2019 Level I Mock Exam AM

The morning 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
1–20	Ethical and Professional Standards	30
21–32	Quant	18
33–44	Econ	18
45–62	Financial Reporting and Analysis	27
63–74	Corporate Finance	18
75–81	Portfolio Management	10.5
82–94	Equity	19.5
95–107	Fixed Income	19.5
108–114	Derivatives	10.5
115–120	Alternative Investments	9
	Total:	**180**

2019 LEVEL I MOCK EXAM AM

1 Who *most likely* determines whether a violation of the CFA Institute Code and Standards or testing policies has occurred and what sanction should be imposed? The:

A Professional Conduct Staff and the Disciplinary Review Committee

B Professional Conduct Staff

C Disciplinary Review Committee

2 Holly Baker, CFA is explaining the CFA Institute Code of Ethics to a client. Which of the following statements could Baker make to *most likely* reflect disciplinary sanctions the CFA Institute may impose? Sanctions include:

A fines for violations.

B revocation of membership.

C banishment from the industry.

3 William Wong, CFA, is an equity analyst with Hayswick Securities. Based on his fundamental analysis, Wong concludes that the stock of a company he follows, Nolvec Inc., is substantially undervalued and will experience a large price increase. He delays revising his recommendation on the stock from "hold" to "buy" to allow his brother to buy shares at the current price. Wong is *least likely* to have violated the CFA Institute Standards of Professional Conduct related to:

A duty to clients.

B reasonable basis.

C priority of transactions.

4 Hui Chen, CFA, develops marketing materials for an investment fund he founded three years ago. The materials show the 3-year, 2-year, and 1-year returns for the fund. He includes a footnote that states in small print "Past performance does not guarantee future returns." He does not claim compliance with GIPS in the disclosures or footnotes. He also includes a separate sheet showing the most recent semi-annual and quarterly returns, which notes that they have been neither audited nor verified. Has Chen *most likely* violated any CFA Institute Standards of Professional Conduct?

A No.

B Yes, because he included un-audited and unverified results.

C Yes, because he did not adhere to the Global Investment Performance standards.

5 Charlie Mancini, CFA, is the Managing Director for Business Development at SV Financial (SVF), a large US-based mutual fund organization. Mancini has been under pressure recently to increase revenues. In order to secure business from a large hedge fund manager based in Asia, Mancini recently approved flexible terms for the fund's client agreement. To allow for time zone differences, the agreement permits the hedge fund to trade in all of SVF's mutual funds six hours after the close of US markets, which is prohibited by US regulators. Did Mancini violate any CFA Institute Standards of Professional Conduct?

A No.

B Yes, with regard to Fair Dealing.

C Yes, with regard to Fair Dealing and Material Nonpublic Information.

6 Ricardo Torres, CFA, is a well-respected telecommunications analyst for Pegasus Advisers. He is known for his thorough analysis, including interviews with suppliers, customers, and competitors. Torres has a strong following, and his research reports can often materially affect the market. As a result, Pegasus limits the distribution of his reports to Pegasus clients. After losing market share to Pegasus for over two years, Marco Rodrigo, a CFA candidate, reports Torres to the local securities regulator on suspicion of using insider information to make share recommendations. What CFA Institute Standard of Professional Conduct has Rodrigo *most likely* violated?

A Misconduct

B Material Nonpublic Information

C Market Manipulation

7 Albert Nyakenda, CFA, was driving to a client's office where he was expected to close a multi-million-dollar deal when he was pulled over by a traffic policeman although he did not believe he had violated any traffic laws. When Nyakenda realized the policeman planned to wrongly ticket him for speeding, he offered to buy him "lunch" so that he could quickly get to his client's office. The lunch would cost significantly more than the ticket. The alternative was to go to the police station and file a complaint of being wrongly accused that would also involve going to court the next day to present his case. Did Nyakenda *most likely* violate the CFA Code of Ethics?

A Yes.

B No, because he was wrongly accused.

C No, because the cost of lunch is more than the ticket.

8 Francesca Ndenda, CFA, and Grace Rutabingwa work in the same department for New Age Managers with Rutabingwa reporting to Ndenda. Ndenda learns that Rutabingwa received a Notice of Enquiry from the Professional Conduct Program at CFA Institute regarding a potential cheating violation when he sat for the CFA exam in June. As Rutabingwa's supervisor, Ndenda is afraid the behavior of Rutabingwa will be seen as a violation of the CFA Code and Standards. Does Ndenda *most likely* have cause for concern?

A Yes.

