Learning Module 1: Alternative Investment Features, Methods and Structures

Q.1074 Which of the following is *not* exhibited by alternative investments in comparison to traditional investments?

A. More liquidity of assets held.

B. Less regulation and transparency.

C. More specialization by investment managers.

The correct answer is **A.**

Alternative investments are generally less liquid than traditional investments, as they tend to involve less frequently traded assets such as private equity, hedge funds, real estate, and commodities. These assets are often held for longer periods of time and may have limited secondary markets, making it difficult to sell them quickly. This can result in longer lock-up periods and limited opportunities for investors to exit their positions.
B is incorrect. Less regulation and transparency are often exhibited by alternative investments in comparison to traditional investments, as they are typically subject to fewer regulatory requirements and may have less public disclosure.

C is incorrect. More specialization by investment managers is often exhibited by alternative investments in comparison to traditional investments, as they tend to involve more complex and specialized strategies that require a high level of expertise and skill from investment managers.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.1215 Which of the following can *most likely* be categorized as alternative investments?

A. U.S Treasury Bills.

B. Real estate investments.

C. Corporate common shares.

The correct answer is **B.**

Alternative investments are non-traditional investments that do not fall within the traditional asset classes of stocks, bonds, and cash. Real estate investments, along with private equity, hedge funds, commodities, and other tangible assets such as art and wine, are commonly classified as alternative investments.

A is incorrect. U.S. Treasury Bills are typically considered traditional investments, as they are a type of fixed-income security that is issued and backed by the U.S. government.

C is incorrect. Corporate common shares are typically considered traditional investments, as they are publicly traded on stock exchanges and are part of the equity asset class.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.1218 Which of the following is *least likely* a category of alternative investments?

A. ETFs.

B. Fine wines.

C. Eurobonds.

The correct answer is **C.**

ETFs, private equity funds, commodities, real estate, and other investments such as antiques, collectibles, fine wines are categories of alternative investments. Traditional investments include stocks, bonds and cash.

A is incorrect. They are traded on stock exchanges and typically track indices, commodities, bonds, or a mix of investment types. However, there are ETFs that focus on alternative investment strategies or assets, such as those that invest in commodities or use leverage and short-selling strategies. Despite this, the broad accessibility and regulatory structure of ETFs align more closely with traditional investment vehicles, making this option a plausible but not the most accurate answer.

B is incorrect. Fine wines represent a classic example of an alternative investment. Investing in fine wines involves purchasing rare or highly sought-after wines with the expectation that their value will increase over time. This market is less correlated with traditional financial markets, offering potential diversification benefits. The value of fine wines can be influenced by factors such as vintage quality, brand reputation, and global demand, distinguishing it from more conventional investments. The tangible and collectible nature of fine wines, along with their unique market dynamics, solidifies their status as an alternative investment.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.1220 Including those assets with low correlations of returns with traditional assets into the portfolio will *most likely*:

A. Increase the risk of the portfolio.

B. Decrease the risk of the portfolio.

C. Decrease the return of the portfolio.

The correct answer is **B.**

The purpose of diversification in a portfolio is to reduce risk by spreading investments across multiple asset classes, such as stocks, bonds, and alternative investments, that have low correlations with each other. When assets with low correlations are added to a portfolio, it can potentially reduce the portfolio's overall volatility and decrease the risk of losses during market downturns. This is because if one asset class is performing poorly, another asset class may perform well and offset those losses, reducing the overall risk of the portfolio.

A is incorrect. Including assets with low correlations with traditional assets will typically not increase the risk of the portfolio but rather can help to diversify the portfolio and reduce overall risk.

C is incorrect. Including assets with low correlations with traditional assets may decrease the overall return of the portfolio if the added assets have lower expected returns than the existing assets in the portfolio. However, diversification can also increase the potential for higher returns by providing exposure to a broader range of investment opportunities. Ultimately, the effect on portfolio returns will depend on the specific assets added and their performance over time.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.1224 The manager of a typical limited partnership hedge fund is *most likely* called a:

A. Limited partner.

B. General partner.

C. Partnership manager.

The correct answer is **B.**

In a limited partnership hedge fund, there are typically two types of partners: limited partners and general partners. The limited partners are the investors who provide the capital for the fund and have limited liability for the fund's debts and obligations. The general partner, on the other hand, is responsible for managing the fund's investments and operations and has unlimited liability for the fund's debts and obligations.

