

2019 Level I Mock Exam (C) 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
1–19	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
Total:		180

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2019 LEVEL I MOCK EXAM (C) AM

- 1 Which of the following statements is *most likely* consistent with the CFA Institute Code of Ethics? CFA Institute members and CFA candidates must:
 - A promote the integrity of and uphold the rules governing capital markets.
 - B practice the highest level of personal and professional integrity and always act in the best interest of their employers.
 - C maintain their professional competence and require investment professionals under their supervision to adopt the CFA Code of Ethics.
- 2 Tibor Figeczky, CFA, is an equity trader at Global Investment Bank (GB). Figeczky traded the bank's investment portfolio profitably for the past three years and earned significant bonuses for his efforts. Subsequently, internal auditors of GB formally accused Figeczky of exceeding his trading authority and engaging in unauthorized trades. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, Figeczky should *most likely*:
 - A disclose the complaint to CFA Institute.
 - B refuse further bonuses until the issue is resolved.
 - C request a temporary suspension of his CFA Institute membership.
- 3 Amanda Covington, CFA, works for McJan Investment Management. McJan employees must receive prior clearance of their personal investments in accordance with McJan's compliance procedures. To obtain prior clearance, McJan employees must provide a written request identifying the security, the quantity of the security to be purchased, and the name of the broker through which the transaction will be made. Pre-cleared transactions are approved only for that trading day. As indicated below, Covington received prior clearance.

Security	Quantity	Broker	Prior Clearance
A	100	Easy Trade	Yes
B	150	Easy Trade	Yes

- Two days after she received prior clearance, the price of Stock B had decreased, so Covington decided to purchase 250 shares of Stock B only. In her decision to purchase 250 shares of Stock B only, did Covington violate any CFA Institute Standards of Professional Conduct?
- A No.
 - B Yes, relating to diligence and reasonable basis.
 - C Yes, relating to her employer's compliance procedures.
- 4 Kazuya Kato, CFA, is a widely followed economist at a global investment bank. When Kato opines on economic trends, markets react by moving stock valuations considerably. When Kato receives information of a temporary oversupply of rare earth metals, he issues a forecast that price trends for rare earth metals will be down significantly on a long-term basis. Kato also secretly sells his report to a widely followed Internet site. Prior to issuing this forecast, Kato emailed all portfolio managers at his bank with a copy of his report indicating that his opinion would be reversed shortly so there will be trading opportunities. Kato *most likely* violated which of the following CFA Institute Code of Ethics and Standards of Professional Conduct?
 - A Market Manipulation.
 - B Priority of Transactions.

C Additional Compensation Arrangements.

- 5 Mailaka Securities (MS) advertises the use of a “bottom up” investment style in its marketing material. Recently, MS senior management decided to switch to a “top down” approach, citing the fact that it is less labor intensive. All other aspects of the research process are to remain the same. The head of research at MS, Mara Cherogony, CFA, is instructed to supervise the implementation of the new procedures, notify clients of the changes, and revise the text of marketing materials when new material is produced. Which of the following CFA Standards pertaining to Investment Analysis, Recommendations, and Actions is Cherogony *least likely* in danger of violating?

- A Supervisory Responsibility
- B Communication with Clients
- C Diligence and Reasonable Basis

- 6 While at a bar in the financial district after work, Ellen Miffitt, CFA, overhears several employees of a competitor discuss how they will manipulate down the price of a thinly traded micro cap stock's price over the next few days. Miffitt's clients have large positions of this stock so when she arrives at work the next day she immediately sells all of these holdings. Because she had determined the micro cap stock was suitable for all of her accounts at its previously higher price, Miffitt buys back her client's original exposure at the end of the week at the new, lower price. Which CFA Institute Standards of Professional Conduct did Miffitt *least likely* violate?

- A Market Manipulation
- B Preservation of Confidentiality
- C Material Nonpublic Information

- 7 Sergio Morales, CFA, believes he has found evidence that his supervisor is engaged in fraudulent activity involving a client's account. When Morales confronts his supervisor, he is told the client is fully aware of the issue. Later that day, Morales contacts the client and upon disclosing the fraudulent activity, is told by the client to mind his own business. Following the requirements of local law, Morales provides all of his evidence, along with copies of the client's most recent account statements, to a government whistle blower program. Has Morales *most likely* violated the CFA Institute Standards of Professional Conduct?

- A No.
- B Yes, concerning Duties to Employers.
- C Yes, concerning Preservation of Confidentiality.

Leng Bo, CFA, is a bond portfolio manager for individual investors. Last year, a client whose portfolio is limited to investment-grade bonds approved Bo's purchase of a below investment grade bond. Because yields in the high grade fixed-income markets declined, Bo subsequently decides to enhance this client's portfolio by investing in several additional bonds with ratings one or two notches below investment grade. The investment strategy implemented by Bo *most likely* violated which of the following CFA Institute Standards of Professional Conduct?

- A Suitability
- B Communications with Clients
- C Independence and Objectivity

Stian Klun, CFA, is preparing a brochure to advertise his firm. The brochure includes the following disclosures:

"I am a CFA so I am a member of the CFA Institute, which constitutes the most elite group of professionals within the investment management business. In order to become a CFA charterholder, I had to complete a comprehensive program of study in the investment management field."