B No, because her responsibilities do not apply.

C No, not until Rutabingwa is found guilty of cheating.

Oni Erobo, CFA, the General Partner in a real estate development project, is responsible for completing the project within an 18-month period and within budget. Erobo will receive an equity stake of 20% in the project if it comes within budget. Concerned that project costs could escalate, the Limited Partners require Erobo to cap expenses at 15% above budget. Costs were within expectation up until the last month of construction when imported lighting fixture costs (accounting for roughly 5% of total costs) escalated by more than 50%. As a result, the overall return declined below the partners expected 35% ROI. Erobo did not inform the Limited Partners about the increased costs. Did Erobo *most likely* violate the CFA Code of Ethics and Standards of Professional Conduct?

A No.

B Yes, because returns are lower than expected by the Partners.

C Yes, because he did not disclose the increased costs to his Partners.

10 Danielle Deschutes, CFA, is a portfolio manager who is part of a 10-person team that manages equity portfolios for institutional clients. A competing firm, South West Managers, asks Deschutes to interview for a position within its firm and to bring her performance history to the interview. Deschutes receives written permission from her current employer to bring the performance history of the stock portfolio with her. At the interview, she discloses that the performance numbers represent the work of her team and describes the role of each member. To bolster her credibility, Deschutes also provides the names of institutional clients and related assets constituting the portfolio. During her interview Deschutes *most likely* violated the CFA Institute Standards of Professional Conduct with regards to:

A the stock portfolio's performance history.

B her contribution to the portfolio's returns.

C providing details of the institutional clients.

11 Sheila Schleif, CFA, is an equity analyst at an investment banking division of Mokara Financial Group, a full service financial group. Schleif uses a multifactor computer model to make stock recommendations for all clients of Mokara. Schleif discovers that the model contains an error. If the error were corrected, her most recent buy recommendation communicated to all clients would change to a sell. Schleif corrects the error, changing the buy to a sell recommendation, and then simultaneously distributes via e-mail the revision to all investment banking clients who received the initial recommendation. A week later, Schleif sells the same shares she held in her personal portfolio. Concerning her actions, Schleif *most likely* violated which of the following CFA Institute Standards of Professional Conduct?

A Fair Dealing

B Priority of Transactions

C Diligence and Reasonable Basis

12 Heidi Katz is a CFA candidate and an analyst at a pension consulting firm. Her father is a major shareholder and managing director at Saturn Partners, a large hedge fund. When assisting in an alternative manager search for a pension client, Katz plans to recommend Saturn's market-neutral strategy because she feels it meets all of the pension plan's criteria. Given this situation, the best course of action for Katz is to:

A not present this strategy to the client and recommend another strategy.

B disclose the potential conflict to the pension client when discussing this recommendation.

C disclose the potential conflict to her employer and follow their guidance regarding disclosure of her relationship to the client.

13 Ileana Inkster, CFA, was recently offered a senior management position within the trust department at a regional bank. The department is new, but the bank has plans to expand it significantly over the next few months. Inkster has been told she will be expected to help grow the client base of the trust department. She is informed that the trust department plans to conduct educational seminars and pursue the attendees as new clients. Inkster notices that recent seminar advertisements prepared by the bank's marketing department do not mention that investment products will be for sale at the seminar. The ads indicate attendees can "learn how to immediately add $100,000 to their net worth." What should Inkster *most likely* do to avoid violating any CFA Institute Standards of Professional Conduct?

A Decline to accept the new position

B Accept the position and revise the marketing material

C Accept the position and inform senior management of inadequate compliance procedures

14 Suni Kioshi, CFA, is an analyst at Pacific Asset Management, where she covers small capitalization companies. On her own time, Kioshi often speculates in low price thinly traded stocks for her own account. Over the last three months, Kioshi has purchased 50,000 shares of Basic Biofuels Company giving her a 5% ownership stake. A week after this purchase, Kioshi is asked to write a report on stocks in the biofuels industry with a request to complete the report within two days. Kioshi wants to rate Basic as a "buy" in this report but is uncertain how to proceed. Concerning the research report, what action should Kioshi *most likely* take to prevent violating any of the CFA Institute Code of Ethics and Standards of Professional Conduct?

A Sell her shares.

B Don't recommend a buy.

C Disclose her stock ownership.

15 Wang Dazong, CFA, is a sole proprietor investment advisor. Dazong believes in putting his money at risk along with his clients and trades the same securities as his clients. In order to ensure fair treatment of all accounts, he rotates trade allocations so that each account has an equal likelihood of receiving a fill on their orders. This allocation procedure also applies to Dazong's own account. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the allocation procedure used by Dazong:

A complies with the Standards.

