Equity

CFA一级押题

讲师：Tom

Equity(1)

- A market has the following limit orders on its book for a particular stock:

Buyer	Bid Size (# of shares)	Limit Price($)	Seller	Offer Size (# of shares)	Limit Price($)
1	500	18.50	1	200	20.20
2	300	18.90	2	300	20.35
3	400	19.20	3	400	20.50
4	200	20.10	4	100	20.65
5	100	20.15	5	200	20.70

- If a trader wants to purchase 700 shares of common stocks with an average execution price between 20 and 21, he would least likely place a (an):

A. market order.

B. stop buy order at 21 and limit buy order at 20.

C. immediate-or-cancel limit buy order at a price of $20.50.

Equity(1)

- **Solution: B.**
  - Both market buy order and limit buy order will be filled from the most aggressively priced limit sell orders to the least. Hence the market buy order and the limit buy order of $20.50 will have same average execution price at $20.35.
  - Average price = [(200 × $20.20) + (300 × $20.35) + (200 × $20.50)] / 700 = $20.35
  - However, a stop buy order at 21 and a limit buy order at 20 will not be executed.

Equity(2)

- Which of the following stock has the lowest risk and the most stable cash flow?

  A. Putable preferred stock.

  B. Putable cumulative preferred stock.

  C. Common stock.

- Solution: B.
  - Putable cumulative preferred stock has the lowest risk and the most stable cash flow. Cumulative preferred shares retain the right to receive any missed dividends before any common stock dividends can be paid.

Equity(3)

- A stock index consists of low price-to-book ratio stocks , what kind of index it mostly like?

  A. Style index

  B. Multi-market index

  C. Sector index

Equity(3)

- Solution: A
  - The price-to-book ratio, which is also referred to as the market-to-book ratio, provides an indication of investors' expectations about a company's future investment and cash flow-generating opportunities. The larger the price-to-book ratio (i.e., the greater the divergence between market value per share and book value per share), the more favorably investors will view the company's future investment opportunities

Equity(4)

- Two analysts Zhou and Wang held different opinions towards the share price of iRobot Incorporation. The current price is $55. Zhou took a long position on the stock and would like to close this position once the price rose to $70. Wang took a short position and would like to cover his loss if the stock price rose to $60. Which of the following orders will meet their requirements?

	Zhou	Wang
A	Limit sell at $70	Limit buy at $60
B	Limit sell at $70	Stop buy at $60
C	Stop sell at $70	Limit buy at $60

Equity(4)

- Solution: B
  - Zhou needs to sell his shares at the price of 70 or above, therefore, a limit sell order is appropriate. However, Wang would like to cover his position when stock price rose to $60. In other words, he decides to buy the stock once the stock price rose up to $60, so a stop order is more appropriate.

Equity(5)

- An investor purchased 5,000 stocks at 57 dollars on margin. The initial margin he deposited to his broker is 40%. The broker will make a margin call when the margin account is less than 25%. The price that will cause a margin call is closest to:
  A. 30.0.
  B. 45.6.
  C. 23.0.

- **Solution: B**

$$\text{Trigger price} = P_0\left(\frac{\text{1-initial margin}}{\text{1-maintenance margin}}\right)=57\left(\frac{1\text{-}40\%}{1\text{-}25\%}\right)=45.6$$

Equity(6)

- An investor gathers the following data. To estimate the stock's justified forward P/E, the investor prefers to use:
  - the earnings growth rate rather than the dividends growth rate and
  - the average of the payout ratios over the relevant period, in this case 2006-2009, rather the most recent payout ratio.

