2019 Level I Mock Exam 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	Quant	18
32–43	Econ	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**

2019 LEVEL I MOCK EXAM PM

1 Which of the following *least likely* forms the basic structure for enforcement of the CFA Institute Professional Conduct Program?

A Bylaws

B Rules of Procedure

C Board of Governors

2 Ross Nelson, CFA, manages accounts for high-net-worth clients including his own family's account. He has no beneficial ownership in his family's account. Because Nelson is concerned about the appearance of improper behavior in managing his family's account, when his firm purchases a block of securities, Nelson allocates to his family's account only those shares that remain after his other client accounts have their orders filled. The fee for managing his family's account is based on his firm's normal fee structure. According to the *Standards of Practice Handbook*, Nelson's best course of action with regard to management of his family's account would be to:

A treat the account like other client accounts.

B treat the account like other employee accounts of the firm.

C remove himself from any direct involvement by transferring responsibility for this account to another investment professional in the firm.

3 Several years ago, Leo Peek, CFA, co-founded an investment club. The club is fully invested but has not actively traded its account for at least a year and does not plan to resume active trading of the account. Peek's employer requires an annual disclosure of employee stock ownership. Peek discloses all of his personal trading accounts, but does not disclose his holdings in the investment club. Peek's actions are *least likely* to be a violation of which of the CFA Institute Standards of Professional Conduct?

A Misrepresentation

B Transaction priority

C Conflicts of interest

4 Madeline Smith, CFA, was recently promoted to senior portfolio manager. In her new position, Smith is required to supervise three portfolio managers. Smith asks for a copy of her firm's written supervisory policies and procedures, but is advised that no such policies are required by regulatory standards in the country where Smith works. According to the *Standards of Practice Handbook*, Smith's *most* appropriate course of action would be to:

A require her firm to adopt the CFA Institute Code of Ethics and Standards of Professional Conduct.

B require the employees she supervises to adopt the CFA Institute Code of Ethics and Standards of Professional Conduct.

C decline to accept supervisory responsibility until her firm adopts procedures to allow her to adequately exercise such responsibility.

5 Marc Davidson, CFA, works as a trust specialist for Integrity Financial. On his own time, Davidson starts a part time consulting business providing advice to Trustees for a fee. He conducts this business on his own time. Davidson asks his assistant to compile a list of Integrity's clients and their contact information. The following month, Davidson is offered a similar role at Integrity's largest competitor, Legacy Trust Services, Inc. After he begins working at Legacy, his new manager arranges for him to meet with a number of prospective clients, many of whom are clients of Integrity. After meeting with Davidson, a number of former Integrity clients decide to transfer their business to Legacy. Did Davidson's action violate the Code and Standards?

A No.

B Yes, Davidson's part time consulting business is a violation of the Standards.

C Yes, both Davidson's part time consulting business and his meetings with Integrity clients are a violation of the Standards.

6 Lee Chu, a CFA candidate, develops a new quantitative security selection model exclusively through back-testing on the Chinese equity market. Chu is asked to review marketing materials including an overview of the conceptual framework for his model, providing back-tested performance results, and listing the top holdings. Chu directs the marketing group to remove the description of his model due to concerns competitors may attempt to replicate his investment philosophy. He also instructs the marketing group to remove the list of the top holdings because it shows that the top holding represents 30 percent of the back-tested model. Which of the following actions is *least likely* to result in a violation of the Code and Standards? Chu's:

A use of back-tested results in communication with prospective clients.

B failure to adequately describe the investment process to prospective clients.

C failure to disclose that the top holding represents such a large allocation in the model.

7 Bob White is a new CFA charterholder and he is updating his resume and company biography (bio) to reflect this accomplishment. In his bio, he states that he successfully passed all three CFA exams in three consecutive years. On his resume he adds the following line: "CFA, 2013, CFA Society of Pittsburgh". Are either his bio or his resume in violation of the Standards regarding referencing the CFA designation and program?

A No.

B Yes, his resume is incorrect.

C Yes, both his bio and his resume are in violation of the Standards.

Kim Klausner, CFA, monitors several hundred employees as head of compliance for a large investment advisory firm. Klausner has always ensured that his company's compliance program met or exceeded those of its competitors. Klausner, who is going on a long vacation, has delegated his supervisory responsibilities to Sue Chang. Klausner informs Chang that her responsibilities include detecting and preventing violations of any capital market rules and regulations, and the CFA Institute Code and Standards. Klausner *least likely* violated the CFA Institute Standards of Professional Conduct by failing to instruct Chang to also consider:

A firm policies.

B legal restrictions.

C industry standards.

On a flight to Europe, Romy Haas, CFA, strikes up a conversation with a fellow passenger, Vincent Trujillo. When Trujillo learns that Haas is in the investment profession, he asks about the CFA designation. Haas tells him the following about the CFA designation:

Statement 1 Individuals who have completed the CFA Program have the right to use the CFA designation.

