

# 2018 Level I Mock Exam AM

The morning session of the 2018 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
1–18	Ethical and Professional Standards	27
19–33	Quant	22.5
34–45	Econ	18
46–69	Financial Reporting and Analysis	36
70–78	Corporate Finance	13.5
79–86	Portfolio Management	12
87–98	Equity	18
99–110	Fixed Income	18
111–115	Derivatives	7.5
116–120	Alternative Investments	7.5
	<b>Total:</b>	<b>180</b>

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## 2018 LEVEL I MOCK EXAM AM

- 1 Andrew Smith, CFA, works for Granite, a commercial bank that also has a sizeable sell side research division. Smith is presenting financing solutions to a potential business client, Dynamic Materials Corp. As part of his presentation, Smith mentions that Granite will initiate research coverage on Dynamic. Is Smith's arrangement *most likely* appropriate with regards to the CFA Standards?
  - A Yes.
  - B No, because Smith cannot offer to provide research coverage on a company if they become a corporate finance client.
  - C No, because Granite cannot provide research coverage on a corporate finance client as this constitutes a violation of research independence.
- 2 During an on-site company visit, Marsha Ward, CFA, accidentally overheard the Chief Executive Officer (CEO) of Stargazer, Inc., discussing the company's tender offer to purchase Dynamica Enterprises, a retailer of Stargazer products. According to the CFA Institute Standards of Professional Conduct, Ward *most likely cannot* use the information because:
  - A it relates to a tender offer.
  - B it was overheard and might be considered unreliable.
  - C she does not have a reasonable and adequate basis for taking investment action.
- 3 Which of the following is not included in the nine major provisions of the Global Investment Performance Standards (GIPS)?
  - A Input Data, Calculation Methodology, and Real Estate
  - B Fundamentals of Compliance, Composite Construction, and Disclosure
  - C Calculation Methodology, Composite Construction, and Alternative Assets
- 4 Which of the following *least likely* reflects the two primary principles of the CFA Institute Rules of Procedure for Proceedings Related to Professional Conduct?
  - A Confidentiality of proceedings
  - B Public disclosure of disciplinary sanctions
  - C Fair process to the member and candidate
- 5 In order to achieve compliance with GIPS Standards, it is recommended that firms:
  - A adopt the broadest, most meaningful definition of the firm.
  - B provide existing clients a compliant presentation applicable to their portfolio, at a minimum of a bi-annual basis.
  - C define the firm by including all geographical offices operating under the same firm name.
- 6 Which of the following is **not** a component of the CFA Institute Code of Ethics?
  - A Promote financial integrity and seek to prevent and punish abuses in the financial markets.
  - B Place the integrity of the investment profession and the interests of clients above their own personal interests.
  - C Practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.

- 7 Jiro Sato, CFA, deputy treasurer for May College, manages the Student Scholarship Trust. Sato issued a Request for Proposal (RFP) for domestic equity managers. Pamela Peters, CFA, a good friend of Sato, introduces him to representatives from Capital Investments, who submitted a proposal. Sato selected Capital as a manager based on the firm's excellent performance record. Shortly after the selection, Peters, who had outstanding performance as an equity manager with another firm, accepted a lucrative job with Capital. Which of the CFA charterholders violated the CFA Institute Standards of Professional Conduct?
- A Both violated Standards.
  - B Peters violated Standards.
  - C Neither violated Standards.
- 8 Umi Grabbo, CFA, is a highly regarded portfolio manager for Atlantic Advisors, a mid-sized mutual fund firm investing in domestic securities. She has watched the hedge fund boom and on numerous occasions suggested that her firm create such a fund. Senior management has refused to commit resources to hedge funds. Attracted by potential higher fees associated with hedge funds, Grabbo and several other employees begin development of their own hedge fund to invest in international securities. Grabbo and her colleagues are careful to work on the fund development only on their own time. Because Atlantic management thinks hedge funds are a fad, she does not inform her supervisor about the hedge fund creation. According to the *Standards of Practice Handbook*, Grabbo should *most likely* address which of the Standards immediately?
- A Disclosure of Conflicts
  - B Priority of Transactions
  - C Additional Compensation Arrangements
- 9 Reiko Kimisaki, CFA, is an investment advisor for a national social security fund in a frontier market with a very limited and illiquid capital market. The labor force is young with an investment time horizon of 25 to 30 years. She has been asked to suggest ways to increase the investment return of the overall portfolio. After careful assessment of the fund's previous investment history and available asset classes, she considers investment in private equity. What is Kimisaki's lowest priority to avoid any Code of Ethics and Standards of Professional Conduct violations prior to making this investment recommendation?
- A Assess the risk tolerance of the fund.
  - B Analyze the expected returns of private equity in the market.
  - C Determine if the Investment Policy Statement allows for alternative investments.
- 10 The Global Investment Performance Standards (GIPS) were developed for the benefit of:
- A prospective clients.
  - B regulators.
  - C broker/dealers.
- 11 Mariam Musa, CFA, head of compliance at Dunfield Brokers, questions her colleague Omar Kassim, a CFA candidate and a research analyst, about his purchase of shares in a company for his own account immediately before he publishes a "buy" recommendation. He defends his actions by stating he has done nothing wrong because Dunfield does not have any personal trading policies in place. The CFA Institute Code of Ethics and Standards of Professional Conduct were most likely violated by:
- A only Musa.