Klun is *least likely* to have violated the CFA Institute Standards of Professional Conduct related to referencing the:

- A CFA Institute.
 - B CFA Program.
 - C CFA Designation.
- 10 Alexandra Zagoreos, CFA, is the head of a government pension plan. Whenever Zagoreos hires a money management firm to work with the pension plan, she finalizes the deal over dinner at a nice restaurant. At these meals, Zagoreos also arranges for the money manager to provide her payments equal to 10% of the management fee the manager receives from the pension plan with no formal documentation of this agreement. Zagoreos keeps half of the payments for her own use and distributes the remainder as cash incentives to a handful of her most trusted staff. Zagoreos *least likely* violated which of the following CFA Institute Code of Ethics and Standards of Professional Conduct?
- A Referral fees.
 - B Loyalty, Prudence and Care.
 - C Additional Compensation Arrangements.
- 11 Florence Zuelekha, CFA, is an equity portfolio manager at Grid Equity Management (GEM), a firm specializing in commodities. Zuelekha, who previously focused on alternative energy, recently attends her first commodity conference, sponsored in large part by GEM. Independent industry experts argued that commodities would increase in value and recommended that investors hold at least 10% of their portfolio assets in commodities based on consistent increases in their values over the previous two years. Without doing any additional research, Zuelekha recommends to all her clients an immediate allocation of 5% of their portfolio into commodities. Over the next few weeks, Zuelekha moves her own portfolio to a 10% commodity allocation. Which of the CFA Standards did Zuelekha *most likely* violate?
- A Priority of Transactions.
 - B Independence and Objectivity.
 - C Diligence and a Reasonable Basis.
- 12 Charles Mbuwanga, a Level 3 CFA Candidate, is the Business Development Manager for Sokoza Investment Group, an investment management firm with high-net-worth retail clients throughout Africa. Sokoza introduced listed Kenyan Real Estate Investment Trusts (REITs) to its line of investment products based on new regulations introduced in Kenya so as to diversify its product offering to clients. The product introduction comes after months of researching Kenyan property correlations with other property markets and asset classes in Africa. Sokoza assigns Mbuwanga as part of the sales team in introducing this product to its clients across Africa. Mbuwanga subsequently determines that most of Sokoza's clients' portfolios would benefit from having a small Kenyan property exposure to help diversify their investment portfolios. By promoting the Kenyan REITS for Sokoza's client portfolios as planned, Mbuwanga would *least likely* violate which of the following Standards?
- A Suitability

- B Knowledge of the Law
- C Independence and Objectivity

13 When Abdullah Younis, CFA, was hired as a portfolio manager at an asset management firm two years ago and was told he could allocate his work hours as he saw fit. At that time, Younis served on the board of three nonpublic golf equipment companies and managed a pooled investment fund for several members of his immediate family. Younis was not compensated for his board service or for managing the pooled fund. Younis' investment returns attract interest from friends and co-workers who persuade him to include their assets in his investment pool. Younis recently retired from all board responsibilities and now spends more than 80% of his time managing the investment pool for which he charges non-family members a management fee. Younis has never told his employer about any of these activities. To comply with the CFA Institute Standards of Professional Conduct with regards to his business activities over the past two years, Younis would *least likely* be required to disclose which of the following to his employer?

- A Board activities
- B Family investment pool management
- C Non-family member management fees

14 Hezi Cohen, a CFA candidate, is a heavy user of social networking sites on the Internet. His favorite site only allows a limited number of characters for each entry so he has learned to abbreviate everything, including CFA trademarks. Cohen also enjoys professional networking sites and contributes regularly to blogs that discuss the broad topical areas covered within the CFA Program. In addition, he posts to these blogs pieces he has written in his area of expertise: retirement planning. By claiming to be an expert on retirement planning, he believes his stature within the investment community increases and he can gain more clients. Which internet activity can Cohen *most likely* continue to be in compliance with the CFA Standards of Professional Conduct?

- A Use of abbreviations.
- B Claiming retirement planning expertise.
- C Blogging about broad topical areas within the CFA Program.

Jacques Lagarde, CFA, is a sell-side analyst at Springhill Financial, a small investment bank. Springhill is the lead manager for the equity offering of Chorale Music. Lagarde is not part of the IPO team for this offering. While finalizing a research report on Chorale, Lagarde discovers inconsistencies that makes him believe the company may have concealed losses in its leasing division last quarter that would significantly reduce its earnings. Lagarde suspects that Springhill's investment banking team are aware of these unreported losses. The prospectus for Chorale's equity offering has already been approved by regulators and distributed to potential investors. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, Lagarde should *most likely*:

- A report the issue to his supervisor.
- B issue a report showing the leasing division losses.
- C issue the report using data as reported in the prospectus.

For firms to claim compliance with the GIPS standards they *most likely* must:

- A take responsibility for their claim of compliance and maintaining that compliance.
- B hire an independent third party to test a sample of their composites.