Statement 2 The CFA designation is globally recognized, which is why I use it as part of my firm's name.

Statement 3 CFA charterholders must satisfy membership requirements to continue using the designation.

In explaining the use of the CFA designation, Haas *least likely* violated the CFA Institute Standards of Professional Conduct concerning which of the following statements?

A Statement 1

B Statement 2

C Statement 3

10 Tonya Tucker, CFA, is a financial analyst at Bowron Consolidated. Bowron has numerous subsidiaries and is actively involved in mergers and acquisitions to expand its businesses. Tucker analyzes a number of companies, including Hanchin Corporation. When Tucker speaks with the CEO of Bowron, she indicates that many of the companies she has looked at would be attractive acquisition targets for Bowron. After her discussion with the CEO, Tucker purchases 100,000 shares of Hanchin Corporation at $200 per share. Bowron does not have any pre-clearance procedures, so the next time she meets with the CEO, Tucker mentions she owns shares of Hanchin. The CEO thanks her for this information but does not ask for any details. Two weeks later, Tucker sees a company-wide email from the CEO announcing Bowron's acquisition of Hanchin for $250 a share. With regards to her purchase of Hanchin stock, Tucker *least likely* violated the CFA Institute Standards of Professional Conduct concerning:

A Loyalty.

B Priority of Transactions.

C Material Nonpublic Information.

11 Thomas Turkman recently hired Georgia Viggen, CFA, as a portfolio manager for North South Bank. Although Viggen worked many years for a competitor, West Star Bank, the move was straightforward since she did not have a non-compete agreement with her previous employer. Once Viggen starts working for Turkman, the first thing she does is to bring a trading software package she developed and used at West Star to her new employer. Using public information, Viggen contacts all of her former clients to convince them to move with her to North South. Viggen also convinces one of the analysts she worked with at West Star to join her at her new employer. Viggen *most likely* violated the CFA Institute Code of Ethics and Standards of Professional Conduct concerning her actions involving:

A clients.

B the analyst.

C trading software.

12 Margie Germainne, CFA, is a risk management consultant who has been asked by a small investment bank to recommend policies to prevent bank employees from front-running client orders. These clients generally invest in one or more of the bank's large cap equity unit trusts. To ensure compliance with the CFA Institute Standards of Professional Conduct, Germainne should *least likely* recommend which of the following? Employees should be restricted from trading:

A equity related securities.

B without prior permission.

C during established time periods.

13 Kirsten Kelso, CFA, is a research analyst at an independent research firm. Kelso is part of a team of analysts who focus on the automobile industry. Recently, Kelso disagreed with two research sell recommendations written by her team even though she felt confident the research process was properly conducted. In a webcast open to all institutional but not retail clients, Kelso states "even though my name is on the sell reports, these stocks are a buy in part because sales and share prices for both auto companies will rise significantly due to strong demand for their vehicles." Kelso's actions would least likely violate which of the following CFA Institute Standards of Professional Conduct?

A Fair Dealing

B Communication with Clients

C Diligence and Reasonable Basis

14 Chris Rodriguez, CFA, is a portfolio manager at Nisqually Asset Management, which specializes in trading highly illiquid shares. Rodriguez has been using Hon Securities Brokers almost exclusively when making transactions for Nisqually clients, as well as for his own relatively small account. Hon always executes Rodriguez's personal trades at a more preferential price than for Rodriguez's client's accounts. This occurs regardless of whether or not Rodriguez personally trades before or after clients. Rodriguez should *least likely* do which of the following in order to comply with the CFA Institute Code of Ethics and Standards of Professional Conduct?

A Eliminate the exclusive trading arrangement.

B Trade client accounts before his own account.

C Average trade prices across all trading accounts.

15 Which of the following statements related to why the GIPS standards were created is *least likely* correct? GIPS standards were created to:

A provide clients certainty in what is presented and allow them to make reasonable comparisons.

B identify a set of ethical principles for firms to follow in calculating and presenting historical investment results.

C establish a standardized, industry wide approach for investment firms to follow.

Which of the following statements concerning the Global Investment Performance Standards (GIPS) is *most likely* correct?

A Clients or prospective clients benefit from the Standards because the historical track record of compliant firms is accurate and precise.

B The Standards eliminate the need for in-depth due diligence by investors.

C Compliance with the Standards enhances the credibility of investment management firms.

Which of the following statements does not accurately represent the GIPS standards concerning the fundamentals of compliance? GIPS standards:

A promote fair competition amongst investment management firms in all markets requiring a common fee structure.

B ensure consistent, accurate investment performance data in areas of reporting, records, marketing, and presentations.

C obtaining global acceptance of calculation and presentation standards in a fair, comparable format with full disclosure.