- B** only Kassim.
- C** both Musa and Kassim.
- 12** Oliver Opdyke, CFA, works for an independent research organization that does not manage any client money. In the course of his analysis of Red Ribbon Mining he hears rumors that the president of Red Ribbon, Richard Leisberg, has recently been diagnosed with late stage Alzheimer's disease, a fact not publicly known. The final stage of Alzheimer's is when individuals lose the ability to respond to their environment, the ability to speak, and, ultimately, the ability to control movement. Leisberg is the charismatic founder of Red Ribbon, and under his leadership the company grew to become one of the largest in the industry. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the most appropriate action for Opdyke is to:
- A** immediately publish a sell recommendation for Red Ribbon Mining.
- B** confirm the president's diagnosis before publishing his research report.
- C** encourage Red Ribbon Mining management to disclose the president's medical condition.
- 13** Based on his superior return history, Vijay Gupta, CFA, is interviewed by the First Faithful Church to manage the church's voluntary retirement plan's equity portfolio. Each church staff member chooses whether to opt in or out of the retirement plan according to his or her own investment objectives. The plan trustees tell Gupta that stocks of companies involved in the sale of alcohol, tobacco, gambling, or firearms are not acceptable investments given the objectives and constraints of the portfolio. Gupta tells the trustees he cannot reasonably execute his strategy with these restrictions and that all his other accounts hold shares of companies involved in these businesses because he believes they have the highest alpha. By agreeing to manage the account according to the trustees' wishes, does Gupta violate the CFA Institute Standards of Professional Conduct?
- A** No.
- B** Yes, because the manager was hired based upon his previous investment strategy.
- C** Yes, because the restrictions provided by the Trustees are not in the best interest of the members.
- 14** Edo Ronde, CFA, an analyst for a hedge fund, One World Investments, is attending a key industry conference for the microelectronics industry. At lunch in a restaurant adjacent to the conference venue, Ronde sits next to a table of conference attendees and is able to read their nametags. Ronde realizes the group includes the president of a publicly traded company in the microelectronics industry, Fulda Manufacturing, a company Ronde follows. Ronde overhears the president complain about a production delay problem Fulda's factories are experiencing. The president mentions that the delay will reduce Fulda earnings more than 20% during the next year if not solved. Ronde relays this information to the portfolio manager he reports to at One World explaining that in a recent research report he recommended Fulda as a buy. The manager asks Ronde to write up a negative report on Fulda so the fund can sell the stock. According to the CFA Institute Code of Ethics and Standards of Professional Conduct Ronde should *least likely*:
- A** revise his research report.
- B** leave his research report as it is.
- C** request the portfolio manager not act on the information.

- 15 What is the theory that *best* describes the process by which financial analysts combine material public information and nonmaterial nonpublic information as a basis for investment recommendations even if those conclusions would have been material inside information had they been communicated directly to the analyst by the company?
- A Mosaic theory
  - B Economic theory
  - C Probability theory
- 16 Ken Kawasaki, CFA, shares a building with a number of other professionals who are also involved in the investment management business. Kawasaki makes arrangements with several of these professionals, including accountants and lawyers, to refer clients to each other. An informal score is kept on the expectation the referrals will equal out over time, eliminating the need for any cash payments. Kawasaki never mentions this arrangement to clients or prospective clients. Does Kawasaki's agreement with the other building occupants *most likely* violate any CFA Institute Standards of Professional Conduct?
- A No.
  - B Yes, related to referral fees.
  - C Yes, related to communication with clients.
- 17 Meshack Bradovic, CFA, was recently hired as a credit analyst at a credit rating agency whose major clients include publicly listed companies on the local stock exchange. One of the clients is currently preparing to issue a new bond to finance a major factory project. Analysts are speculating that without the new factory the company will not survive the onslaught of competition from increasing imports; therefore, the company is counting on an upgraded credit rating to enhance the subscription level of the issue. Bradovic's research suggests that the creditworthiness of the company has severely deteriorated over the last year due to negative operating cash flows. Without conducting extensive research, Bradovic's boss puts pressure on him to upgrade the credit rating to an investment grade rating. Bradovic reports this to the firm's compliance department where he is encouraged to follow his boss's advice. What course of action is *most* appropriate for Bradovic to prevent any violation of the CFA Institute Code or Standards?
- A Quit his position with the firm
  - B Upgrade the rating but note his objections in writing
  - C Disassociate with the credit rating report, the bond issue and the client
- 18 Manuel Tacqueria, CFA, is a sole proprietor investment adviser managing accounts for a diversified group of clients. Tacqueria obtains his investment research through a subscription service with Alpha Services, a large financial services organization. Tacqueria notes that the research reports are sound because they are extremely detailed and comprehensive. As a result, Tacqueria feels comfortable relying solely upon this research when making recommendations to clients. Tacqueria should *most likely* do which of the following in order to conform to the CFA Institute Code of Ethics and Standards of Professional Conduct?
- A Utilize additional sources of third-party research
  - B Undertake and add his own research to the existing reports
  - C Conduct additional due diligence on Alpha Services