Year	EPS	DPS	ROE
2009	\$3.20	\$1.92	12%
2008	\$3.60	\$1.80	17%
2007	\$2.44	\$1.71	13%
2006	\$2.50	\$1.60	15%

- The yield on 10-year T-notes is 3 percent and the current equity risk premium is 6.5 percent. If beta is 1.3, then the stock's justified forward P/E is *closest* to:

  A. 12.

  B. 16.

  C. 21.

Equity(6)

- Solution: C.
  - Earnings growth rate over the period 2006-2009=2.50 × $(1 + g)^3$=3.2; g=8.6%
  - Average payout ratio= (0.60+0.50+0.70+0.64)/4=0.61
  - Required rate of return on share i= Current expected risk-free rate of return+ Beta × [Market (equity) risk premium] =3%+1.3(6.5%) =11.45%
  - P/E_1=payout rate/(r-g) =0.61/ (0.1145-0.086) = 21.4

Equity(7)

- ABC Fund invests in Singapore's government debt with maturities up to three months. It is *most likely* classified as a:

  A. fixed-income arbitrage fund.

  B. money market fund.

  C. bond mutual fund.

- Solution: B.
  - B is correct. Money market funds invest in short-term corporate or government debt. The difference between a bond mutual fund and a money market fund is the maturity of the underlying assets. In a money market fund, the maturity is as short as overnight and rarely longer than 90 days.

Equity(8)

- An analyst collected the following data about a listed company:

Earnings per share	20
Dividend declared	5
Return on assets	8%
Debt/Equity ratio	1.5
Net profit margin	15%

- The constant growth rate of dividends is *closest* to:

  A. 12%.

  B. 15%.

  C. 20%.

Equity(8)

- Solution: B.
  - From debt/equity ratio we can calculate the Asset/Equity ratio=2.5.
  - ROE= ROA × Financial Leverage = 8% × 2.5 = 20%
  - Constant growth rate of dividends g= ROE × retention ratio = ROE × (1- payout ratio) = 20% × (1-5/20) = 15%

Equity(9)

- Which of the following is most likely a cross-sectional anomaly in financial markets?

  A. Closed-end fund discount

  B. Overreaction effect

  C. Value effect

- **Solution: C.**
  - The value effect—that is, stocks with below-average price-to-earnings and market-to-book ratios and above-average dividend yields have consistently outperformed growth stocks over long periods—is a cross-sectional anomaly.
  - A is incorrect because a closed-end fund discount is an anomaly where a closed-end fund trades at a discount from its net asset value. It is not a cross-sectional anomaly.
  - B is incorrect because overreaction effect is a time-series anomaly, not a cross-sectional anomaly.

Equity(10)

- An index consists of 100 shares of security A, 200 shares of security B and 300 shares of security C. Security A is currently priced at $10, security B is currently priced at $20 and security C is currently priced at $50. If the observed returns of the three securities are 12%, 15% and 18% respectively, what of the following weighting method will have the highest index return?
  - A. Equal
  - B. Price
  - C. Value

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Equity(10)

- **Solution: C.**
  - Equal-weighted index places an equal weight on the returns of all index stock, regardless of their price or market value.
  - The return of an equal weighted index = (12%+15%+18%)/3=15%
  - The return of a price weighted index =
    10/(10+20+50) × 12%+20/(10+20+50) × 15%+50/(10+20+50) × 18%=16.5%
  - The return of a value weighted index=
    10 × 100/ (10×100+20 × 200+50×300) × 12%+20 ×
    200/(10×100+20×200+50×300) × 15%+
    50 × 300/ (10×100+20 × 200+50×300) × 18%=17.1%

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Equity(11)

- If an industry is observed to have high pricing power, it is *most likely* that the industry:
  - A. has high barriers to entry.
  - B. is fragmented.
  - C. is overcapacity.

- Solution: A.
  - An industry that has high barriers to entry generally requires substantial physical capital and/or financial investment, indicating fewer suppliers and a less competitive industry.
  - An industry that is fragmented does not necessarily have high pricing power.
  - An industry that is overcapacity has low pricing power.