The belief that one's ethical standards are above average is *most likely* a reflection of which of the following behavioral biases?

A Overconfidence

B Short-term focus

C Situational influence

19 Examples of the beneficial features of using an ethical decision-making framework *least likely* includes analyzing:

A the best course of action when alternatives are available.

B the decision maker's perspective of contemplated actions.

C a broader picture from a long-term point of view.

20 An investor wants to maximize the possibility of earning at least 5% on her investments each year.

Portfolio	Expected Return	Standard Deviation	Roy's Safety-First Ratio
1			0.35
2			0.64
3	22%	40%	??

Using Roy's safety-first criterion, the *most* appropriate choice for the investor is portfolio:

A 3.

B 2.

C 1.

21 Compared with historical simulation, Monte Carlo simulation is *most* appropriate when:

A probability distributions are unavailable.

B "what if" analysis is required.

C analytical methods are required.

22 An investor purchases one share of stock for $85. Exactly one year later, the company pays a dividend of $2.00 per share. This is followed by two more annual dividends of $2.25 and $2.75 in successive years. Upon receiving the third dividend, the investor sells the share for $100. The money-weighted rate of return on this investment is *closest* to:

A 7.97%.

B 8.15%.

C 8.63%.

23 A one-tailed hypothesis testing has a *p*-value for a test statistic of 3%. An analyst would not reject the null hypothesis at a significance level of:

A 0.01.

B 0.05.

C 0.10.

24 Event X and Event Y are independent events. The probability of X is 0.2 [$P(X)$ = 0.2] and the probability of Y is 0.5 [$P(Y)$ = 0.5]. The joint probability of X and Y, $P(XY)$, is *closest* to:

A 0.7.

B 0.3.

C 0.1.

25 An investor in Abco stock forecasts the probability that Abco exceeded, met, or fell short of consensus expectations for free cash flow (FCF) during the prior quarter:

- *P(FCF exceeded consensus)* = 0.50
- *P(FCF met consensus)* = 0.35
- *P(FCF fell short of consensus)* = 0.15

While waiting for Abco to release last quarter's FCF data, the investor learns that Abco will acquire a competitor. Believing that the upcoming acquisition makes it more likely that last quarter's FCF will exceed the consensus, the investor generates a list of FCF events that may have influenced the acquisition:

- *P(Acquisition | FCF exceeded consensus)* = 0.40
- *P(Acquisition | FCF met consensus)* = 0.25
- *P(Acquisition | FCF fell short of consensus)* = 0.35

Using Bayes' Formula, calculate the probability that Abco is likely to exceed consensus FCF expectations for last quarter given the acquisition. *P(FCF exceeded consensus | Acquisition)* is *closest* to:

A 34%.

B 59%.

C 27%.

26 An analyst applies four valuation screens to a set of potential investments. The screens are independent of each other.

Valuation Screen	Probability of Passing
1	0.65
2	0.45
3	0.40
4	0.30

If there are 1,200 potential investments, the number expected to simultaneously pass all four screens is *closest* to:

A 360.

B 97.

C 42.

An analyst gathered the following information about a stock index:

Mean net income for all companies in the index	\$2.4 million
Standard deviation of net income for all companies in the index	\$3.2 million

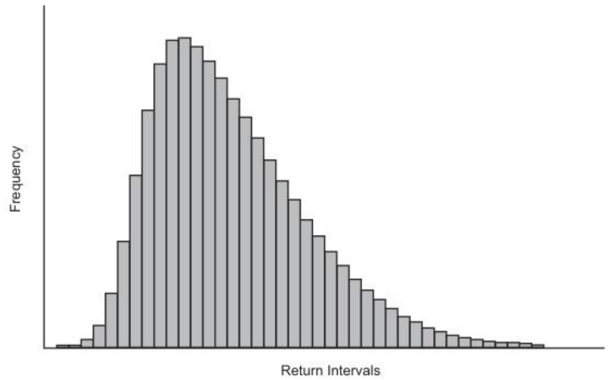
If the analyst takes a sample of 36 companies from the index, the standard error of the sample mean is *closest* to:

A \$400,000.

B \$533,333.

C \$88,889.

The figure below shows the histogram for the distribution of weekly returns on an index.



The median of the returns on the index, if compared to the mean, will *most likely* be:

A smaller.

B equal.

C greater.

29 A technical analyst observes a head and shoulders pattern in a stock she has been following. She notes the following information:

Head price	$83.50
Shoulder price	$72.00
Neckline price	$65.75
Current price	$64.00

Based on this information, her estimate of the price target is *closest* to:

A $59.50.

B $48.00.

C $44.50.

30 The minimum rate of return an investor must receive in order to accept an investment is *best* described as the:

A internal rate of return.

B required rate of return.

C expected return.

31 A borrower is considering three competing mortgage loan offers from her bank. The amount borrowed on the mortgage is $100,000 with monthly compounding.