- 19 A financial contract offers to pay €1,200 per month for five years with the first payment made immediately. Assuming an annual discount rate of 6.5%, compounded monthly the present value of the contract is *closest* to:
- A €63,731.  
B €61,330.  
C €61,663.
- 20 The following table shows the discrete uniform probability distribution of gross profits from the purchase of an option:

Profit	Cumulative Distribution Function
\$0	0.2
\$1	0.4
\$2	0.6
\$3	0.8
\$4	1.0

The probability of a profit greater than or equal to \$1 and less than or equal to \$4 is *closest* to:

- A 0.4.  
B 0.6.  
C 0.8.
- 21 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.
- 22 Investor A and Investor B invest in a fund for two years:

	Year 1	Year 2
Fund Return	Positive	Negative

  

Portfolio	Money-Weighted Rate of Return
Investor A	7.5%
Investor B	8.2%

Given the information in the table, which of the following is *least likely* to be an explanation for the difference between the two money-weighted rates of return?

- A Investor A increased the investment in the fund at the end of year 1 whereas investor B did not make any additions or withdrawals.  
B Investor B decreased the investment in the fund at the end of year 1 whereas investor A did not make any additions or withdrawals.  
C The investors invested different amounts at inception and afterward did not make any additions or withdrawals.
- 23 All else held constant, the width of a confidence interval for a population mean is *most likely* to be smaller if the sample size is:
- A larger and the degree of confidence is lower.  
B larger and the degree of confidence is higher.  
C smaller and the degree of confidence is lower.

- 24 A two-tailed test of the null hypothesis that the mean of a distribution is equal to 4.00 has a  $p$ -value of 0.0567. Using a 5% level of significance (i.e.,  $\alpha = 0.05$ ), the *best* conclusion is to:
- A fail to reject the null hypothesis.
  - B increase the level of significance to 5.67%.
  - C reject the null hypothesis.
- 25 A price range in which selling is sufficient to stop the rise in price is *best* described as:
- A change in polarity.
  - B resistance.
  - C support.
- 26 A portfolio manager would like to calculate the compound rate of return on an investment. Which of the following mean returns will he *most likely* use?
- A Geometric
  - B Harmonic
  - C Arithmetic
- 27 A portfolio manager estimates the probabilities of the following events for a mutual fund:
- Event A: the fund will earn a return of 5%.
  - Event B: the fund will earn a return below 5%.
- The *least* appropriate description of the events is that they are:
- A dependent.
  - B mutually exclusive.
  - C exhaustive.
- 28 The effective annual yield (EAY) for an investment is 8.0%. Its bond equivalent yield is *closest* to:
- A 8.00%.
  - B 7.85%.
  - C 8.16%.
- 29 With Bayes' formula, it is possible to update the probability for an event given some new information. Which of the following *most* accurately represents Bayes' formula?
- A  $P(\text{Event} \mid \text{Information}) = \frac{P(\text{Information} \mid \text{Event})}{P(\text{Information})} P(\text{Event})$
  - B  $P(\text{Event} \mid \text{Information}) = \frac{P(\text{Information})}{P(\text{Information} \mid \text{Event})} P(\text{Event})$
  - C  $P(\text{Event} \mid \text{Information}) = \frac{P(\text{Information} \mid \text{Event})}{P(\text{Event})} P(\text{Information})$
- 30 An analyst collects data relating to five commonly used measures of leverage and interest coverage for a randomly chosen sample of 300 firms. The data comes from those firms' fiscal year 2012 annual reports. These data are *best* characterized as:
- A time-series data.
  - B cross-sectional data.
  - C longitudinal data.