Equity(12)

- Which date in the chronology of a dividend payment is most likely determined by a security exchange?
  A. Holder-of-record date
  B. Declaration date
  C. Ex-dividend date

- **Solution: C**
  - C is correct. The ex-dividend date is normally determined by the security exchange on which the shares are listed. The corporation determines the holder-of-record date and declaration date.
  - A is incorrect because the holder-of-record date is determined by the company.
  - B is incorrect because the declaration date is determined by the company.

Equity(13)

- A portfolio manager wants to calculate the return of a market cap-weighted index. Which of the following will take place if a new stock is included in the market-cap index?
  A. Rebalancing.
  B. Reconstitution.
  C. Both.

- **Solution: C**

  Both rebalancing reconstitution will occur if a new stock is included in the market-cap index.
  Rebalancing is used to adjusting the weights of securities in a portfolio to their target weights since price changes may affect the weights of securities used to calculate the indexes.
  Reconstitution refers to periodically adding and deleting securities that make up an index.

Equity(14)

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

		Annualized Data	
Strategy	Type of Strategy	Fees and Expenses(%)	Net Return(%)
1	Passive	0.5	15.5
2	Exploits price patterns	1.5	14.5
3	Uses fundamental analysis	1	

- The return, gross of fees and expenses that causes Strategy 3 to be most consistent with the strong form of market efficiency is:
  A. 16%.
  B. 18%.
  C. 17%.

Equity(14)

- **Solution: A**

  For a violation of the strong form of market efficiency to occur, the strategy based on fundamental analysis must achieve a net return higher than the gross return of the passive strategy, on a risk-adjusted basis. This threshold Gross return = Net return + Fees and expenses = 15.5% + 0.5% = 16%. Anything in excess of 16% would violate the strong form of market efficiency for the fundamental analysis strategy.

Equity(15)

- An analyst found that in his market, fundamental analysis cannot generate abnormal return. However, inside traders always beat the market. According to the efficient market hypothesis, the market this analyst belongs to is most likely a:
  - Weak form efficient market.
  - Semi-strong form efficient market.
  - Strong form efficient market.

- Solution: B.
  - Under a semi-strong form efficient market, fundamental analysis cannot beat the market but inside information can generate abnormal return.

Equity(16)

- Selene Yan, a customer of digital technology company named Pineapple store, considers the products the company provides are very fashion and of high quality. Pineapple store is recently go public. Therefore Yan concludes that Pineapple store will be a very good investment. Which of the following statements concerning this behavioral bias is *most accurate*?

  A. This behavior can be described as the bias of mental accounts.
  B. This behavior can be described as the bias of narrow framing.
  C. This behavior can be described as the bias of representativeness.

- Solution: C
  - Representativeness assuming investors regard good companies or good markets as good investments, which on account of historical information.

Equity(17)

- For a US investor, which of the following statements concerning investing in depository receipts (DRs) is least accurate?
  - A. Investors in unsponsored DRs would have the same voting rights as the direct owners of common shares.
  - B. Investing in DRs could provide arbitrage opportunities and entail currency risk.
  - C. Sponsored DRs are subject to greater reporting requirements than unsponsored DRs.

- **Solution: A**

  Investors of unsponsored DRs would not have the same voting rights as the direct owners of common shares because the depository bank retains the voting rights.

Equity(18)

- Bob founded Pineapple, which develops digital technology products. Pineapple watch was a new product at that time. Recently, Bob noticed the profit of Pineapple shrunk massively and the competitions Pineapple facing are more intensive. The industry Pineapple belongs is most likely steps into a:
  - A. embryonic stage.
  - B. shakeout stage.
  - C. mature stage.

- Solution: B.
  - During the shakeout stage, an industry will suffer a declining profit due to fewer new customers found and increasing competitions.

Equity(19)

- Which of the following characteristics is *least likely* belongs to a cyclical company?
  - A. High price elasticity.
  - B. Stable demand.
  - C. High operating leverage.