Mortgage Type	Stated Annual Interest Rate at Initiation of the Loan	Year in Which Rate First Adjusts
30-year fixed rate	5.000%	N/A
20-year fixed rate	4.385%	N/A
30-year adjustable-rate mortgage (ARM)	3.750%	3

The rate on the ARM resets at the end of Year 3. Assuming the ARM is permanently reset at 5.500% (i.e., the remaining balance on the loan is assumed to be repaid with a 5.500% stated annual interest), which of the three loans will have the *smallest* monthly payment after the rate reset at the end of Year 3?

A 30-year fixed-rate loan

B 20-year fixed-rate loan

C 30-year ARM

32 A New Zealand traveler returned from Singapore with SGD7,500 (Singapore dollars). A foreign exchange dealer provided the traveler with the following quotes:

Ratio	Spot Rates
USD/SGD	1.2600
NZD/USD	0.7670

USD: US dollar; NZD: New Zealand dollar

The amount of New Zealand dollars (NZD) that the traveler would receive for his Singapore dollars is *closest* to:

A NZD7,248.

B NZD4,565.

C NZD7,761.

33 A dealer report includes the following exchange rate details:

	Spot Rate	Expected Change over Next Year
USD/EUR	1.30	1.75%
CAD/USD	0.95	−0.25%
CHF/EUR	1.22	0.75%

The expected CAD/CHF cross rate in one year is *closest to*:

A 1.04.

B 0.98.

C 1.02.

Which of the following statements is *most* accurate? For a country to gain from trade, it *must* have:

A economies of scale or lower labor costs.

B an absolute advantage.

C a comparative advantage.

A country having a current account deficit *most likely* will still be able to consume more output than it produces by:

A adjusting interest rates to stimulate higher domestic savings.

B restricting foreign direct investment.

C increasing its net foreign liabilities.

Which of the following statements regarding the money creation process in fractional reserve banking is correct?

A The reserve requirement is negatively related to the quantity of money created.

B The reserve requirement is positively related to the availability of credit.

C The money multiplier is unaffected by the reserve requirement.

37 In an effort to influence the economy, a central bank conducted open market activities by selling government bonds. This action implies that the central bank is *most likely* attempting to:

A contract the economy by reducing bank reserves.

B expand the economy through a lower policy interest rate.

C contract the economy through a lower policy interest rate.

38 The effectiveness of infrastructure spending as a near-term fiscal stimulant would be *least* constrained by the:

A impact lag.

B action lag.

C recognition lag.

39 A firm in a market environment characterized by monopolistic competition is *most likely* to:

A continue to experience economic profit in the long run.

B have a well-defined supply function reflecting its marginal and average costs.

C have many competitors each following its own product differentiation strategy.

40 Six companies in an industry have the following market shares:

Company	A	B	C	D	E	F
Market Share (%)	30	25	16	12	10	7

If Companies D and F merge into a new Company, G, the industry's three-company concentration ratio would be *closest* to:

A 72%.

B 74%.

C 71%.

41 In the short run, a firm operating in a perfectly competitive market will *most likely* avoid shutdown if it is able to earn sufficient revenue to cover which of the following costs?

A Fixed

B Marginal

C Variable

42 Assuming all other factors remain unchanged, which of the following changes would *most likely* cause a simultaneous increase in the participation ratio and a decrease in the unemployment rate?

A A decrease in the number of unemployed people

B A decrease in the total population of working-age people

C An increase in the number of people included in the labor force

43 After noting positive changes in the aggregate index of coincident economic indicators, an increase in the ratio of consumer installment debt to income would *most likely* help confirm that an expansion is:

A forthcoming.

B underway.

C ending.

44 Selected information for a company and its industry's average return on equity (ROE) is provided:

Company	**(£)**	**Industry**	**(£)**
Earnings before interest and taxes (EBIT)	76,000	EBIT margin	0.28
Pretax profit	66,400	Interest burden	0.70
Net income	44,500	Tax burden	0.67
Sales	400,000	Total asset turnover	0.71
Total assets	524,488	Financial leverage	1.89
Total equity	296,488		
ROE	15.0%		17.6%

Which of the following is *most likely* a contributor to the company's inferior ROE compared with that of the industry? The company's lower:

A financial leverage.

B tax burden ratio.

C interest burden ratio.

45 When forecasting earnings, an analyst's *best* approach is to:

A establish a precise forecast based on the results of economic and financial analysis.

B calculate a range of possibilities based on the results of financial analysis.

C utilize the results of financial analysis and professional judgment.

46 Which of the following is lowest in quality on the spectrum of GAAP conforming financial reports?

A Aggressive accounting choices

B Earnings management

C Conservative accounting choices

Which of the following techniques is *most likely* to provide a company with the opportunity to inflate earnings?