- 31 Over a four-year period, a portfolio has returns of 10%, –2%, 18%, and –12%. The geometric mean return across the period is *closest* to:
- A 3.5%.
  - B 8.1%.
  - C 2.9%.
- 32 An equally weighted portfolio is composed of four stocks. An analyst knows the mean and variance for each of the four stocks. In order to estimate the portfolio mean and variance, the analyst will require the stocks’:
- A skewness.
  - B pairwise correlations.
  - C kurtosis.
- 33 Two events  $A$  and  $B$  are independent if the probability of occurrence of  $A$ :
- A equals the product of the individual probabilities of occurrence of  $A$  and  $B$ .
  - B is related to the occurrence of  $B$ .
  - C does not affect the probability of occurrence of  $B$ .
- 34 If the prices of substitute resources decrease, the demand for a given resource will *most likely*:
- A remain unchanged.
  - B decrease.
  - C increase.
- 35 The following equations have been developed for a company:
- Demand curve:  $P = 150 - 5 \times Q$
- Total revenue curve:  $TR = 150 \times Q - 5 \times Q^2$
- Marginal revenue curve:  $MR = 150 - 10 \times Q$
- Total cost curve:  $TC = Q^3 - 10 \times Q^2 + 73 \times Q + 120$
- Average cost curve:  $AC = Q^2 - 10 \times Q + 73 + 120/Q$
- Marginal cost curve:  $MC = 3 \times Q^2 - 20 \times Q + 73$
- $P$  indicates price per unit, and  $Q$  indicates cost per unit.
- The profit maximizing output for this firm (in units) is *closest* to:
- A 11.
  - B 8.
  - C 7.
- 36 For a given economy and a given period of time, GDP measures the:
- I. aggregate income earned by all households, all companies, and the government.
  - II. total income earned by all of the country’s citizens, firms, and the government.
  - III. total market value produced of resalable and final goods and services.
- The *most* appropriate description of what is measured by GDP is given by:
- A I only.
  - B I and II.
  - C I and III.
- 37 The following information applies to a hypothetical economy:



Total population	1,100
Working age population	975
Labor force	750
Underemployed	120
Unemployed	95
Discouraged workers	80
Frictionally unemployed	25
Voluntarily unemployed	40

The unemployment rate is *closest* to:

- A 12.7%.
- B 16.0%.
- C 9.7%.

- 38 Three countries produce tables and chairs, and the output per worker per day in each country as follows:

Country	Tables	Chairs
A	60	80
B	40	60

Assume that Country C produces 10% more tables than Country B and 10% fewer chairs than Country A. Which country *most likely* has the greatest comparative advantage for producing tables? Country

- A C
- B B
- C A

- 39 Which of the following is *least likely* to affect the growth of the economy?

- A The workforce attending an average of 20 hours of training per year
- B When capital depreciation exceeds gross investment within the economy
- C An increase in the labor force that is offset by a decrease in the average hours worked per worker, making the total hours worked unchanged

- 40 The *most likely* initial (short-run) effect of demand–pull inflation is an increase in:

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

- 41 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 expand the economy through a lower policy interest rate.
- B contract the economy through a lower policy interest rate.
- C contract the economy by reducing bank reserves.

- 42 An investor examines the following rate quotes for the Brazilian real (BRL) and the Australian dollar (AUD) and shorts BRL500,000.

- Spot rate BRL/AUD: 2.1128
- BRL 1-year interest rate: 4.1%
- Forward rate BRL/AUD: 2.1388

- AUD 1-year interest rate: 3.1%
- The risk-free arbitrage profit that is available is *closest* to:
- A –BRL6,327.
  - B BRL1,344.
  - C BRL6,405.
- 43 Which of the following factors is *most likely* to lead to economies of scale?
- A Supply constraints
  - B Duplication of product lines
  - C Specialization by workers
- 44 A liquidity trap is *most* closely associated with:
- A deflation.
  - B an inelastic demand for money.
  - C a positive nominal central bank policy rate.
- 45 Given stable inflation, a tight fiscal policy accompanied by easy monetary policy will *most likely*:
- A increase the private sector share of GDP.
  - B have no impact on the private sector share of GDP.
  - C decrease the private sector share of GDP.
- 46 Providing information about the performance of a company, its financial position, and changes in financial position that is useful to a wide range of users is *most* accurately described as the role of:
- A financial reporting.
  - B the audit report.
  - C financial statement analysis.
- 47 According to the International Accounting Standards Board's (IASB) Conceptual Framework for Financial Reporting, the two fundamental qualitative characteristics that make financial information useful are *best* described as:
- A understandability and verifiability.
  - B relevance and faithful representation.
  - C timeliness and accrual accounting.
- 48 At the end of the year, a company reported an impairment loss on its manufacturing plant, reducing its carrying amount by 10%. The impairment loss is *least likely* to cause the company's:
- A debt-to-asset ratio to increase.
  - B cash flow from operations to decline.
  - C fixed asset turnover to increase.
- 49 Obligations arising from past events that are expected to result in an outflow of economic benefits from an entity are *most likely* known as:
- A expenses.
  - B liabilities.
  - C operating activities.
- 50 The following information applies to a capital asset of a company:

Year Ending	2014	2013	2012
Capital asset	€2,500	€2,500	€2,500
Accumulated depreciation	375	250	125
Net book value	2,125	2,250	2,375

This company uses the straight-line depreciation method for this capital asset.