- Solution: B.
  - A cyclic company will be easily affected by economic cycle. This fact attributes the cyclical companies meant to have high earnings volatility and unstable demand. High operating leverage company are easier affected by the economic turnover, therefore companies with high operating leverage are generally cyclical companies.

Equity(20)

- Which of the following firms would be best classified as operating in a consumer discretionary industry?
  - A. Tobacco manufacturer
  - B. Biotechnology
  - C. Hotel

- Solution: C.
  - Consumer discretionary companies derive a majority of revenue from the sale of consumer-related products or services for which demand tends to exhibit a relatively high degree of economic sensitivity. A hotel would be an example of a business activity that falls into this category.

Equity(21)

- The following information is available about a company:

Next year's sales revenue	$360 million
Next year's net profit margin	18%
Dividend payout ratio	50%
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	16.2 million

- The current value per share of the company's common stock according to the two-stage dividend discount model is closest to:
  - A. $22.46.
  - B. $39.36.
  - C. $45.21.

Equity(21)

- **Solution: B**

Net profit margin = Net earnings/Sales

Net earnings = Net profit margin × Sales;

Dividends per share (Dn) = (Net earnings × Payout ratio)/Number of outstanding shares;

Therefore, D1 = ($360 million × 0.18 × 0.50)/16.2 million = $2.00

D2 = $2.00(1 + 0.25) = $2.50

D3 = $2.00(1 + 0.25)^2 = $3.13

D4 = $2.00(1 + 0.25)^2 (1 + 0.05) = $3.28

V3 = $3.28 / (0.12-0.05) =46.86

V0= $2 / (1 + 0.12) +$ 2.5 / (1 + 0.12) ^{2} + $3.13 / (1 + 0.12) ^{3} + $46.86 / (1 + 0.12) ^{3} = $39.36

Equity(22)

- **Which of following is least likely the benefit of shelf registration?**
  A. the corporation doesn't need to makes all public disclosures
  B. the corporation reduce the borrower cost
  C. the corporation increase the flexibility in the timing of the capital transactions

- **Solution: A**
  - In a shelf registration , a firm makes its public disclosures as in a regular offering, but then issues the registered securities over time when it needs capital and when the markets are favorable. A is not the benefit of shelf registration.
  - In a shelf registration, it sells the shares directly into the secondary market over time, generally when it needs additional capital. Shelf registrations provide corporations with flexibility in the timing of their capital transactions .B and C are the benefit of shelf registration.

Equity(23)

- Which of the following is most likely considered a weakness of present value models?
  A. Present value models cannot be used for companies that do not pay dividends.
  B. Small changes in model assumptions and inputs can result in large changes in the computed intrinsic value of the security.
  C. The value of the security depends on the investor's holding period; thus, comparing valuations of different companies for different investors is difficult.

- **Solution: B**

  Very small changes in inputs, such as required rate of return or dividend growth rate, can result in large changes to the valuation model output. Some present value models, such as FCFE models, can be used to value companies without dividends. Also, the intrinsic value of a security is independent of the investor's holding period.

Equity(24)

- An investor gathered the following information to estimate the enterprice value multiple.

Market value of long-term debt	$6 million
Book value of long-term debt	$4 million
Book value of debt	$8 million
Market capitalization	$40 million
Cash and short-term investments	$2 million
EBITDA	$15 million
Firm's marginal tax rate	30%

- The company's EV/EBITDA multiple is *closest* to:
  A. 2.5.
  B. 3.2.
  C. 5.8.

Equity(24)

- **Solution: B.**
  - Enterprise value measures total company value.
  - EV = Market value of common and preferred stock + MV of debt - cash & short-term investments
  - MV of debt = MV of LT debt + MV of ST debt = MV of LT debt + (BV of debt – BV of LT debt)
  - EV = 40 + (6+8-4) -2 = 48; EV/EBITDA = 48 / 15 = 3.2

Equity(25)

- Which of the following statements concerning different valuation approaches is most accurate?
  - A. The justified forward price-to-earnings ratio (P/E) approach offers the advantage of incorporating fundamentals and presenting intrinsic value estimations.
  - B. 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.
  - C. 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.