A Reductions in the useful lives of fixed assets

B Last-in, first-out (LIFO) liquidation

C Increases to tax asset valuation allowances

The SEC's approach to addressing the significant differences in financial reporting under International Financial Reporting Standards (IFRS) and US GAAP is *best* described as:

A requiring issuers to provide disclosures describing key differences.

B mandating that non-US issuers provide a reconciliation to US GAAP.

C publicly advocating for global accounting standards and convergence.

Analysts can *best* address the challenges of comparing financial statements prepared under US GAAP with those prepared under International Financial Reporting Standards (IFRS) by:

A referring to the reconciliation from IFRS to US GAAP provided in the notes.

B assuming differences are minor given US GAAP and IFRS convergence.

C monitoring changes in both sets of standards and interpreting cautiously.

An analyst's examination of the performance of a company is *least likely* to include an assessment of a company's:

A assets relative to its liabilities.

B profitability.

C cash flow generating ability.

51 A company has a building with a net carrying amount of $100,000 and a tax base of $120,000. The tax rate was 20% when the asset was purchased, but it is scheduled to be reduced to 17% this year. Which of the following will the company *most likely* report related to this building?

A Deferred tax asset: $4,000

B Deferred tax asset: $3,400

C Deferred tax liability: $600

52 A company manufactures aluminum cans for the beverage industry and prepares its financial statements in accordance with International Financial Reporting Standards (IFRS). During its latest full fiscal year, the company recorded the following:

Inventory Item	Amount € (thousands)
Raw material aluminum costs	150,000
Storage of finished cans	15,000
Wasted aluminum materials from abnormal production errors during the year	500
Transportation-in costs	640
Tax-related duties	340
Administrative overhead	7,500
Trade discounts due to volume purchases throughout the year	520

The total costs included in inventory (in € thousands) for the year are *closest* to:

A €150,980.

B €150,460.

C €149,820.

53 A company purchased a warehouse for €35 million and incurred the following additional costs in getting the warehouse ready for use:

- €2.0 million for upgrades to the building's roof and windows
- €0.5 million to modify the interior layout to meet their needs (moving walls and doors, inserting and removing partitions, etc.)
- €0.1 million on an orientation and training session to familiarize employees with the facility

The cost to be capitalized to the building account (in millions) is *closest* to:

A €37.6.

B €37.5.

C €37.0.

54 The following information is available for an asset purchased at the start of its first year of operations (Year 1):

- Purchase price: $1.8 million
- Estimated useful life: 5 years
- Estimated residual value: $500,000

If the company uses the double declining balance method of depreciation, the depreciation expense in Year 3 will be *closest* to:

A $187,200.

B $259,200.

C $148,000.

55 Under IFRS, it is *most* appropriate to include which of the following pension costs of a defined-benefit plan in other comprehensive income?

A Net interest expense accrued on the beginning net pension liability

B Actuarial gains or losses

C Employees service cost

56 If a company repurchases its own shares and can reissue them at a later time, these shares are *best* described as:

A preferred stock.

B marketable securities.

C treasury stock.

57 Last year, a company's current ratio was 0.96. Partial information is provided from the company's balance sheet for the current year:

Current Year	($ millions)
Cash and equivalents	1,950
Intangible assets	870
Inventory	950
Goodwill	4,990
Accounts receivable	2,540
Current portion of long-term debt	720
Total current liabilities	4,920

No other current assets or current liabilities were reported.

Comparing the company's current ratio this year with the prior year *most likely* indicates that the company's ability to meet short-term obligations has:

A increased.

B decreased.

C not changed.

The following information (in millions) on a company is available:

Cost of goods sold	$500
Increase in total assets	$250
Increase in total liabilities	$200
Change in inventory	–$30
Change in accounts payable	–$25

The amount of cash (in millions) that the company paid to its suppliers is *closest* to:

A $505.

B $495.

C $445.

Compared with its net income, a mature company's operating cash flow is *most likely*:

A the same.

B lower.

C higher.

60 A retailer provides credit cards only to its most valued customers who pass a rigorous credit check. A credit card customer ordered an item from the retailer in May. The item was shipped and delivered in July. The item appeared on the customer's July credit card statement and was paid in full by the due date in August. The *most* appropriate month in which the retailer should recognize the revenue is:

A May.

B July.

C August.

61 The following relates to a company's common equity over the course of the year:

Outstanding shares, at start of the year	2,000,000
Stock options outstanding, at start and end of the year (Exercise price: $5)	100,000
Shares issued on 1 April	300,000
Shares repurchased (treasury shares) on 1 July	100,000
Average market price of common shares for the year	$20/share

If the company's net income for the year is $5,000,000, its diluted EPS is *closest* to:

A $2.17.

B $2.22.

C $2.20.

62 When a new project reduces the cash flows of an existing project of the same firm, it is *best* described as a(n):

A sunk cost.