- C increase the consistency and quality of the firm's compliant presentations.
- 17 When claiming GIPS compliance, a firm will *least likely* have to apply all of the required provisions in the first five major sections of the GIPS standards when investing in:
- A separately managed accounts.
 - B equity mutual funds or unit trusts.
 - C commodity related portfolios.
- 18 Which of the following *best* outlines the minimally acceptable behaviors expected of a member belonging to a societal group?
- A Standards of conduct
 - B Code of ethics
 - C A firm's employee handbook
- 19 Most societies would *least likely* consider ethical principles to include:
- A justice.
 - B duplicity.
 - C diligence.
- 20 The following is an excerpt from the cumulative distribution function for the standard normal random variable table:

Cumulative Probabilities for a Standard Normal Distribution
 $P(Z \leq x) = N(x)$ for $x \geq 0$ or $P(Z \leq z) = N(z)$ for $z \geq 0$

x or z	0	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.10	0.5398	0.5438	0.5478	0.5517	0.5557	0.5596	0.5636	0.5675	0.5714	0.5753
0.20	0.5793	0.5832	0.5871	0.5910	0.5948	0.5987	0.6026	0.6064	0.6103	0.6141
0.30	0.6179	0.6217	0.6255	0.6293	0.6331	0.6368	0.6406	0.6443	0.6480	0.6517
0.40	0.6554	0.6591	0.6628	0.6664	0.6700	0.6736	0.6772	0.6808	0.6844	0.6879
...										
1.10	0.8643	0.8665	0.8686	0.8708	0.8729	0.8749	0.8770	0.8790	0.8810	0.883
1.20	0.8849	0.8869	0.8888	0.8907	0.8925	0.8944	0.8962	0.8980	0.8997	0.9015
1.30	0.9032	0.9049	0.9066	0.9082	0.9099	0.9115	0.9131	0.9147	0.9162	0.9177
1.40	0.9192	0.9207	0.9222	0.9236	0.9251	0.9265	0.9279	0.9292	0.9306	0.9319
...										
1.80	0.9641	0.9649	0.9656	0.9664	0.9671	0.9678	0.9686	0.9693	0.9699	0.9706
1.90	0.9713	0.9719	0.9726	0.9732	0.9738	0.9744	0.9750	0.9756	0.9761	0.9767
2.00	0.9772	0.9778	0.9783	0.9788	0.9793	0.9798	0.9803	0.9808	0.9812	0.9817
2.10	0.9821	0.9826	0.9830	0.9834	0.9838	0.9842	0.9846	0.9850	0.9854	0.9857

A variable is normally distributed with a mean of 2.00 and a variance of 16.00. Using the excerpt, the probability of observing a value of 7.40 or less is *closest* to:

- A 63.3%.
- B 91.2%.
- C 96.8%.

- 21 Which of the following *most* accurately describes how to standardize a random variable X ?
- A Subtract the mean of X from X , and then divide that result by the standard deviation of the standard normal distribution.
 - B Divide X by the difference between the standard deviation of X and the standard deviation of the standard normal distribution.
 - C Subtract the mean of X from X , and then divide that result by the standard deviation of X .

- 22 The time-weighted rate of return:
- A results in a lower return when compared with the money-weighted rate of return.
 - B is affected by the amount and timing of cash flows to and from a portfolio.
 - C calculates multi-period cash flows mirroring a portfolio's compound growth rate.

- 23 Given a discount rate of 10%, the net present value (NPV) of the following investment is *closest* to:

Time	0	1	2	3	4	5	6
Cash flow	-1,500	300	600	1,000	200	500	300

- A 605.
 - B 578.
 - C 636.
- 24 A parametric test is *most likely* preferred to a non-parametric test when:
- A the data are given in ratio or ordinal scale.
 - B defined sets of assumptions are given.
 - C the population is heavily skewed.
- 25 The conditional expected value of a random variable is *best* described as the:
- A expected value of a random variable given an event or scenario.
 - B probability-weighted average of the possible outcomes of the random variable.
 - C weighted average of the probabilities of an event given all possible scenarios.
- The variance of returns of Asset A is 625. The variance of returns of Asset B is 1,225. The covariance of returns between Asset A and Asset B is 600. The correlation of returns between Asset A and Asset B is *closest* to:
- A 0.29.
 - B 0.69.
 - C 0.47.

Survivorship bias is *most likely* an example of which bias?

- A Sample selection
- B Data mining
- C Look-ahead

A sample of 438 observations is randomly selected from a population. The mean of the sample is 382, and the standard deviation is 14. Based on Chebyshev's inequality, the endpoints of the interval that must contain at least 88.89% of the observations are *closest* to:

- A 340 and 424.