- **Solution: A**

  The justified forward P/E approach offers the advantage of incorporating fundamentals and presenting intrinsic value estimations.

Equity(26)

- 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.

Equity(26)

- **Solution: C.**
  - Trailing P/E ratio = Current stock price/Current earnings per share = 35/6 = 5.83.
  - P/E ratio based on the Gordon growth dividend discount model = $\frac{D_1/E_1}{r-g}$ = $\frac{(2.4\times1.08)/(6\times1.08)}{0.15-0.08}$ = 5.71

Alternative

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Alternatives(1)

- Which of the following statements is *most likely* correct?
  A. Most alternative investments are actively managed.
  B. Activist strategy refers to purchase sufficient debt to influence a company's policy.
  C. Merger arbitrage strategy refers to long the stock of acquirer company and short stock of target company.

- **Solution: A.**
  - In real world, most alternative investments are actively managed. Activist strategy is investors purchase sufficient equity to influence a company's policy. Merger arbitrage strategy refer to long the target company and short the acquirer company.

Alternatives(1)

- **Characteristics:**
  - Illiquidity of underlying investments;
  - Narrow manage specialization;
  - Low correlation with traditional investments;
  - Low level of regulation and less transparency;
  - Limited and potentially problematic historical risk and return data;
  - Unique legal and tax considerations.

Alternatives(2)

- Which of the following hedge fund strategies is most likely categorized as an event-driven strategy?
  A. Fixed-Income Convertible Arbitrage.
  B. Quantitative Directional.
  C. Merger Arbitrage.

- **Solution: C.**
  Generally, these strategies involve going long (buying) the stock of the company being acquired and going short (selling) the stock of the acquiring company when the merger/acquisition is announced. The manager expects the acquirer to ultimately overpay for the acquisition and perhaps suffer from an increased debt load. The primary risk in this strategy is that the announced merger or acquisition does not occur, and the hedge fund has not closed its positions on a timely basis.

Alternatives(3)

- 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%.

Alternatives(3)

- **Solution: C**
  - The soft hurdle rate is surpassed, because the return of the fund is 10%. For that reason, the full fee, based on the full performance, is due.
  - Management fee: 2% of $110 million = $2.2 million.
  - Incentive fee: 20% of $10 million = $2 million.
  - Total fees: $4.2 million.
  - Therefore, the fund assets at the end of the period after fees are $105.8 million. The return for the investor is 5.8%.

Alternatives(4)

- Considering a hedge fund that invests primarily in distressed debt, we can get quoted market prices for the underlying holdings but the underlying holdings trade infrequently. Which of the following will the hedge fund most likely use in calculating net asset value for trading purposes?

  A. Average quotes.

  B. Average quotes adjusted for liquidity.

  C. Bid price for shorts and ask price for longs.

- **Solution: B.**

  Many practitioners believe that liquidity discounts are necessary to reflect fair value. This has resulted in some funds having two NAVs—for trading and reporting. The fund may use average quotes for reporting purposes but apply liquidity discounts for trading purposes.

Alternatives(5)

- Capital provided for companies beginning operation but before commercial manufacturing and sales have occurred best describes which stage in venture capital investing?

  A. Seed-stage.

  B. Early-stage.

  C. Later-stage.

- **Solution: B.**

  Early-stage financing is capital provided for companies moving into operation and before commercial manufacturing and sales have occurred.

Alternatives(6)

- Which attributes would a private equity firm most likely consider when deciding if a company is particularly attractive as a leveraged buyout target?
  A. high cash flow
  B. Efficiently managed companies
  C. high leverage

- **Solution: A.**
  The characteristics include undervalued/depressed stock price, willing management, inefficient management, strong and sustainable cash flow, low leverage and more physical assets.