At the end of 2014, the expected remaining life of the capital asset, in years, is *closest* to:

- A 17.
- B 20.
- C 6.

- 51 Because of significant changes in the marketplace, the demand for a company's product has fallen and is not expected to recover to previous levels. The following information is related to the patent under which the product is produced:

Item Description	\$ thousands
Carrying value amount	36,000
Undiscounted expected future cash flows	38,000
Present value of expected future cash flows	32,000
Fair value if sold	34,000
Costs to sell	4,000

Which of the following statements is *most* accurate? The patent is impaired under:

- A IFRS only.
- B both IFRS and US GAAP.
- C US GAAP only.

- 52 The method used by a high-end custom-built motorcycle manufacturer to value its inventory results in the matching of the physical flow of the particular items sold, and the items remaining in inventory, to their actual cost. Which of the following inventory valuation methods is the manufacturer *most likely* using?

- A FIFO
- B Weighted average cost
- C Specific identification

- 53 Net revenue *most likely* refers to revenue minus:

- A revenues attributable to non-controlling interests.
- B estimates of warranty expense.
- C volume discounts and estimated returns.

- 54 Consider the following information available for a company for last year:

ROE	4.74%
Net profit margin	2.6%
Revenue	\$400,000
Average total assets	\$300,000

The average shareholder's equity is *closest* to:

- A \$164,557.
- B \$123,418.
- C \$219,409.

55 A company's balance sheet shows the following values (€):

Cash	12,000
Marketable securities	3,000
Accounts receivable	16,500
Inventory	8,745
Prepaid expenses	2,305
Current liabilities	32,580

The company's cash ratio is *closest* to:

- A 0.46.
  - B 0.97.
  - C 0.37.
- 56 The following table presents excerpts from financial statements for two merchandising companies following the format found in each of their annual reports.

Company A (US\$ millions)		Company B (¥ millions)	
Assets		Assets	
Noncurrent assets	9,640	Current assets	4,333
Current assets	2,096	Noncurrent assets	19,923
Total assets	11,736	Total assets	24,256

Which of the companies *most likely* prepares its financial statements in accordance with US GAAP?

- A Only Company B
  - B Both companies
  - C Only Company A
- 57 If a company that leases assets for its own use classifies its leases as finance leases instead of as operating leases, its financial statements in the first year would *most likely* report:
- A lower cash from operations.
  - B higher debt.
  - C higher equity.
- 58 The following financial statement data are available for a company:

Metric	Current Year (£ thousands)	Prior Year (£ thousands)
Total debt	1,600	1,600
Total assets	4,800	5,200
Total liabilities	2,700	3,200

The company's financial leverage ratio for the current year is *closest* to:

- A 3.12.
- B 0.32.
- C 2.44.

- 59 On 1 January 2011, a company that prepares its financial statements according to International Financial Reporting Standards (IFRS) issued bonds with the following features:

- Face value: £20,000,000
- Term: Five years
- Coupon rate: 6% paid annually on 31 December
- Market rate at issue: 4%

The company carries all its bonds at cost. In December 2013, the market rate on similar bonds had increased to 5%, and the company decided to buy back (retire) the bonds after the coupon payment on 31 December. As a result, the gain on retirement reported on the 2013 income statement income is *closest* to:

- A £340,410.  
 B £371,882.  
 C £382,556.
- 60 A global equity investor makes investment decisions based on only the P/E. The average P/E of all global equities is 14. The screen of a large number of global equities based on P/E resulted in the following distribution:

	Earnings Growth	P/E
Lower third	5%	8
Middle third	10%	15
Top third	8%	25

If the investor selects only stocks from the lower third of the distribution, it would be *most* appropriate to classify the investor as a:

- A growth investor.  
 B market-oriented investor.  
 C value investor.
- 61 Information about a company's historical performance for the last two years and additional information are summarized in the following table.

(\$ thousands)	2013	2012
Sales	5,500.0	5,350.0
Cost of goods sold	–2,200.0	–2,140.0
Operating expenses	–2,350.0	–2,350.0
Gain on sale of short-term investments	0	140.0
Tax expense	–237.5	–325.0
Income (loss) from discontinued operations (net of tax)	–312.5	112.5
Net income	400.0	787.5

Industry sales are expected to increase 5%, and the company expects to maintain its current market share and gross profit margin. Operating expenses are not expected to change with the increase in sales.

The company sold off its portfolio of marketable securities in 2012 and used the funds to purchase operating assets. In 2012, the company announced its intention to sell off a division, and that sale was completed in 2013. The results from the division and the gain or loss incurred on the sale are classified as discontinued operations.