B requires revision to ensure client trades take precedence.

C should be disclosed and written approval received from clients.

16 Benefits of compliance with the CFA Institute Global Investment Performance Standards (GIPS) *least likely* include:

A strengthening of internal controls.

B participation in competitive bidding.

C elimination of in-depth due diligence for investors.

Firms claiming GIPS compliance must make every reasonable effort to provide a compliant presentation to which of the following?

A Existing clients

B Prospective clients

C Both existing and prospective clients

A research analyst is facing a moral dilemma and decides to use an ethical decision-making framework. After looking at the facts at hand and identifying the situational influences, he still cannot make a decision on the best course of action. His *least* appropriate next step is to:

A determine what additional information is needed.

B decide, act, monitor, and reflect.

C ask someone else to give guidance.

How does ethical conduct *most likely* compare with what is legally required?

A Ethical conduct goes beyond what is legally required.

B There are no differences between the two; they are the same.

C Doing what is legally required removes the need for ethical conduct.

The goals of the CFA Institute Code of Ethics would *least likely* include:

A publicly communicating established principles.
B addressing past ethical failings.
C fostering public confidence.

21 A nonparametric test is *most* appropriate when:
A comparing differences between means.
B data are given in ranks.
C data meet distributional assumptions.

22 The bank discount yield of a $100,000 US Treasury bill with 90 days until maturity is 4.60%. The selling price of this bill is *closest* to:
A $98,863.
B $98,866.
C $98,850.

23 When considering two mutually exclusive capital budgeting projects with conflicting rankings—one has a higher positive net present value (NPV), the other has a higher internal rate of return (IRR)—the *most* appropriate conclusion is to choose the project with the:
A higher NPV.
B higher IRR.
C shorter payback.

24 A Type I error is *best* described as the probability of:
A failing to reject a false null hypothesis.
B rejecting a true alternative hypothesis.
C rejecting a true null hypothesis.

25 The joint probability of returns for securities A and B are as follows:

Joint Probability Function of Security A and Security B Returns (Entries Are Joint Probabilities)

	Return on Security B = 30%	Return on Security B = 20%
Return on Security A = 25%	0.60	0
Return on Security A = 20%	0	0.40

The covariance of the returns between Securities A and B is *closest* to:
A 12.
B 14.
C 13.

26 The number of permutations that are possible when choosing 4 objects from a total of 10 objects is *closest* to:
A 30.
B 210.
C 5,040.

27 An increase in which of the following items will *most likely* result in a wider confidence interval for the population mean?
A Reliability factor

B Sample size

C Degrees of freedom

28 The following ten observations are a sample drawn from an approximately normal population:

Observation	1	2	3	4	5	6	7	8	9	10
Value	−31	−14	3	−18	34	20	−6	9	7	−16

The sample standard deviation is *closest* to:

A 17.56.

B 19.59.

C 18.58.

29 Based on historical returns, a portfolio has a Sharpe ratio of 2.0. If the mean return to the portfolio is 20%, and the mean return to a risk-free asset is 4%, the standard deviation of return on the portfolio is *closest* to:

A 12%.

B 8%.

C 10%.

30 Which of the following *most* accurately describes a distribution that is more peaked than normal?

A Leptokurtic

B Mesokurtic

C Platykurtic

31 A stock is declining in price and reaches a price range wherein buying activity is sufficient to stop the decline. This range is *best* described as the:

A change in polarity point.

B resistance level.

C support level.

The stated annual interest rate is 12.75%. If the frequency of compounding is monthly, the effective annual rate (EAR) is *closest* to:

A 13.52%.

B 12.75%.

C 12.06%.

Stagflation is *best* described as an economic situation involving high inflation and high:

A economic growth.

B aggregate supply.

C unemployment.

Assume that the nominal spot exchange rate (USD/EUR) increases by 7.5%, the eurozone price level decreases by 4%, and the US price level increases by 2.5%. The change in the real exchange rate (%) is *closest* to:

A 0.7%.

B −6.3%.

C 14.8%.

Which of the following statements is *most* accurate based on the FX quotations in the table?

	Spot Rate	One-Year Forward Rate
USD/EUR	1.2952	1.3001

A The forward rate is trading at a discount to the spot rate by 0.0049 points.

B The euro is trading at a forward premium of 49 points.

C The US dollar is trading at a forward premium of 49 points.