- B 396 and 480.
C 354 and 410.
- 29 Compared with the occurrence of fundamental developments related to a company, when do technical analysts believe that related security price movements are *most likely* to arise?
A After
B Before
C Simultaneously
- 30 If the stated annual interest rate is 9% and the frequency of compounding is daily, the effective annual rate (EAR) is *closest* to:
A 9.00%.
B 9.86%.
C 9.42%.
- 31 Using a discount rate of 5%, compounded monthly, the present value (PV) of \$5,000 to be received three years from today is *closest* to:
A \$4,319.
B \$4,305.
C \$4,250.
- 32 Assume the following:

Current spot rate for the USD/EUR	0.7500
Forward rate for the EUR/AUD	1.4300
EUR/AUD forward premium to the spot rate	400 points

USD: US dollar; EUR: Euro; AUD: Australian dollar

- The USD/AUD spot rate is *closest* to:
A 1.0296.
B 1.0425.
C 1.1154.
- 33 If the domestic currency is trading at a forward premium, then relative to the interest rate of the domestic country, the interest rate in the foreign country is *most likely*:
A lower.
B higher.
C the same.
- 34 In the classification of currency regimes, a currency board system (CBS) *most likely* differs from a fixed-rate parity system in that:
A a CBS can peg to a basket of currencies but a fixed-rate system cannot.
B the monetary authority within a CBS does not act as a traditional lender of last resort.
C a CBS has a discretionary target level of foreign exchange reserves.
- 35 During the last month, a food company located in the United States had the following transactions:

Transaction Amount	(US\$ millions)
Bought raw material from Indonesia	50.0
Sold food products to France	65.0
Received royalty fees from its branch in the United Kingdom	0.5
Donated to a charitable institution in Africa	0.1
Borrowed from a bank in Singapore	2.0
Paid legal fees to its German legal consultant company	1.2
Received interest coupon from its investment in Eurobonds issued in Luxembourg	0.8

These transactions will *most likely* increase the US current account by:

- A \$15.0 million.
 B \$14.5 million.
 C \$17.0 million.
- 36 The transmission of a central bank's policy rate action through the economy ultimately affects:
 A total demand.
 B inflation.
 C long-term interest rates.
- 37 If there is a policy rate of 3%, a real trend rate of growth in the underlying economy of 1%, and long-run expected inflation of 3%, then the central bank policy stance operating within a credible inflation-targeting regime is *best* described as:
 A neutral.
 B contractionary.
 C expansionary.
- 38 The two dominant supermarket chains in the area are attempting to increase their market share by moving to 24-hour service instead of closing at 9 p.m. every night. The strategic outcomes and payoff matrix that arise from their actions are depicted in the diagram (with the shaded sections representing pay-offs for Chain 2).

		Chain 2	
		Close at 9 p.m.	Open 24 hours
Chain 1	Close at 9 p.m.	<div style="display: flex; justify-content: space-between;"> 290 180 </div>	<div style="display: flex; justify-content: space-between;"> 592 55 </div>
	Open 24 hours	<div style="display: flex; justify-content: space-between;"> 75 540 </div>	<div style="display: flex; justify-content: space-between;"> 140 108 </div>

According to the Nash equilibrium, the *best* strategy is for:

- A both chains to open for 24 hours.
 B only Chain 2 to open for 24 hours.
 C both chains to close at 9 p.m.

- 39 First-degree price discrimination is *best* described as pricing that allows producers to increase their economic profit while consumer surplus:
- A is eliminated.
 - B increases.
 - C decreases.
- 40 Over a given period, the price of a commodity falls by 5.0%, and the quantity demanded rises by 7.5%. The price elasticity of demand for the commodity is *best* described as:
- A perfectly elastic.
 - B elastic.
 - C inelastic.
- 41 Assume economic activity is accelerating, inflation is increasing modestly, and unemployment is low. The economy is *most likely* in which phase of the business cycle?
- A Peak
 - B Early expansion
 - C Late expansion
- 42 Holding the working-age population constant, if the labor force participation rate declines while the number of people employed remains unchanged, the unemployment rate will *most likely*:
- A remain unchanged.
 - B increase.
 - C decrease.
- 43 The unemployment rate is *best* described as the ratio of unemployed to:
- A labor force.
 - B labor force minus frictionally unemployed.
 - C total population of people who are of working age.
- 44 A company's most recent balance sheet shows the following values (NZ\$ thousands):
- | | |
|-----------------------------|-------|
| Accounts payable | 3,800 |
| Long-term debt | 5,590 |
| Other long-term liabilities | 800 |
| Common stock | 1,200 |
| Retained earnings | 1,810 |
- The company's debt-to-capital ratio is *closest* to:
- A 0.77.
 - B 1.86.
 - C 0.65.
- 45 An analysis used to forecast earnings that shows the changes in key financial quantities that result from alternative sets of economic events *best* describes which of the following techniques?
- A Sensitivity analysis
 - B Simulation
 - C Scenario analysis

- 46 A company operating in a highly fragmented and competitive industry reported an increase in return on equity (ROE) over the prior year. Which of the following reasons for the increase in ROE is *least likely* to be sustainable? The company:
- A increased the prices of its product significantly.
 - B decided to make greater use of long-term borrowing capacity.
 - C implemented a new IT system, allowing it to reduce working capital levels as a percentage of assets.