B opportunity cost.

C externality.

63 A company has 100 million shares outstanding. The share price of a company's stock is £15 just prior to announcing a £100 million expansionary investment in a new plant, and the company estimates that the present value of future after-tax cash flows will be £150 million. Analysts, however, estimate that the new plant's profitability will be lower than the company's expectations. The company's stock price will *most likely*:

A drop below £15 per share due to the cannibalization of revenue from the new plant.

B increase by less than £0.50 per share.

C increase by the new plant's net present value per share.

64 Which of the following conditions is *most likely* to facilitate shareholder activism?

A Cross-shareholdings

B Cumulative voting

C Staggered boards

65 The *least likely* reason investors incorporate environmental and societal factors into their investment analysis is to:

A improve investment performance.

B have a more comprehensive understanding of a company's risks.

C limit investments to those equities that are consistent with their moral or ethical values.

66 A company's data are provided in the following table:

Cost of debt	10%
Cost of equity	16%
Debt-to-equity ratio (D/E)	50%
Tax rate	30%

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

A 14.0%.

B 11.5%.

C 13.0%.

67 When estimating the NPV for a project with a risk level higher than the company's average risk level, an analyst will *most likely* discount the project's cash flows by a rate that is:

A determined by the firm's target capital structure.

B below the WACC.

C above the WACC.

68 A class of noncallable, nonconvertible preferred stock was issued at $45.00 per share with a dividend of $5.25. The preferred stock is now trading at $60.00 per share. Earnings of the company are growing at 3.00%. The cost of preferred stock is *closest* to:

A 11.7%.

B 8.8%.

C 5.8%.

69 Which of the following statements is the *most* appropriate treatment of flotation costs for capital budgeting purposes? Flotation costs should be:

A expensed in the current period.

B incorporated into the estimated cost of capital.

C deducted as one of the project's initial-period cash flows.

Business risk *most likely* incorporates operating risk and:

A financial risk.

B sales risk.

C interest rate risk.

The following data apply to two companies producing similar products.

	Company A	Company B
umber of units produced and sold	1 million	1 million
ale price per unit	$100	$100
ariable cost per unit	$60	$50
ixed operating costs	$20 million	$40 million
ixed financing expenses	$10 million	$5 million
egree of operating leverage (DOL)	?	5.0
egree of financial leverage (DFL)	2.0	2.0

Compared with Company B, Company A has:

A a higher degree of total leverage.

B a lower sensitivity of operating income to changes in units sold.

C the same sensitivity of operating income to changes in net income.

72 The unit contribution margin for a product is $12. Assuming fixed costs of $12,000, interest costs of $3,000, and a tax rate of 40%, the operating breakeven point (in units) is *closest* to:

A 1,250.

B 750.

C 1,000.

73 The following information is available for a company's bank account:

Total deposits (millions)	$16.0
Average daily float (millions)	$2.5
Number of days	15

The float factor for the company is *closest* to:

A 2.3.

B 6.4.

C 0.4.

74 You are preparing an investment policy statement for a client who manages her own successful marketing consultancy. Her annual income is approximately $500,000. She describes herself as a finance novice. Most of her savings are invested in bank term deposits and short-term government securities. In her responses to the standard risk assessment questionnaire, she strongly agrees with the statements that she "feels more comfortable putting money in a bank account than in the stock market." Also, she "thinks of the word 'risk' as being a 'loss'". Based on this information, your client's ability and willingness to take risk can best be described as:

A low ability and high willingness.

B high ability and willingness.

C high ability and low willingness.

75 A key difference between a wrap account and a mutual fund is that wrap accounts:

A have assets that are owned directly by the individual.

B cannot be tailored to the tax needs of a client.

C have a lower required minimum investment.

76 The correlation between the historical returns of Stock A and Stock B is 0.75. If the variance of Stock A is 0.16 and the variance of Stock B is 0.09, the covariance of returns of Stock A and Stock B is *closest* to:

A 0.01.

B 0.09.

C 0.16.

77 An asset has an annual return of 19.9%, standard deviation of returns of 18.5%, and correlation with the market of 0.9. If the standard deviation of returns on the market is 15.9% and the risk-free rate is 1%, the beta of this asset is *closest* to:

A 1.02.

B 1.05.

C 1.16

78 A security has a beta of 1.30. If the risk-free rate of interest is 3% and the expected return of the market is 8%, based on the capital asset pricing model (CAPM), the expected return of the security is *closest to*:

A 6.5%.

B 13.4%.

C 9.5%.

79 Two risk managers are discussing how an organization's risk tolerance should be determined. The first manager says, "The risk tolerance must reflect the losses or shortfalls that will cause the organization to fail to meet critical objectives." The second manager responds, "The risk tolerance must reflect the external forces that bring uncertainty to the organization." Which of them is *most likely* correct?