The projected net income (in thousands) for 2014 is *closest* to:

- A \$745.
  - B \$836.
  - C \$635.
- 62 Which of the following companies would *most likely* be considered to have the lowest financial reporting quality, other things equal?
- A A company that provides high quality, decision-useful information under GAAP but delays its reports.
  - B A company that reports significant profits due to a favorable exchange rate movement.
  - C A company that reports the results from two different segments as a combined entity.
- 63 In accrual accounting, if an adjusting entry results in the reduction of an asset and the recording of an expense, the originating entry recorded was *most likely* a(n):
- A deferred revenue.
  - B prepaid expense.
  - C accrued expense.
- 64 Inherent risks in an investment are *most* appropriately evaluated in which step of the financial statement analysis framework?
- A Develop and communicate conclusions/recommendations
  - B Articulate the purpose and context of analysis
  - C Process data
- 65 A company purchased equipment for \$50,000 on 1 January 2011. It is depreciating the equipment over a period of 10 years on a straight-line basis for accounting purposes, but for tax purposes it is using the declining balance method at a rate of 20%. Given a tax rate of 30%, the deferred tax liability at the end of 2013 is *closest* to:
- A \$6,720.
  - B \$2,820.
  - C \$420.
- 66 During a period of rising inventory costs, a company decides to change its inventory method from FIFO to the weighted average cost method. Under the weighted average method, which of the following financial metrics will *most likely* be higher than under FIFO?
- A Current ratio
  - B Number of days in inventory
  - C Debt-to-equity ratio
- 67 Which of the following is *most likely* to signal manipulation of financial reporting for a large, diversified company?
- A A history of large expense items classified as unusual
  - B Operating margins out of line with other diversified companies
  - C Changes in accounting policies to reflect new accounting standards

- 68 Under the indirect method, a US GAAP-compliant company reported total revenue of \$359 million, net income of \$35 million, a decrease in income tax payable of \$16 million, and an increase in interest expense payable of \$22 million. Based on this information, converting to the direct method would result in cash paid for operating expenses of:
- A \$330 million.
  - B \$353 million.
  - C \$318 million.
- 69 Under general principles of expense recognition, a company should:
- A apply uniform treatment for administrative and depreciation costs.
  - B recognize expenses in the period that it consumes the associated economic benefits.
  - C allocate lost economic benefits prospectively over the expected period in which the benefits would have been earned.
- 70 Which action is *most likely* considered a secondary source of liquidity?
- A Increasing the efficiency of cash flow management
  - B Renegotiating current debt contracts to lower interest payments
  - C Increasing the availability of bank lines of credit
- 71 Which of the following is *most likely* considered an example of matrix pricing when determining the cost of debt?
- A Debt-rating approach only.
  - B Yield-to-maturity approach only.
  - C Both the yield-to-maturity and the debt-rating approaches.
- 72 Given the following information, the degree of operating leverage (DOL) is *closest to*:

Income Statement	Millions (\$)
Revenues	9.8
Variable operating costs	7.2
Fixed operating costs	1.5
Operating income	1.1
Interest	0.6
Taxable income	0.5
Tax	0.2
Net income	0.3

- A 2.4.
  - B 1.1.
  - C 1.7.
- 73 Other factors held constant, the reduction of a company's average accounts payable because of suppliers offering less trade credit will *most likely*:
- A not affect the operating cycle.
  - B reduce the operating cycle.
  - C increase the operating cycle.

- 74 A firm's estimated costs of debt, preferred stock, and common stock 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 (WAAC) is *closest* to:
- A 13.9%.
  - B 14.7%.
  - C 16.3%.
- 75 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.
- 76 Given two mutually exclusive projects with normal cash flows, the point at which their net present value profiles intersect the horizontal axis is *most likely* the projects':
- A weighted average cost of capital.
  - B crossover rate.
  - C internal rate of return.
- 77 Based on best practices in corporate governance procedures, it is *most* appropriate for a company's compensation committee to:
- A link compensation with long-term objectives.
  - B include a retired executive from the firm.
  - C include a representative from the firm's external auditor.
- 78 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.
- 79 If Investor A has a lower risk aversion coefficient than Investor B, will Investor B's optimal portfolio *most likely* have a higher expected return on the capital allocation line?
- A No, because Investor B has a lower risk tolerance
  - B No, because Investor B has a higher risk tolerance
  - C Yes
- 80 Which of the following institutional investors is *most likely* to have a low tolerance for investment risk and relatively high liquidity needs?
- A Insurance company
  - B Defined-benefit pension plan
  - C Charitable foundation