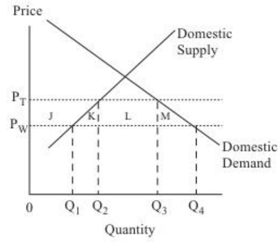
36 In order to reduce a trade deficit, the government of a country experiencing full employment moves to depreciate its currency. As a result, if the country's domestic spending declines relative to income, the *most likely* mechanism that causes this to occur is the:

A income effect.

B wealth effect.

C substitution effect.

37 The diagram below shows the domestic demand and supply curves for a country that imports a commodity, where P_W is its world price and P_T is its domestic price after the imposition of a tariff.



The gain in government revenues arising from the imposition of the tariff is *best* described by area(s):

A L.

B J.

C K + M.

38 An Australian firm purchases a patent for USD20,000 and machinery for USD21,500 from a US firm when the exchange rates are as follows:

	Exchange Rate
USD/EUR	1.29
AUD/EUR	1.24

The impact of these transactions on the capital account of Australia is *closest* to:

A AUD19,225.

B AUD39,891.

C AUD20,667.

39 In theory, money neutrality holds in the long run if:

A the money supply is positively related to the velocity of circulation of money.

B increases in the money supply do not influence output and employment.

C price levels are unaffected by changes in the money supply.

40 If a government increases its spending on domestically produced goods by an amount that is financed by an equivalent increase in taxes, the aggregate demand will *most likely*:

A increase.

B decrease.

C remain unchanged.

41 The elasticity of demand for a good is *most likely* greater when:

A a lesser proportion of income is spent on the good.

B the good is a necessity.

C the adjustment to a price change takes a longer time.

42 Holding the working-age population constant, if the labor force participation ratio declines while the number of people employed remains unchanged, the unemployment rate will *most likely*:

A increase.

B remain unchanged.

C decrease.

43 The statement that is *most* consistent with real business cycle (RBC) models is that:

A persons are unemployed because their asking wages are too high.

B governments should intervene when the economy is in contraction.

C monetary variables have a major impact on GDP growth.

44 A decrease in average weekly initial claims for unemployment is *most likely* indicative of:

A an economic recovery beginning.

B the business cycle reaching its peak.

C an economic downturn beginning.

45 An analyst has calculated the following ratios for a company:

Operating profit margin	17.5%
Net profit margin	11.7%
Total asset turnover	0.89 times
Return on assets (ROA)	10.4%
Financial leverage	1.46
Debt to equity	0.46

The company's return on equity (ROE) is *closest* to:

A 22.7%.

B 4.8%.

C 15.2%.

The following financial data are available for a company:

Return on assets (ROA)	4.8%
Total asset turnover	1.92
Financial leverage	1.75
Dividend payout ratio	48.1%

The company's sustainable growth rate is *closest* to:

A 4.40%.

B 4.78%.

C 4.00%.

47 Which of the following ratios will *most likely* result in an increase in a company's sustainable growth rate?

A Higher dividend payout

B Higher tax burden

C Lower interest burden

48 The following information is given about a company:

(€ millions)	2013	2012
Short-term borrowings	2,240	5,400
Current portion of long-term interest-bearing debt	2,000	1,200
Long-term interest-bearing debt	12,000	9,000
Total shareholders' equity	23,250	21,175
Earnings before interest and taxes (EBIT)	3,850	3,800
Interest payments	855	837
Operating lease payments	800	800

What is the most appropriate conclusion an analyst can make about the solvency of the company? Solvency has:

A improved because the debt-to-equity ratio decreased.

B improved because the fixed charge coverage ratio increased.

C deteriorated because the debt-to-equity ratio increased.

49 Private contracts, such as bank loan agreements, are *most likely* to provide an effective disciplinary mechanism to insure high financial reporting quality because:

A loan covenants require the firm to meet specific financial ratios in order to renew the loan.

B lenders monitor managers and pay close attention to the firm's financial reports.

C loan covenants may allow the lender to recover all or part of their investment if certain financial conditions are triggered.

50 The International Financial Reporting Standards (IFRS) Conceptual Framework identifies fundamental qualitative characteristics that make financial information useful. Which of the following is *least likely* to be one of these characteristics?

A Faithful representation

B Relevance

C Materiality

51 Which of the following is *least likely* to be an acceptable approach for accounting standard setting bodies to use when developing accounting standards?

A Revenue/expense-based

B Objectives-oriented

C Rules-based

52 An analyst has observed that the profit margins of a company have not increased or decreased significantly in the last few years. Which of the following is the *most* appropriate inference that can be made as to how this observation affects the company's credit risk? The company's credit risk is:

A unaffected.