- 47 The following data are available on a company:

Financial data (HK\$ millions)	Current Year	Prior Year
Revenue	18,980	18,250
Cost of sales	14,600	14,040
Ending inventory	2,150	1,850
Ending accounts receivable	2,900	3,300
Ending accounts payable	2,700	2,900
Ratios		
Number of days of payables		60
Days of sales outstanding (DSO)		70
Days of inventory on hand (DOH)		40

The *least likely* explanation for the improvement in the cash conversion cycle is that the firm improved on its:

- A ability to collect from customers.
 - B payments to suppliers.
 - C inventory management.
- 48 For a company reporting under IFRS, which of the following events *most likely* represents low financial reporting quality? The company:
- A included gains from foreign exchange rate changes in its cost of goods sold.
 - B entered a long-term lease for a customized piece of equipment and classified it as a finance lease.
 - C reported an increase in EPS as a result of the sale of a subsidiary.
- Which of the following is *most likely* a sign of inventory manipulation to improve reported financial results?
- A Inventory markdowns for obsolescence.
 - B Declining inventory turnover ratio.
 - C Selective sales of older layers of inventory.
- Which of the following reports is *least likely* to be filed with the US SEC?
- A Annual report
 - B Form 10-K
 - C Proxy statement
- Compared with the management discussion and analysis (MD&A), notes to the financial statements are the *most* appropriate source for:
- A a comprehensive description of all of the entity's accounting policy choices.
 - B information on capital expenditures and how they support the entity's strategic direction.

- C aspects of accounting policy choices most important to understanding the financial statements.
- 52 During the process data phase of financial statement analysis, an analyst will *most likely* develop a:
- A statement of purpose.
 - B common-size balance sheet.
 - C statement of cash flows.

- 53 The following information is available about a company:

(\$ thousands)	2013	2012
Deferred tax assets	200	160
Deferred tax liabilities	-450	-360
Net deferred tax liabilities	-250	-200
Earnings before taxes	4,000	3,800
Income taxes at the statutory rate	1,200	1,140
Income tax payable (Current income tax expense)	1,000	900

The company's 2013 income tax expense (in thousands) is *closest* to:

- A \$1,250.
 - B \$950.
 - C \$1,050.
- 54 Which of the following inventory valuation methods *best* matches the actual historical cost of the inventory items sold to their physical flow?
- A LIFO
 - B FIFO
 - C Specific identification

- 55 Selected financial information about a company is provided in the table:

(€ millions)	2014	2013
Sales	4,448	4,246
Inventories		
Raw materials	125	141
Work in process	230	240
Finished goods	410	296
Supplies and other	73	72
Valuation allowance	-133	-118
Total	705	631

Which of the following conclusions is *most* accurate based on the foregoing information?

- A The company faces a strong possibility of future write-downs.
 - B The price of supplies increased significantly.
 - C Management anticipates a strong increase in product demand.
- 56 The following excerpt was taken from the notes of a company's financial statements that were prepared in accordance with International Financial Reporting Standards. All figures are in thousands of Australian dollars.

Note 12 Broadcast Licenses

During 2014, the company successfully disposed of broadcast licenses that were held for sale for A\$37,900 (net book value of A\$23,500). Based on the successful completion of that sale, the impairment losses taken in 2012 on other licenses have been reversed, restoring those intangible assets to their amortized historical cost. Broadcast licenses are amortized over a period of 15–25 years.

The note leads an analyst to believe that the rapid reversal of the impairment loss related to the broadcast licenses arose as an attempt by management to manage earnings.

If the analyst's belief is correct, her analysis of the original 2013 financial statements would *most likely* have shown that, compared with the economic reality in 2013, the company had:

- A understated ROA.
 - B understated fixed asset turnover.
 - C overstated net profit margin.
- 57 Which of the following is *most likely* a reason that a lessor can offer attractive lease terms and lower cost financing to a lessee?
- A The lessor retains the tax benefits of ownership.
 - B The lessor avoids reporting the liability on its balance sheet.
 - C The lessee is better able to resell the asset at the end of the lease.
- 58 Liabilities of a company equal:
- A assets plus equity.
 - B equity minus assets.
 - C assets minus equity.
- 59 In the statement of cash flows, interest paid by a company is *most likely* included in:
- A either the operating or financing section under US GAAP.
 - B either the operating or financing section under IFRS.
 - C only the financing section under both IFRS and US GAAP.
- In applying the principles of expense recognition, companies should:
- A record any estimates of uncollectible amounts as a direct reduction of revenues.
 - B exclude costs of intangible assets with indefinite useful lives.
 - C recognize credit losses on customer receivables when defaults occur.

The following table summarizes income statement data for a manufacturing company:

	2020 (€ thousands)	2021 (€ thousands)
Net Revenue	2,325	2,611
Cost of Goods Sold	1,550	1,700
Gross Profit	775	930
Selling, General & Administrative Expense	260	295
Operating Income	515	635
Interest Expense	55	55
Pre-Tax Income	460	580
Income Tax	120	155
Net Income	340	425

Compared with 2020, the 2021 common-size income statement most likely indicates:

- A a lower tax rate.
 - B cost cutting in selling, general and administration.
 - C sale of a new, differentiated product.
- 62 A firm is considering a project that would require an initial investment of THB270 million (Thai baht). The project will help increase the firm's after-tax net cash flows by THB30 million per year in perpetuity, and it is found to have a negative NPV of THB20 million. The IRR (%) of the project is *closest* to:
- A 11.1%.
 - B 10.3%.
 - C 12.0%.