- 81 An analyst uses a multi-factor model to estimate the expected returns of various securities. The model analyzes historical and cross-sectional return data to identify factors that explain the variance or covariance in the securities' observed returns. This model is *most likely* a:
- A statistical factor model.
  - B macroeconomic factor model.
  - C fundamental factor model.
- 82 The slope of the security market line (SML) represents the portion of an asset's expected return attributable to:
- A diversifiable risk.
  - B market risk.
  - C total risk.
- 83 With respect to the portfolio management process, asset allocation decisions are *most likely* made in the:
- A execution step.
  - B planning step.
  - C feedback step.
- 84 A factor that *most likely* measures a client's ability to bear risk is his or her:
- A time horizon.
  - B inclination to independent thinking.
  - C personality type.
- 85 An optimal risky portfolio has an expected return of 15% and standard deviation of 20%. The risk-free rate is currently 5%. A risk-seeking investor who is considering investing along the capital allocation line (CAL) would *most likely*:
- A borrow 25% of her wealth at the risk-free rate and invest 125% in the optimal risky portfolio.
  - B invest 100% of her wealth in the optimal risky portfolio.
  - C lend 100% of her wealth at the risk-free rate.
- 86 Which of the following pairs of risks are *most closely* related?
- A Model risk and tail risk
  - B Liquidity risk and operational risk
  - C Credit risk and solvency risk
- 87 Which of the following financial intermediaries is *most likely* to provide liquidity service to its clients?
- A Brokers
  - B Dealers
  - C Exchanges
- 88 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
- 89 Compared with its market-value-weighted counterpart, a fundamental-weighted index is *least likely* to have a:
- A momentum effect.

**B** contrarian effect.

**C** value tilt.

- 90** Which of the following is *least likely* to be directly reflected in the returns on a commodity index?

**A** Changes in the futures prices of commodities in the index

**B** Changes in the spot prices of underlying commodities

**C** Roll yield

- 91** The following information is available about a company:

Next year's sales revenue	\$180 million
Next year's net profit margin	15%
Dividend payout ratio	60%
Dividend growth rate expected during Years 2 and 3	25%
Dividend growth rate expected after Year 3	5%
Investors' required rate of return	12%
Number of outstanding shares	8.1 million

The current value per share of the company's common stock according to the two-stage dividend discount model is *closest* to:

**A** \$39.36.

**B** \$49.20.

**C** \$52.86.

- 92** An investor gathers the following data to estimate the intrinsic value of a company's stock using the justified forward price-to-earnings ratio (P/E) approach.

Next year's earnings per share	\$3.00
Return on equity	12.5%
Dividend payout ratio	60%
Required return on shares	10%

The intrinsic value per share is *closest* to:

**A** \$36.

**B** \$48.

**C** \$72.

- 93** Which of the following statements concerning different valuation approaches is *most* accurate?

**A** One advantage of the three-stage dividend discount model (DDM) model is that it is equally appropriate to young companies entering the growth phase and those entering the maturity phase.

**B** It is advantageous to use asset-based valuation approaches rather than forward-looking cash flow models in the case of companies that have significant intangibles.

**C** The justified forward price-to-earnings ratio (P/E) approach offers the advantage of incorporating fundamentals and presenting intrinsic value estimations.

- 94** 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.
- 95 The type of voting in board elections that is most beneficial to shareholders with a small number of shares is *best* described as:
- A statutory voting.
- B cumulative voting.
- C voting by proxy.
- 96 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.
- 97 Which of the following is *least likely* a primary reason a company would raise capital through the issuance of equity securities? To:
- A finance the purchase of long-lived assets
- B maximize the wealth of shareholders
- C directly satisfy stock compensation plans
- 98 The value effect market-pricing anomaly *most likely* occurs when stocks that have below-average price-to-earnings and market-to-book ratios, as well as above-average dividend yields, consistently outperform:
- A large-cap stocks.
- B growth stocks.
- C stocks that have had negative earnings surprises.
- 99 Using the following US Treasury spot rates, the arbitrage-free value of a two-year \$100 par value Treasury bond with a 6% coupon rate is *closest* to:

Period	Years	Spot Rate
1	0.5	1.60%
2	1.0	2.20%
3	1.5	2.70%
4	2.0	3.10%

- A \$107.03.
- B \$105.65.
- C \$99.75.
- 100 Which of the following is *least likely* to be a type of embedded option in a bond issue granted to bondholders? The right to:
- A put the issue.
- B convert the issue.
- C call the issue.
- 101 In a securitization structure, credit tranching allows investors to choose between:
- A subordinated bonds and senior bonds.
- B extension risk and contraction risk.
- C partially amortizing loans and fully amortizing loans.

- 102 A portfolio manager holds the following three bonds, which are option-free and have the indicated durations.

Bond	Par Value Owned	Market Value Owned	Duration
A	\$8,000,000	\$12,000,000	3
B	\$8,000,000	\$6,000,000	7
C	\$4,000,000	\$6,000,000	6

The portfolio's duration is *closest* to:

- A 4.75.  
 B 5.20.  
 C 5.33.
- 103 The Macaulay duration of a non-callable perpetual bond with a yield in perpetuity of 8% is *closest* to:
- A 7.4.  
 B 8.0.  
 C 13.5.
- 104 A credit analyst observes the following information for Alpha Co. at fiscal years ending 20X1 and 20X2.

