
- |                            |        |
|----------------------------|--------|
| Current earnings per share | \$5.00 |
| Current dividend per share | \$3.00 |
| Required rate of return    | 15.0%  |
| Return on equity (ROE)     | 17.5%  |
- Using the dividend discount model, the value of the company's stock is *closest* to:
- A \$40.13.
  - B \$73.67.
  - C \$37.50.
- 83 Which of the following statements concerning different valuation approaches is *most* accurate?
- A One advantage of the three-stage dividend discount model (DDM) model is that it is equally appropriate to young companies entering the growth phase and those entering the maturity phase.
  - B It is advantageous to use asset-based valuation approaches rather than forward-looking cash flow models in the case of companies that have significant intangibles.
  - C The justified forward price-to-earnings ratio (P/E) approach offers the advantage of incorporating fundamentals and presenting intrinsic value estimations.
- 84 An industry experiencing intense competitive rivalry among incumbent companies is *best* characterized by:
- A differentiated products and low exit barriers.
  - B a small number of competitors and low fixed costs.
  - C customers basing purchase decisions largely on price.
- 85 An industry characterized by rising volumes, improving profitability, falling prices, and relatively low competition among companies is *most likely* in which of the following life-cycle stages?
- A Growth
  - B Mature
  - C Embryonic
- 86 Which of the following statements is *most* accurate in an efficient market?
- A Active strategies will lead to excess risk-adjusted portfolio returns.
  - B Securities market prices fully reflect their fundamental values.
  - C Securities market prices respond over time to changes in economic information.
- 87 Which of the following situations will *most likely* promote an increase in market efficiency?
- A An increase in arbitrage opportunities
  - B A decrease in trading activity



- C An increase in information availability
- 88 A trader is able to obtain persistent abnormal returns by adopting an investment strategy that purchases stocks that have recently experienced high returns. This strategy exploits a market-pricing anomaly *best* described as:
- A data mining.
- B momentum.
- C the overreaction effect.
- 89 A market has the following limit orders standing on its book for a particular stock:

Buyer	Bid Size (# of shares)	Limit Price (\$)	Seller	Offer Size (# of shares)	Limit Price (\$)
1	500	18.5	1	200	20.2
2	300	18.9	2	300	20.35
3	400	19.2	3	400	20.5
4	200	20.1	4	100	20.65
5	100	20.15	5	200	20.7

- If a trader submits an immediate-or-cancel limit buy order for 700 shares at a price of \$20.50, the average price the trader would pay is *closest* to:
- A \$20.35.
- B \$20.58.
- C \$20.50.
- 90 Which of the following is *most likely* a primary market transaction?
- A A private placement of shares
- B A market order sale of bonds
- C The exercise of an exchange-traded call option
- 91 A trader seeking to sell a very large block of stock for her client will *most likely* execute the trade in a(n):
- A quote-driven market.
- B order-driven market.
- C brokered market.
- The advantages to an investor owning convertible preference shares of a company *most likely* include:
- A less price volatility than the underlying common shares.
- B an opportunity to receive additional dividends if the company's profits exceed a pre-specified level.
- C preference dividends that are fixed contractual obligations of the company.
- Which of the following statements regarding a commodity index is *most* accurate?
- A Commodity index returns differ from the changes in the prices of their underlying commodities.
- B Commodity indexes in the same markets will share similar risk and return profiles.
- C Commodity indexes commonly use an equal weighting method.
- Which of the following products provides protection from inflation?
- A Consols

- B Linkers
  - C Floaters
- 95 A South Korean electronics company issued bonds denominated in US dollars in the United States and registered with the SEC. These bonds are *most likely* known as a:
- A foreign bond.
  - B Eurobond.
  - C global bond.
- 96 Consider two 10-year bonds, one that contains no embedded options and the other that gives its owner the right to convert the bond to a fixed number of shares of the issuer's common stock. The convertibility option in the second bond cannot be exercised for five years. The bonds are otherwise identical. Compared with the yield on the convertible bond, the yield on the option-free bond is *most likely*:
- A the same.
  - B lower.
  - C higher.
- 97 What type of risk *most likely* affects an investor's ability to buy and sell bonds in the desired amounts and at the desired time?
- A Market liquidity
  - B Spread
  - C Default
- 98 In a securitization, the seller of the pool of securitized assets is the:
- A trustee.
  - B special purpose entity.
  - C depositor.
- 99 Which of the following is *least likely* a feature of a credit card receivable ABS?
- A An early amortization provision
  - B Amortizing collateral
  - C A lockout period
- 100 The market value of an 18-year zero-coupon bond with a maturity value of \$1,000 discounted at a 12% annual interest rate with semi-annual compounding is *closest* to:
- A \$130.04.
  - B \$192.86.
  - C \$122.74.
- 101 An investor sells a bond at the quoted price of \$98.00. In addition, she receives accrued interest of \$4.40. The flat price of the bond is equal to the:
- A par value plus accrued interest.
  - B agreed-on bond price excluding accrued interest.
  - C accrued interest plus the agreed-on bond price.
- 102 A bond has a 10-year maturity, a \$1,000 face value, and a 7% coupon rate. If the market requires a yield of 8% on similar bonds, it will *most likely* trade at a:
- A discount.
  - B premium.
  - C discount or premium, depending on its duration.