A The second risk manager

B The first risk manager

C Both risk managers

80 An example of risk transfer combined with self-insurance is *most likely*:

A a bond portfolio hedged with an interest rate option.

B an insurance policy with a deductible.

C a bank that establishes a loan loss reserve fund.

81 A company's $100 par value perpetual preferred stock has a dividend rate of 7% and a required rate of return of 11%. The company's earnings are expected to grow at a constant rate of 3% per year. If the market price per share for the preferred stock is $75, the preferred stock is *most* appropriately described as being:

A overvalued by $11.36.

B undervalued by $15.13.

C undervalued by $36.36.

82 The following data pertain to a company that can be appropriately valued using the Gordon growth model. The dividend is expected to grow indefinitely at the existing sustainable growth rate.

EPS growth rate (three-year average)	7.50%
Current dividend per share	$3.00
Return on equity	15%
Dividend payout ratio	45%
Investors' required rate of return	16%

The stock's intrinsic value is *closest* to:

A $34.62.

B $37.94.

C $41.90.

An investor wants to estimate the market capitalization of a company located in India and has gathered the following data:

Values (INR millions)	
Market value of debt	10.0
Market value of preferred stock	5.0
Cash and short-term investments	4.5
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	15.0

Assuming an enterprise value multiple of 3.2×, the company's market capitalization (in INR millions) is *closest* to:

A 28.5.

B 37.5.

C 33.0.

84 Which of the following statements concerning the use of industry analysis is most accurate? Industry analysis is *most* useful for:

A sector allocations in passive equity portfolios.

B portfolio performance attribution.

C evaluating market efficiency.

85 An equity portfolio manager is evaluating her sector allocation strategy for the upcoming year. She expects the global economy to experience a slowdown period for the next two years. Furthermore, she believes that companies will be facing diminishing growth rates with respect to revenues and profits. On the basis of these beliefs, the portfolio manager will *most likely* overweight:

A materials.

B consumer staples.

C autos.

86 Companies pursuing cost leadership will *most likely*:

A invest in productivity-improving capital equipment.

B establish strong market research teams to match customer needs with product development.

C engage in defensive pricing when the competitive environment is one of high rivalry.

87 After the public announcement of the merger of two firms, an investor makes abnormal returns by going long on the target firm and short on the acquiring firm. This *most likely* violates which form of market efficiency?

A Semi-strong-form only

B Semi-strong-form and strong-form

C Weak-form and semi-strong-form

88 Which of the following statements is *most* accurate concerning a short position of 100 shares of a stock at $50 per share?

A Maximum loss of $5,000

B Maximum gain of $5,000

C Unlimited maximum gain

89 The following data pertain to a margin purchase of a stock:

Purchase price	$50/share
Sale price	$55/share
Shares purchased	500

Margin	45%
Call money rate	6%
Dividend	$1.80/share
Commission on purchase and sale	$0.05/share

If the stock is sold exactly one year after the purchase, the total return on this investment is *closest* to:

A 22.4%.

B 14.4%.

C 19.4%.

90 Accounting standards and reporting requirements that produce meaningful and timely financial disclosures are *most* critical for achieving which of the following efficiencies associated with a well-functioning financial system?

A Allocational

B Informational

C Operational

91 Which of the following statements is *most* accurate?

A Putable common shares provide benefits to both the issuing company and investors.

B Convertible preference shares are more volatile and riskier than the underlying common shares.

C Investors owning a small number of common shares would prefer statutory voting to cumulative voting.

92 Security market indexes can be used to calculate alphas, which are *best* described as:

A the systematic risk of a security, using the index as a proxy for the entire market.

B a measure of market sentiment.

C the difference between the return of the actively managed portfolio and the return of the passive portfolio.

A market index has the following information:

Period	Quarterly Price Returns (%)	Dividend Income (%)	Value of Index
At the beginning of the year			1,000.00 (Base)
Quarter 1	3.0%	1.5%	
Quarter 2	2.0%	—	
Quarter 3	–5.0%	—	

By the end of Quarter 3, which of the following statements is *most* accurate?

A The value of the price return index is 998.1.

B The value of the total return index is below 1,000.

C The price return is 1.26%.

In a repurchase agreement, the repo margin will be lower the:

A higher the supply of the collateral.

B higher the quality of the collateral.

C lower the demand for the collateral.

95 Which of the following is *most likely* a form of internal credit enhancement?

A Letter of credit

B Surety bond

C Overcollateralization

96 Which of the following bonds is *most likely* to trade at a lower price relative to an otherwise identical option-free bond?