**Excerpt from the Consolidated Income Statement of Alpha Co. for the Fiscal Years Ending 31 December 20X1 and 20X2 (in millions)**

	20X1	20X2
Gross profit	\$550.0	\$505.0
Operating expenses	450.0	370.0
Operating profit	100.0	135.0
Interest expense	30.0	35.0
Income before taxes	70.0	100.0
Income taxes (at 30%)	21.0	30.0
Net income	49.0	70.0
<i>Additional information</i>		
Depreciation and amortization	25.0	35.0

Based on this information, over this period Alpha's interest coverage ratio has:

- A improved.  
 B remained unchanged.  
 C deteriorated.
- 105 Eldora Ltd. recently issued deferred-coupon bonds for which no coupon payments will be paid in the first two years of the bond's life. Regular annual coupon payments at a rate of 9% will then be made until the bonds mature at the end of six years. The spot rates for various maturities are given in the following table.

Time to Maturity	Spot Rate
1 year	8.0%
2 years	7.5%
3 years	7.0%
4 years	6.5%
5 years	6.0%
6 years	5.5%

On the basis of these spot rates, the price of the bond today is *closest* to:

- A 100.12.
- B 108.20.
- C 116.24.

106 Which of the following factors will *most likely* drive the repo margin lower?

- A Lower quality of the collateral
- B Shorter supply of the collateral
- C Lower credit quality of the counterparty

107 Using the following information and assuming coupons are paid annually, the G-spread of the Steel Co. bond is *closest* to:

Bond	Maturity	Coupon	Price
Steel Co.	2 Years	5.00%	101.70
Treasury bond	2 Years	4.00%	100.50

- A 36 bps.
- B 94 bps.
- C 100 bps.

108 Which of the following *most likely* has the highest priority claim in the event of default?

- A Unsecured debt
- B Subordinated debt
- C Secured debt

109 AMK Corp. purchased US government bonds through the Bloomberg fixed-income electronic trading platform. This transaction is *most likely* known as:

- A exchange traded.
- B private placement.
- C over-the-counter.

110 During the lockout period for a non-amortizing asset-backed security, the principal payment of €100 million on a €1 billion face value issue will result in the security having a total face value of:

- A €0.9 billion.
- B €1.1 billion.
- C €1.0 billion.

111 A swap in which the investor receives a variable payment in line with market conditions and makes a fixed payment can *best* be replicated by purchasing a:

- A set of long futures contracts which are matched with short forward contracts.

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- B** series of forward contracts, each with an initial value of zero.
- C** floating rate bond financed using a fixed-rate bond.
- 112** During its life, the value of a forward contract is *most likely* equal to the price of the underlying minus the price of the:
- A** forward.
- B** forward, discounted over the original term of the contract.
- C** forward, discounted over the remaining term of the contract.
- 113** Which of the following statements *best* describes a feature of an American option? Early exercise of an American:
- A** put option is optimal only if the underlying is dividend paying.
- B** call option is never optimal if the underlying is dividend paying.
- C** put option that is deep in the money may be optimal.
- 114** In a currency swap, the underlying principal amount is exchanged:
- A** only at the start of the swap.
- B** only at the end of the swap.
- C** both at the start and at the end of the swap.
- 115** All, else held equal, the value of a European call option is *best* characterized as having a:
- A** negative relationship with the price of the underlying.
- B** negative relationship with the volatility of the underlying.
- C** positive relationship with the time to expiration.
- 116** The real estate index *most likely* to suffer from sample selection bias is a(n):
- A** repeat sales index.
- B** REIT index.
- C** appraisal index.

- 117** The following information is available about a hedge fund:

Initial fund assets	\$100 million
Fund assets at the end of the period (before fees)	\$110 million
Management fee based on assets under management	2%
Incentive fee based on the return	20%
Soft hurdle rate	8%

No deposits to the fund or withdrawals from the fund occurred during the year. Management fees are calculated using end-of-period valuation. Management fees and incentive fees are calculated independently. The net-of-fees return of the investor is *closest* to:

- A** 7.8%.
- B** 7.4%.
- C** 5.8%.
- 118** Relative to traditional investments, alternative investments are *best* characterized as having:
- A** higher correlations with other asset classes.
- B** unique legal and tax considerations.
- C** greater liquidity.
- 119** The *most likely* impact of adding commodities to a portfolio of equities and bonds is to:

- A increase risk.
- B provide higher current income.
- C reduce exposure to inflation.

**120** Which of the following is *most likely* a private real estate investment vehicle?

- A Real estate limited partnership
- B Real estate investment trust
- C Collateralized mortgage obligation