B lower than otherwise.

C higher than otherwise.

53 If a company has a deferred tax asset reported on its statement of financial position and the tax authorities reduce the tax rate, which of the following statements is *most* accurate concerning the effect of the change? The existing deferred tax asset will:

A not be affected.

B increase in value.

C decrease in value.

54 An analyst gathers the following information about a company:

LIFO reserve as of 31 December 2013	$420,000
LIFO reserve as of 31 December 2014	$450,000
Marginal tax rate	30%

If the company had used the first-in, first-out (FIFO) method instead of last-in, first-out (LIFO), its 2014 net income would *most likely* have been:

A $9,000 higher.

B $21,000 higher.

C $30,000 lower.

55 Greene Corporation uses the last-in, first-out (LIFO) inventory method, but most of the other companies in Greene's industry use first-in, first-out (FIFO). To *best* compare Greene's financial statements with its competitors', an analyst would make which of the following adjustments to Greene's ending inventory? It should be:

A increased by the LIFO reserve.

B decreased by the LIFO reserve.

C increased by the change in the LIFO reserve for that period.

The following information is available for a company that prepares its financial statements in accordance with US GAAP:

- It has production facilities with a net book value of $28.4 million.
- Recently, several other companies have entered the market, and the company now estimates that it will be able to generate cash flows of only $3 million per year for the next seven years with its facilities.
- The firm has a cost of capital of 10%.

Reflecting these recent events related to its production facilities, the company's financial statements will *most likely* report (in millions) a:

A $13.8 impairment loss on the income statement.

B $7.4 reduction in the balance sheet carrying amount.

C $13.8 reduction in operating cash flows.

The following table represents selected financial statement data for a company given three different scenarios:

Year	0	1	2	3
Scenario I				
Retained Earnings	0	8,500	18,100	27,975
Common Stock	150,000	150,000	150,000	150,000

(continued)

Year	0	1	2	3
Total Shareholders' Equity	150,000	158,500	168,100	177,975
ROE (%)		5.5	5.9	
Scenario II				
Retained Earnings	0	8,142	17,359	27,975
Common Stock	150,000	150,000	150,000	150,000
Total Shareholders' Equity	150,000	158,142	167,359	177,975
ROE (%)		5.3	5.7	
Scenario III				
Retained Earnings	0	9,325	18,650	27,975
Common Stock	150,000	150,000	150,000	150,000
Total Shareholders' Equity	150,000	159,325	168,650	177,975
ROE (%)		6	5.7	

Assume the company did not have other comprehensive income, did not pay dividends, and experienced no capital contributions from shareholders.

Using the data provided in the table to calculate ROE in Year 3, in which scenario is the company *most likely* a lessee in a finance lease?

- **A** Scenario I
- **B** Scenario II
- **C** Scenario III

58 An advantage to the lessee in a leasing agreement is most likely:

- **A** economies of scale in servicing assets.
- **B** tax benefits associated with interest expense.
- **C** lower financing costs than purchasing the asset.

59 If a company purchases, at a premium, bonds that it expects to hold until maturity, they are *most likely* measured on the balance sheet at:

- **A** historical cost.
- **B** amortized cost.
- **C** fair value.

60 An increase in which of the following items would *most likely* result in an increase in a company's quick ratio, all else being held equal?

- **A** Current liabilities
- **B** Receivables
- **C** Inventory

61 Which of the following is the *most likely* reason for an analyst to choose the direct method rather than the indirect method for analyzing a firm's operating cash flows?

- **A** To understand the relationship between net income and operating cash flows
- **B** To identify operating cash flows by source and by use
- **C** To avoid making adjustments for non-cash items

62 A company incurred the following unrealized holding gains in the current year:

- $100,000 on securities held for trading
- $500,000 on the foreign currency translation adjustment of a self-sustaining non-domestic subsidiary

Other comprehensive income for the year is *closest* to:

A $600,000.

B $100,000.

C $500,000.

63 A company has a fixed $1,100 capital budget and has the opportunity to invest in the four independent projects listed in the table:

Project	Investment Outlay	NPV
1	$600	$100
2	$500	$100
3	$300	$50
4	$200	$50

The combination of projects that provides the *best* choice is:

A 2, 3, and 4.

B 1, 3, and 4.

C 1 and 2.

64 A project has a cost of €16,253 with a net present value (NPV) of €423.11. The corresponding profitability index (PI) is *most likely*:

A 1.42.

B 0.03.

C 1.03.