Alternatives(7)

- An attractive target company for leveraged buyout will share all of the following characteristics except:
  A. Strong and sustainable cash flow.
  B. High leverage.
  C. Undervalued company.

- **Solution: B.**
  To serve as an attractive target for LBO, the company should have the following characteristics include, undervalued/depressed stock price, willing management, inefficient companies, strong and sustainable cash flow, low leverage and assets that can be used as security, and secured debt is cheaper than unsecured debt.

Alternatives(8)

- A venture capital typically provides fund for firms to prepare initial public offering. In which stage this venture capital is most like provide financing?
  A. Formative stage.
  B. Mezzanine-stage.
  C. Later stage.

- **Solution: B.**
- Mezzanine-stage venture capital financing is provided to the firms which prepare to go public. It also represents the bridge between the expanding company and the IPO. Formative-stage financing occurs when the company is still in the process of being formed and encompasses several financial steps. Later stage financing is provided after commercial production and sales have begun but before any IPO.

Alternatives(9)

- Which of the following can explain the reason why the price of a commodity futures contract is below the spot price?
  - A. Cost of carry exceeds the convenience yield.
  - B. Convenience yield exceeds storage costs.
  - C. Roll yield is negative.

- **Solution: B.**
  The convenience yield must exceed the cost of carry to arrive at a futures price below the spot price because the futures price is approximately equal to the spot price [(1 + r) + Storage cost – Convenience yield] and the cost of carry is defined as interest cost plus storage cost. Given that interest cost is always positive, the convenience yield must also exceed storage costs to arrive at a futures price below the spot price.

Alternatives(10)

- Which of the following infrastructure investments would most likely be easiest to value? A:
  - A. private equity fund holding brownfield investments.
  - B. master limited partnership holding greenfield investments.
  - C. master limited partnership holding brownfield investments.

- **Solution: C.**
  A master limited partnership (MLP) is publicly traded, whereas a private equity fund is not. Therefore the MLP will have market pricing information to help with valuation. A brownfield investment is an existing asset that likely has operational and financial history to aid in valuation; whereas a Greenfield investment is in new construction.

Alternatives(11)

- Those who pay considerable attention on the liquidity of the portfolio will most likely invest in:
  - A. real estate investment trusts.
  - B. hedge funds.
  - C. private equity.

- **Solution: A.**
  Comparing to hedge funds and private equity traded privately, real estate investment trusts are publicly traded and thus provide more liquidity.

Alternatives(12)

- An investor will most likely prefers high water mark in the incentive fee structure of a specific hedge fund to avoid:
  A. duplicated charge for same returns.
  B. prime brokerage fees.
  C. management fees.

- **Solution: A.**
  Clients are not charged an incentive fee if the latest cumulative return does not exceed the prior high water mark. This use of a high water mark protects clients from paying twice for the same performance. Although poorly performing hedge funds may not receive an incentive fee, the management fee is earned irrespective of returns.

Alternatives(13)

- With regard to venture capital, which of the following statements is most likely true regarding venture capital?
  A. Investors require a higher return than investors in publicly traded equity.
  B. Investments typically are in later stage and more established companies.
  C. Investors tend to have short time horizons.

- **Solution: A.**
  The historical standard deviations of annual return for venture capital are higher than that of common stocks. Investors should therefore require a higher return in exchange for accepting this higher risk, along with the illiquidity of venture capital investing.

Alternatives(14)

- U.S. farmers have become concerned that the future supply of wheat production will exceed demand. Any hedging activity to sell forward would most likely protect against which market condition?
  A. Contango.
  B. Full carry.
  C. Backwardation.

- **Solution: C.**
  C is correct because when a commodity market is in backwardation, the futures price is below the spot price because market participants believe the spot price will be lower in the future. When futures prices are above spot prices, the market is said to be in contango.