- 63 A project has the following annual cash flows:

Year 0	Year 1	Year 2	Year 3
-\$606,061	\$2,151,515	-\$2,542,424	\$1,000,000

Which discount rate *most likely* provides a positive net present value (NPV)?

- A. 15%
 - B 21%
 - C 18%
- 64 Which of the following is *most likely* associated with a strong corporate code of ethics? The code of ethics is:
- A updated at least every 10 years.
 - B signed by employees on a voluntary basis.
 - C developed and its implementation overseen by the governance committee.
- 65 A company's management team is proposing to sell a major division because of low future growth prospects in that industry. To which committee of the board is the proposal *most likely* to be presented?
- A Risk
 - B Audit
 - C Investment

- 66 A consultant sees the following information about a publicly listed company:

- The company has a 12-person board of directors.
- The board is chaired by the chief executive officer (CEO) of the company.
- All members of the audit committee are outside directors with relevant financial and accounting experience.

Which of the following changes would provide the *greatest* improvement in the corporate governance of this company?

- A The chairman of the board should be an independent director.
 - B The company's Vice President of Finance should be a member of the audit committee.
 - C The board of directors should have an odd number of directors to preclude tied votes.
- 67 Which of the following scenarios can *best* be described as offering superior protection of shareholder interests?
- A When common law is practiced

- B When CEO duality is common
 - C When stakeholder theory prevails
- 68 A firm with a marginal tax rate of 40% has a weighted average cost of capital of 7.11%. The before-tax cost of debt is 6%, and the cost of equity is 9%. The weight of equity in the firm's capital structure is *closest* to:
- A 79%.
 - B 65%.
 - C 37%.
- 69 Which method of calculating the firm's cost of equity is most likely to incorporate the long-run return relationship between the firm's stock and the market portfolio?
- A Capital asset pricing model
 - B Dividend discount model
 - C Bond yield plus risk premium approach
- 70 Which of the following is *least likely* to be a component of a developing country's equity premium?
- A Annualized standard deviation of the developing country's equity index
 - B Sovereign yield spread
 - C Annualized standard deviation of the sovereign bond market in terms of the developing country's currency
- 71 Financial risk is *least likely* affected by:
- A debentures.
 - B dividends.
 - C long-term leases.
- 72 Which of the following is *most likely* a secondary source of liquidity?
- A Bank line of credit
 - B Inventory liquidation
 - C Trade credit
- A 30-day \$10,000 US Treasury bill sells for \$9,932.40. The discount basis yield (DBY) is *closest* to:
- A 8.11%.
 - B 8.17%.
 - C 8.28%.
- A 35-year-old financial analyst expects to retire at the age of 65 and is interested in investing to fund her retirement. She describes herself as being financially astute with average risk tolerance. Which asset class is *least likely* to be suitable for a majority allocation in her portfolio to meet her retirement needs?
- A Long-term bonds
 - B US Treasury bills
 - C Exchange-listed equities
- Which of the following is *least likely* true for a separately managed account (SMA) compared with a mutual fund?
- A Assets are directly owned by the individual.
 - B The minimum investment required to open a SMA is lower than that of a mutual fund.
 - C Transactions can be tailored to the specific tax needs of the investor.

- 76 Based on the information in the table, which of the following is *closest* to the geometric mean annual return for the full period of 2010–2014?

Annual Return	
12/31/2010	–8.0%
12/31/2011	–5.5%
12/31/2012	–7.2%
12/31/2013	20.8%
12/30/2014	4.4%

- A 0.90%
 B 1.75%
 C 0.35%
- 77 A portfolio has the following returns:

Portfolio Returns	
2006	2.4%
2007	9.6%
2008	–4.0%
2009	5.6%
2010	4.8%
2011	–3.2%

- The sample variance of the portfolio is closest to:
- A 0.23%.
 B 0.36%.
 C 0.28%.
- 78 A return-generating model that provides an estimate of the expected return of a security based on such factors as earnings growth and cash flow generation is *best* described as a:
- A market factor model.
 B fundamental factor model.
 C macroeconomic factor model.
- 79 The stock of GBK Corporation has a beta of 0.65. If the risk-free rate of return is 3% and the expected market return is 9%, the expected return for GBK is *closest* to:
- A 10.8%.
 B 3.9%.
 C 6.9%.
- 80 A successful portfolio risk budget will *most likely*:
- A lead to investment in assets with the highest return per unit of risk.
 B be based on multiple sources of risk.
 C produce superior performance compared to passive investing.
- 81 Expected future benefits to be received from a common share are *most likely* an important input for a(n):
- A asset-based model.
 B multiplier model.

C present value model.

82 An analyst gathered the following information about a company:

Current earnings per share	\$6.00
Current dividend per share	\$2.40
Current market price per share	\$35
Required rate of return on the stock	15.0%
Expected growth rate of earnings and dividends	8.0%

Which of the following statements best describes the company's price-to-earnings ratio (P/E)? Compared to the company's trailing P/E ratio, the justified forward P/E ratio based on the Gordon growth dividend discount model is:

- A the same.
- B higher.
- C lower.

83 A firm reports negative earnings for the year just ended. The price multiple of the firm's stock that is *least likely* to be meaningful is:

- A trailing price to earnings.
- B price to cash flow.
- C leading price to earnings.