65 Which of the following statements is the *most* accurate description concerning the internal rate of return (IRR) method? IRR:

A is the preferred method for evaluating mutually exclusive projects.

B assumes that all cash flows from a project will be reinvested at the computed IRR.

C is sensitive to changes in the firm's weighted average cost of capital.

Recent trends in corporate governance *most likely* include:

A focusing on the corporate governance system's responsibility to maximize shareholder value.

B expanding the scope to consider the interests of employees, customers, and suppliers.

C increasing the diversity of corporate governance systems tailored to specific jurisdictions.

The *primary* motivation of activist shareholders is to promote:

A improved shareholder value.

B environmentally sustainable business practices.

C consideration of human rights in employee relations.

A firm's before-tax costs of debt, preferred stock, and equity are 12%, 17%, and 20%, respectively. Assuming equal funding from each source and a marginal tax rate of 40%, the weighted average cost of capital (%) is *closest* to:

A 14.7%.

B 9.8%.

C 13.9%.

69 A company issues new 20-year $1,000 bonds with a coupon rate of 6.2% payable semiannually at an issue price of $1,030.34. Assuming a tax rate of 28%, the firm's annual after-tax cost of debt (%) is *closest* to:

A 5.94.

B 4.28.

C 4.46.

70 Using the debt-rating approach to find the cost of debt is *most* appropriate when market prices for a company's debt are:

A below par value.

B unreliable.

C stable.

71 A company's asset beta is 1.2 based on a debt-to-equity ratio (D/E) of 50%. If the company's tax rate increases, the associated equity beta will *most likely*:

A increase.

B decrease.

C remain unchanged.

72 The following information is available for a company:

- Bonds are priced at par and have an annual coupon rate of 9.2%.
- Preferred stock is priced at $8.18 and pays an annual dividend of $1.35.
- Common equity has a beta of 1.3.
- The risk-free rate is 4% and the market premium is 11%.
- Capital structure: Debt = 30%; Preferred stock = 15%; Common equity = 55%.
- The tax rate is 35%.

The weighted average cost of capital (WACC) for the company is *closest* to:

A 11.5%.

B 14.3%.

C 13.4%.

73 The unit contribution margin for a product is $20. A firm's fixed costs of production up to 300,000 units is $500,000. The degree of operating leverage (DOL) is *most likely* the lowest at which of the following production levels (in units):

A 300,000.

B 200,000.

C 100,000.

74 A company manages its treasury function to exactly maintain its minimum daily cash balance requirement. The following events occurred for the company on the same day:

	$ millions
Funds transfer to subsidiaries	200
Maturing investments	150
Issues a stock dividend	25

	$ millions
Debt repayments	100
Minimum daily cash balance	50

Which of the following *best* describes the activities required of the Treasurer's office this day? They would need to increase borrowing by:

A $175 million.

B $100 million.

C $150 million.

75 The strategic asset allocation and portfolio rebalancing policy are *most likely* addressed in which section of an investment policy statement?

A Appendices

B Investment objectives

C Procedures

76 Which of the following is *least likely* a part of the execution step of the portfolio management process?

A Security analysis

B Portfolio construction

C Performance measurement

77 The return measure that *best* allows one to compare asset returns earned over different length time periods is the:

A holding period return.

B annualized return.

C net portfolio return.

78 When considering a portfolio that is optimal for one investor, a second investor with a higher risk aversion would *most likely*:

A expect a higher variance for the portfolio.

B derive a lower utility from the portfolio.

C have a lower return expectation for the portfolio.

The point of tangency between the capital allocation line (CAL) and the efficient frontier of risky assets *most likely* identifies the:

A optimal risky portfolio.

B optimal investor portfolio.

C global minimum-variance portfolio.

The slope of the security market line is *best* derived from the:

A risk-free rate of return.

B beta of the security.

C market risk premium.

Last year, a portfolio manager earned a return of 12%. The portfolio's beta was 1.5. For the same period, the market return was 7.5%, and the average risk-free rate was 2.7%. Jensen's alpha for this portfolio is *closest* to:

A 4.50%.

B 2.10%.

C 0.75%.

82 Which of the following transactions is *most likely* to affect a company's financial leverage ratio?

A Payment of a 9% stock dividend

B An increase in cash dividends paid

C Completion of a previously announced 1-for-20 reverse stock split

83 The Gordon growth model is *most* appropriate for valuing the common stock of a dividend paying company that is:

A mature and relatively insensitive to economic fluctuations.

B young and just entering the growth phase.

C experiencing growth that is higher than the sustainable growth rate.