A Convertible bond

B Putable bond

C Callable bond

97 Which bonds *most likely* rank the highest with respect to priority of claims?

A Subordinated debt

B Second lien debt

C Senior unsecured bond

98 Which of the following is *least likely* a component of the "Four Cs of Credit Analysis" framework?

A Covenants

B Competition

C Collateral

99 A credit analyst observes the following information for Zeta Corp. and its industry.

	Zeta Corp.	Industry Median
Return on capital (%)	19.0%	20.0%
Total debt/Total capital (%)	42.0%	15.5%
FFO/Total debt (%)	45.3%	40.0%
Total debt/EBITDA (x)	3.5x	1.2x
EBITDA interest coverage (x)	4.0x	7.5x

Based on this information, it is *most likely* that the credit risk of Zeta Corp. is:

A below its industry peers.

B similar to its industry peers.

C above its industry peers.

100 The absolute priority rule is *most likely* violated in a:

A bankruptcy liquidation.

B special purpose entity securitization.

C bankruptcy reorganization.

101 Which statement *best* describes the risk to senior tranche investors in a collateralized debt obligation (CDO)?

A There are no triggers that require the payoff of the principal to investors.

B In default, the manager will not earn a return sufficient to payoff investors.

C Leverage inherent in the CDO transaction results in higher risk.

102 Given two otherwise identical bonds, when interest rates rise, the price of Bond A declines more than the price of Bond B. Compared with Bond B, Bond A *most likely*:

A has a shorter maturity.

B is callable.

C has a lower coupon.

103 If the yield to maturity on an annual-pay bond is 7.75%, the bond-equivalent yield is *closest* to:

A 8.05%.

B 7.90%.

C 7.61%.

104 All else being equal, the difference between the nominal spread and the Z-spread for a non-Treasury security will *most likely* be larger when the:

A yield curve is steep.

B security has a bullet maturity rather than an amortizing structure.

C yield curve is flat.

105 Duration is *most* accurate as a measure of interest rate risk for a bond portfolio when the slope of the yield curve:

A stays the same.

B decreases.

C increases.

106 A bond with a par value of $100 matures in 10 years with a coupon of 4.5% paid semiannually; it is priced to yield 5.83% and has a modified duration of 7.81. If the yield of the bond declines by 0.25%, the approximate percentage price change for the bond is *closest* to:

A 3.91%.

B 1.95%.

C 0.98%.

107 The value of a long position in a forward contract at expiration is *best* defined as:

A forward price agreed in the contract minus spot price of the underlying.

B spot price of the underlying minus forward price agreed in the contract.

C value of the forward at initiation minus spot price of the underlying.

Convenience yield is *best* described as a nonmonetary benefit of holding a(n):

A option contract.

B asset.

C forward contract.

A swap that involves the exchange of a fixed payment for a floating payment is *most likely* equivalent to a series of:

A off-market forward contracts.

B forward contracts that all have an initial positive value.

C forward contracts that all have an initial value equal to the fixed payment.

Exercise of a European put option is *most likely* justified if:

A the option is out of the money.

B the exercise price exceeds the value of the underlying.

C the exercise value is negative.

At expiration, an option that is in the money will *most likely* have:

A time value, but no exercise value.

B exercise value, but no time value.

C both time value and exercise value.

112 For a stock that pays no dividends, the value of an American call option is *most likely*:

A the same as the value of a European call option with otherwise identical features.

B greater than the value of a European call option with otherwise identical features.

C less than the value of a European call option with otherwise identical features.

113 Which of the following attributes is *least likely* to be a requirement for the existence of riskless arbitrage? The underlying security:

A can be sold short.

B is a financial asset.

C is relatively liquid.

114 Compared with long-only investments in stocks and bonds, alternative investments are *most likely* characterized by less:

A flexibility to use derivatives.

B manager specialization.

C transparency.

115 Which of the following *least likely* describes an advantage of investing in hedge funds through a fund of funds? A fund of funds may provide investors with:

A access to due diligence expertise.

B lower fees because of economies of scale.

C access to managers who can negotiate better redemption terms.

116 Illiquidity is *most likely* a major concern when investing in:

A real estate investment trusts.

B private equity.

C commodities.

117 A real estate investor looking for equity exposure in the public market is *most likely* to invest in:

A real estate limited partnerships.

B shares of real estate investment trusts.

C collateralized mortgage obligations.

118 Which of the following statements concerning the historical record of alternative investments is *most likely* correct?

A The exclusion of returns of funds that have been liquidated leads to an upward bias in index performance.

B The use of appraised values instead of market prices leads to an upward bias in volatility.

C The inclusion of previous return data for funds that enter the index leads to a downward bias in index performance.

119 High-water marks are typically used when calculating the incentive fee on hedge funds. They are *most likely* used by clients to:

A avoid prime brokerage fees.

B avoid paying twice for the same performance.

C claw back the management fees.

120 The value at risk of an alternative investment is *best* described as the:

A probability of losing a fixed amount of money over a given time period.

B minimum amount of loss expected over a given time period at a given probability level.

C time period during which a fixed amount is lost at a given probability level.