- 103 Holding all other characteristics the same, the bond exposed to the greatest level of reinvestment risk is *most likely* the one selling at:
- A a premium.
  - B a discount.
  - C par.
- 104 In a low interest rate environment, the effective duration of a callable bond relative to a comparable non-callable bond, will *most likely* be:
- A higher.
  - B lower.
  - C the same.
- 105 A bond has a Macaulay duration of 6.0, modified duration of 6.5, and convexity of 50.25. If the bond's yield to maturity decreases by 50 bps, the expected percentage price change is *closest* to:
- A 3.06%.
  - B 3.31%.
  - C 3.25%.
- 106 A long-term bond investor with an investment horizon of 8 years invests in option-free, fixed-rate bonds with a Macaulay duration of 10.5. The investor *most likely* currently has a:
- A positive duration gap and is currently exposed to the risk of lower interest rates.
  - B positive duration gap and is currently exposed to the risk of higher interest rates.
  - C negative duration gap and is currently exposed to the risk of higher interest rates.
- 107 What is the *most likely* reason why arbitrage will not completely eliminate all pricing discrepancies for derivatives?
- A Differences in risk aversion
  - B Transaction costs
  - C Inaccurate forecasts
- Over time, a forward contract *most likely* has variable:
- A value and constant price.
  - B price and constant value.
  - C value and variable price.
- The underlying in a forward rate agreement is *most likely* a(n):
- A growth rate of an equity index.
  - B interest rate.
  - C exchange rate.
- Which of the following statements *best* describes a feature of an American option? Early exercise of an American:
- A put option is optimal only if the underlying is dividend paying.
  - B call option is never optimal if the underlying is dividend paying.
  - C put option that is deep in the money may be optimal.
- Which of the following derivatives is *least likely* to be classified as a contingent claim?
- A A futures contract

- B A call option contract
  - C A credit default swap
- 112 A corporation issues five-year fixed-rate bonds. Its treasurer expects interest rates to decline for all maturities for at least the next year. She enters into a one-year agreement with a bank to receive quarterly fixed-rate payments and to make payments based on floating rates benchmarked on three-month Libor. This agreement is *best* described as a:
- A futures contract.
  - B forward contract.
  - C swap.
- 113 In an efficient market, it is *more likely* that fundamental value will be reflected in the:
- A underlying spot market before the derivative market.
  - B derivatives market and the underlying spot market at the same time.
  - C derivatives market before the underlying spot market.
- 114 Relative to traditional investments, alternative investments are *most likely* to be characterized by higher:
- A fees.
  - B liquidity.
  - C transparency.
- 115 In the context of venture capital financing, seed-stage financing *most likely* supports:
- A initial commercial production and sales.
  - B product development and/or marketing efforts.
  - C transformation of an idea into a business plan.
- 116 Concentrated portfolio strategies are attractive because of their:
- A potential to generate alpha.
  - B ability to track market indices.
  - C low risk.
- 117 Compared with other investment asset classes, an investment in real estate is *least likely* to be characterized by:
- A homogeneity.
  - B fixed location.
  - C basic indivisibility.
- 118 One hedge fund strategy that involves simultaneously holding short and long positions in common stock is *most likely*:
- A volatility.
  - B distressed/restructuring.
  - C quantitative directional.
- 119 A private equity firm sells a portfolio company to a buyer that is active in the same industry as the portfolio company. This transaction is best described as a(n):
- A trade sale.
  - B secondary sale.
  - C initial public offering.

- 120 A hedge fund limited partnership agreement describes the general partner's total fees for each year as follows: The general partner will measure the fair value of the fund's assets at the beginning of the year (net of fees from the previous year) and the fair value of the fund's assets at the end of the year. The general partner will receive 15% of any increase in fair value in excess of the 1-year US Treasury yield at the beginning of the year. This fee structure *most likely* includes a:
- A hard hurdle rate.
  - B management fee.
  - C high-water mark provision.