84 A group of analysts estimate a security's mean expected value to be \$98.00 with a standard deviation of \$0.55. Using a confidence interval of plus or minus two standard deviations and given the security is trading at \$97.50, the security appears to be:

A undervalued.

B fairy valued.

C overvalued.

85 A company has initiated the process of selling unproductive land, representing 5% of its total assets, and using the proceeds to buy back its common shares. Holding other factors constant, these actions by the company will *most likely* result in a:

A lower sustainable growth.

B higher return on equity.

C higher operating margin.

86 An industry experiencing slow growth, high prices, and volumes insufficient to achieve economies of scale is *most likely* in the:

A shakeout stage.

B embryonic stage.

C mature stage.

87 Which of the following is *most likely* classified as a defensive industry?

A A mature industry with government-controlled pricing

B A non-cyclical, high-growth industry

C A cyclical industry with a few competitors

88 If a test rejects the hypothesis that market prices reflect private information but does not reject the hypothesis that they reflect past market data and public information, then the form of market efficiency is *best* described as:

A weak.

B strong.

C semi-strong.

89 A behavioral bias in which an investor assesses probabilities of outcomes depending on how similar they are to the current state is called:

A conservatism.

B representativeness.

C narrow framing.

90 Which of the following is most likely a characteristic of real assets?

A Substantial management costs

B High liquidity

C Homogeneity

91 A Japanese exporter will sell US dollars for Japanese yen in the quote-driven currency markets. Which of the following statements *best* describes her currency exchange transactions?

A Her counterparties are dealers.

B She will pay commissions for exchange services.

C This currency exchange transaction takes place in organized exchanges.

92 A company's market information and balance sheet data at the end of fiscal year 2012 are as follows:

Price per Share and Shares Outstanding	
Current market price per share	$15.0
Number of shares outstanding (millions)	1.0

Balance Sheet Data As of 2012 ($ millions)			
Cash and cash equivalents	0.4	Current liabilities	1.0
Accounts receivable	1.2	Long-term liabilities	61.0
Inventories	40.0		
Investment securities	6.0	Common shareholders' equity	15.6
Property, plant, and equipment	30.0		
Total assets	**77.6**	**Total liabilities and equity**	**77.6**

If an analyst estimates that the market value of the company's investment securities is 115% of their reported value, the company's ratio of price to adjusted book value is *closest* to:

A 0.91.

B 0.96.

C 1.10.

A market index contains the following two securities:

tock	**Shares in Index**	**Start-of-Period Price ($)**	**End-of-Period Price ($)**	**Dividend per Share ($)**
	600	40	37	2.00
	500	50	52	1.50

The total return on an equal-weighted basis is *closest* to:

A –1.75%.

B 2.78%.

C 2.25%.

A trader buys a stock at $30 and wants to limit downside risk. Which of the following orders will *most likely* guarantee that he can sell the stock at $25? (GTC means good till cancelled)

A Put option buy market order with a strike price of $25

B GTC, stop $25, limit $25 sell order

C GTC, stop $25, market sell order

95 A "junk" bond is *most likely* a:

A supranational bond.

B high-yield bond.

C bond with credit rating above BBB–.

96 A company issues a 10-year bond on 1 January 2014. Its contract requires that the coupon rate increase by specified margins at specified dates as shown in the following table:

Coupon Payment Date Range	Coupon Rate
1 Jan 2014–31 Dec 2015	4.0%
1 Jan 2016–31 Dec 2017	5.0%
1 Jan 2018–31 Dec 2019	7.5%
1 Jan 2020–31 Dec 2023	9.0%

This security is *most likely* a:

A step-up coupon bond.

B deferred coupon bond.

C floating rate bond.

97 The Zera Company has borrowed capital by issuing a number of different securities. Which of the following *most likely* ranks the highest with respect to priority of payments?

A Subordinate loan

B Third lien debt

C Senior unsecured bond

98 In assigning credit ratings, the practice of notching by the rating agencies is *least likely* used to quantify the:

A probability of default.

B priority of payment in the event of default.

C potential severity of loss in the event of default.

99 An investor who owns a mortgage pass-through security is exposed to contraction risk, which is the risk that when interest rates:

A decline, the security will effectively have a longer maturity than was anticipated at the time of purchase.

B decline, the security will effectively have a shorter maturity than was anticipated at the time of purchase.

C rise, the security will effectively have a shorter maturity than was anticipated at the time of purchase.

100 How much will the value of a three-year $100 par value coupon bond with annual payments, a coupon rate of 9%, and a discount rate of 7% *most likely* change if market interest rates immediately increase by 1%?