84 A fund manager compiles the following data on two companies:

	Company A	Company B
Return on assets (ROA)	10.9%	9.0%
Return on equity (ROE)	15.4%	14.3%
Dividend payout ratio	0.35	0.30
Required rate of return	13.0%	12.4%
Weighted average cost of capital	11.8%	11.7%

The *best* conclusion the fund manager can make is that Company A's stock is more attractive than Company B's stock because of its:

- A smaller price-to-earnings ratio (P/E).
- B greater financial leverage.
- C higher dividend growth rate.

Which of the following firms would be *best* classified as operating in a consumer discretionary industry?

- A Tobacco manufacturer
- B Biotechnology
- C Hotel

When constructing a list of peer companies to be used in equity valuation, which of the following would *least likely* improve the group? Companies in the same peer group should ideally:

- A be exposed to similar stages in the business cycle.
- B have similar valuations.
- C have the effects of finance subsidiaries minimized.

The following table shows information on three different investment strategies with equivalent systematic risk:

Strategy	Type of Strategy	Annualized Data	
		Fees and Expenses	Net Return
1	Passive	0%	15%
2	Exploits price patterns	1%	14%
3	Uses fundamental analysis	2%	

The return, gross of fees and expenses, that causes Strategy 3 to be *most* consistent with the strong form of market efficiency is:

- A 18%.
 - B 16%.
 - C 17%.
- 88 An asset-based valuation model is *most* applicable for a company with significant:
- A intangible assets.
 - B property, plant, and equipment.
 - C proportions of current assets and current liabilities and few intangible assets.
- 89 A trader buys a stock at \$64 on margin with a leverage ratio of 2.5 and a maintenance margin of 30%. Below what price will a margin call *most likely* occur?
- A \$36.57
 - B \$54.86
 - C \$44.80
- 90 Compared with public equity markets, which of the following statements is *most* accurate about private equity markets? Operating in the private market:
- A offers stronger incentives to improve corporate governance.
 - B allows more opportunities to raise capital.
 - C allows management to better adopt a long-term focus.
- 91 A company just paid an annual dividend of €1.25 per share. If the required annual rate of return is 14% and dividends are expected to grow indefinitely at a constant rate of 8%, the company's intrinsic value per share is:
- A €16.88.
 - B €20.83.
 - C €22.50.
- 92 The index weighting that results in portfolio weights shifting away from securities that have increased in relative value toward securities that have fallen in relative value whenever the portfolio is rebalanced is *most* accurately described as:
- A float-adjusted market-capitalization weighting.
 - B fundamental weighting.
 - C equal weighting.
- 93 In futures markets, contract performance is *most likely* guaranteed by:
- A the futures exchanges.
 - B regulatory agencies.
 - C clearing houses.

- 94 Which of the following embedded options *most likely* provides a right to the issuer?
- A Conversion provision
 - B Put feature
 - C Call feature
- 95 An analyst reviews a corporate bond indenture that contains these two covenants:
- 1 The borrower will pay interest semiannually and principal at maturity.
 - 2 The borrower will not incur additional debt if its debt-to-capital ratio is more than 50%.
- What types of covenants are these?
- A Covenant 1 is affirmative, and Covenant 2 is negative.
 - B Both are affirmative covenants.
 - C Covenant 1 is negative, and Covenant 2 is affirmative.
- 96 Using the “Four Cs of Credit Analysis” framework, which of the following is the *least likely* factor to be considered under the category of “capacity”?
- A Level of competition
 - B Industry fundamentals
 - C History of fraud or malfeasance
- 97 Compared with investment-grade bonds, the spread movements on high-yield bonds are influenced:
- A less by interest rate changes and exhibit a greater correlation with movements in equity markets.
 - B less by interest rate changes and exhibit a lower correlation with movements in equity markets.
 - C more by interest rate changes and exhibit a greater correlation with movements in equity markets.
- Two years ago, a homeowner took out a \$1 million home mortgage from a bank. The current principal on the loan is \$750,000, and the homeowner has defaulted on the loan. Following foreclosure proceedings, the bank sells the property for \$600,000 and is only entitled to use these funds to satisfy the loan obligation. The homeowner *most likely* had a:
- A bullet loan.
 - B non-recourse loan.
 - C recourse loan.
- Which scenario is *most likely* to result in a competitive return to a CDO equity holder?
- A The collateral earns a higher yield than the bond classes.
 - B The senior bond class experiences early principal repayment.
 - C The debt funding costs are higher than the CDO return.
- The value of a 10-year, 6% coupon, \$100 par value bond with semiannual payments, assuming an annual discount rate of 7%, is *closest* to:
- A \$99.07.
 - B \$92.89.
 - C \$107.44.