A –2.68

B –3.47

C –2.40

101 A two-year spot rate of 5% is *most likely* the:

A yield to maturity on a zero-coupon bond maturing at the end of Year 2.

B coupon rate in Year 2 on a coupon-paying bond maturing at the end of Year 4.

C yield to maturity on a coupon-paying bond maturing at the end of Year 2.

102 In using matrix pricing to estimate the required yield spread on a new corporate bond issue, the benchmark rate used is *most likely* to be the:

A coupon rate on a government bond with a similar time to maturity.

B yield to maturity on a corporate bond with similar credit risk and time to maturity.

C yield to maturity on a government bond with a similar time to maturity.

103 Consider a $100 par value bond with an 8% coupon paid annually, maturing in 20 years. If the bond currently sells for $96.47, the yield to maturity is *closest* to:

A 8.37%.

B 8.29%.

C 7.41%.

104 Which of the following statements is *most likely* correct regarding the spot and forward curves. The spot curve:

A can be calculated from the forward curve, and the forward curve can be calculated from the spot curve.

B can be calculated from the forward curve, but the forward curve cannot be calculated from the spot curve.

C cannot be calculated from the forward curve, but the forward curve can be calculated from the spot curve.

105 An investor purchases an option-free bond paying an annual coupon rate of 10% and maturing in 10 years at its par value of $100. The investor sells the bond after seven years, receiving a total of seven coupons over this period. Assume that the coupons are reinvested at an annual interest rate of 8% over the investor's holding period. The future value of the reinvested coupon payments at the end of the investor's holding period is *closest* to:

A 70.00.

B 75.90.

C 89.23.

Which of the following statements is *least* accurate regarding the factors that affect the interest rate risk characteristics of an option-free bond?

A The lower the coupon rate, the greater the bond's price sensitivity to changes in interest rates.

B The higher the yield, the greater the bond's price sensitivity to changes in interest rates.

C The longer the bond's maturity, the greater the bond's price sensitivity to changes in interest rates.

Which of the following events will *most likely* increase the short-term bond yield volatility?

A Slow economic growth expectation

B Central bank engaging in expansionary monetary policy

C High inflation expectation

Valuation of a swap during its life will *least likely* involve the:

A application of the principle of no arbitrage.

B use of replication.

C investor's risk aversion.

109 If a forward contract requires no cash outlay at initiation, it is *most likely* true that at initiation:

A value exceeds price.

B price exceeds value.

C price is equal to value.

110 A forward rate agreement *most likely* differs from most other forward contracts because:

A positions cannot be closed out prior to maturity.

B it involves an option component.

C its underlying is not an asset.

111 The pricing of forwards and futures will *most likely* differ if:

A interest rates exhibit zero volatility.

B futures prices and interest rates are negatively correlated.

C futures prices and interest rates are uncorrelated.

112 The price of an interest rate swap that involves the exchange of a fixed payment for a floating payment is *most likely*:

A equal to its value at expiration.

B set at initiation and constant over time.

C affected by changes in the floating payment.

113 Using put–call parity, a long call can *best* be replicated by going:

A long the put, short the asset, and long the bond.

B short the put, long the asset, and short the bond.

C long the put, long the asset, and short the bond.

114 For a call option, if the underlying asset's value is less than the option's exercise price, the option is said to be:

A at the money.

B out of the money.

C in the money.

115 A *least likely* reason for investors to include commodity derivatives in their investment portfolios is:

A commodity-related stocks' positive correlation with the overall equity market.

B it eliminates the need to understand the physical supply chain and general supply–demand dynamics of a commodity.

C the tendency for commodity prices to be positively correlated with inflation.

116 Hedge funds are *least likely* to have restrictions concerning:

A the withdrawal of invested funds.

B the use of derivatives.

C the number of investors in the fund.

117 Which of the following is *most likely* a private equity strategy?

A Merger arbitrage

B Venture capital

C Quantitative directional

118 Which of the following characteristics of a target company is *likely* the *least* attractive for a leveraged buyout?

A Substantial amount of physical assets

B Strong and sustainable cash flow

C High leverage

119 If the price of a commodity futures contract is below the spot price, it is *most likely* that the:

A cost of carry exceeds the convenience yield.

B roll yield is negative.

C convenience yield exceeds storage costs.

120 Investors will *most likely* have difficulty managing diversification across hedge funds if the funds:

A make decisions via investment committees.

B fail to appoint chief risk officers.

C seek to keep their strategies private.