- 101 The option-free bonds of Argus Corporation have a duration of eight years. When interest rates rise by 100 bps, the bond's price declines by 7.9%. When interest rates fall by 100 bps, however, the price rises by 8.2%. The asymmetrical price change is *most likely* caused by the:
- A coupon effect.
 - B maturity effect.
 - C convexity effect.
- 102 The current yield for a 4.5% coupon, 10-year bond, with a maturity par value of \$100 and currently priced at \$85.70 is *closest to*:
- A 4.50%.
 - B 5.93%.
 - C 5.25%.
- 103 Assume the yields to maturity on four-year and five-year zero-coupon bonds are 4.67% and 5.35%, respectively, stated on a semiannual bond basis. The "4y1y" implied forward rate is *closest to*:
- A 8.092%.
 - B 8.114%.
 - C 4.046%.
- 104 Which of these definitions of duration is most relevant to a bond investor? A bond's duration is its:
- A price sensitivity to yield changes.
 - B first derivative of value with respect to its yield.
 - C half-life.
- 105 The following table provides information about a portfolio of three bonds.

Bond	Maturity	Price	Par Amount	Duration
1	17-year	\$109.2461	\$16 million	8.56
2	20-year	\$100.4732	\$4 million	9.19
3	25-year	\$84.6427	\$8 million	11.48

- Based on this information, the duration of the portfolio is *closest to*:
- A 9.48.
 - B 9.35.
 - C 9.74.
- 106 The option-free bonds issued by ALS Corp. are currently priced at 108.50. Based on a portfolio manager's valuation model, a 1 bp increase in interest rates will result in the bond price falling to 108.40, whereas a 1 bp decrease in interest rates will result in the bond price rising to 108.59. The price value of a basis point (PVBP) for the bonds is *closest to*:
- A 0.095.
 - B 0.088.
 - C 0.190.
- 107 There are two forward contracts, contract 1 and contract 2, on the same underlying. The underlying makes no cash payments, does not yield any nonfinancial benefits, and does not incur any storage costs. Contract 1 expires in one year, and contract 2 expires in two years. It is *most likely* that the price of contract 1:
- A is equal to the price of contract 2.

- B is less than the price of contract 2.
 - C exceeds the price of contract 2.
- 108 For a forward contract with a value of zero, a situation where the spot price is above the forward price is *best* explained by high:
- A interest rates.
 - B storage costs.
 - C convenience yield.
- 109 Which of the following statements is *least* accurate concerning differences in the pricing of forwards and futures?
- A Differences in the pattern of cash flows of forwards and futures can explain pricing differences.
 - B Pricing differences can arise if futures prices and interest rates are uncorrelated.
 - C Interest rate volatility can explain pricing differences.
- 110 If dividends paid by the underlying increase, the value of a European call option will *most likely*:
- A not change.
 - B increase.
 - C decrease.
- 111 According to put–call parity, if a fiduciary call expires in the money, the payoff is *most likely* equal to the:
- A difference between the market value of the asset and the face value of the risk-free bond.
 - B market value of the asset.
 - C face value of the risk-free bond.
- 112 When valuing a call option using the binomial model, an increase in the probability that the underlying will go up *most likely* implies that the current price of the call option:
- A increases.
 - B remains unchanged.
 - C decreases.
- Which of the following is *least likely* to be an example of a derivative?
- A An exchange-traded fund
 - B A contract to sell Alphabet Inc.'s shares at a fixed price
 - C A contract to buy Australian dollars at a predetermined exchange rate
- An alternative investments fund that uses leverage and takes long and short positions in securities is *most likely* a:
- A leveraged buyout fund.
 - B hedge fund.
 - C venture capital fund.
- If the level of broad inflation indexes is largely determined by commodity prices, the average real yield on direct commodity investments is *most likely*:
- A less than zero.
 - B equal to zero.
 - C greater than zero.

- 116 At the first of the year, an investor decides to invest \$1.5 million in a hedge fund with an incentive fee of 15% and a hard hurdle rate of 4%. At the end of the year, the fund has a return of 23.3%. The incentive fee payment that the general partner of the fund earned based on this client's investment at the end of the year is closest to?

A \$43,425
 B \$52,425
 C \$38,445

- 117 A hedge fund begins the year with \$120 million and earns a 25% return for the year. The fund charges a 1.5% management fee on end-of-year fund value and a 15% incentive fee on the return, net of the management fees, that is in excess of a 6% fixed hurdle rate. The fund's investors' return for the year, net of fees, is closest to:

A 20.56%.
 B 21.25%.
 C 19.66%.

- 118 A hedge fund with an initial value of \$100 million has a management fee of 2% and an incentive fee of 20%. Management and incentive fees are calculated independently using end-of-period valuation. The value must reach the previous high-water mark before incentive fees are paid. The table below provides end-of-period fund values over the next three years.

Year	Fund Value (\$ millions)	
	Before Fees	After Fees
1	120	113.6
2	110	107.8
3	125	?

The total amount of fees earned by the hedge fund in Year 3 is closest to:

A \$4.8 million.
 B \$5.5 million.
 C \$5.9 million.

- 119 An investor who has positions in multiple long-short equity hedge funds and is concerned about whether these positions are sufficiently diversified will *most likely* be concerned about the lack of:

A transparency in reported positions.
 B frequent independent valuations.
 C liquidity in the underlying assets.

- 120 Which of the following is *least likely* to reduce the likelihood of being defrauded by a dishonest money manager?

A Third-party custody of assets under management
 B Strong and consistent reported investment performance
 C Independent verification of investment results