The general partner is also commonly referred to as the fund manager or investment manager. They are responsible for making investment decisions on behalf of the fund, executing trades, managing risk, and reporting to the limited partners on the fund's performance. The general partner is typically compensated through management and performance fees based on the fund's assets under management and performance.

A is incorrect. Referring to the manager of a limited partnership hedge fund as a limited partner is a misunderstanding of the fund's operational structure. While limited partners do play a crucial role by providing the necessary capital for the fund, they do not partake in the day-to-day management or investment decision-making processes. Their involvement is primarily financial, and they entrust the management of the fund to the general partner.

C is incorrect. Although the term "partnership manager" might seem like a plausible title for the manager of a limited partnership hedge fund, it is not the term commonly used within the industry. The specific titles of "limited partner" and "general partner" are deeply ingrained in the legal and operational frameworks of limited partnerships. These titles carry specific legal implications, particularly concerning liability and management authority. Therefore, while "partnership manager" could be seen as a descriptive term, it lacks the precision and legal significance of the term "general partner."

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.1225 Restrictions on redemption of funds invested in hedge fund until the specific time during which withdrawals are not allowed is *most likely* called a:

A. Lock-up period.

B. High-water mark.

C. Non-withdrawal period.

The correct answer is **A.**

A lock-up period is a restriction on investors' ability to redeem or withdraw their funds from a hedge fund for a specific period of time, typically one to three years. During the lock-up period, investors are unable to redeem their shares or withdraw their invested capital from the fund, even if they experience a change in financial circumstances, or the fund's performance does not meet their expectations.

Lock-up periods are commonly used in hedge funds to provide fund managers with a longer-term investment horizon and to prevent a sudden outflow of capital from the fund, which could disrupt the fund's investment strategy or cause liquidity issues. The lock-up period also helps to align the interests of the fund manager and investors, as the fund manager is incentivized to make long-term investments and avoid short-term trading strategies that may result in higher turnover or transaction costs.

B is incorrect. The high-water mark is a term used to describe a method for calculating performance fees in a hedge fund, which ensures that the fund manager is only paid performance fees on gains that exceed the fund's previous highest net asset value.

C is incorrect. The non-withdrawal period is not a commonly used term in the hedge fund industry.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.1226 An investment company that invests in a number of hedge funds to provide diversification to investors is *most likely* called a/an:

A. Fund of funds.

B. Limited partnership.

C. Asset management company.

The correct answer is **A.**

A fund of funds (FOF) is an investment vehicle that pools capital from investors and invests that capital in a diversified portfolio of hedge funds or other alternative investments. FOFs offer investors access to a diversified range of hedge funds, which can help to reduce the risk associated with investing in a single hedge fund. FOFs also provide smaller investors with access to a range of hedge funds that might not be available to them individually due to high minimum investment requirements.

B is incorrect. A limited partnership is a common legal structure used by hedge funds to organize their operations and structure their relationships with investors.

C is incorrect. An asset management company is a firm that manages investment portfolios on behalf of clients, which can include mutual funds, pension funds, and other institutional investors. Asset management companies may invest in a range of asset classes, including stocks, bonds, and alternative investments.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.1235 Which of the following is *most likely* the appropriate name for the provision which requires managers to return periodic incentive fees if the investors received less than 80% of the profits generated by the fund?

A. Claw back provision.

B. Committed capital clause.

C. Loss reimbursement clause.

The correct answer is **A.**

A clawback provision requires managers to return periodic incentive fees if the investors received less than 80% of the generated profits. The compensation for the hedge funds firm is typically structured as a “2 and 20” fee where the “2” refers to the management fees charged, and the 20 refers to the carried interest on any returns above the preferred return. The clawback provision allows the limited partners to “claw back” any carry paid during the life of the fund on previous portfolio investments in order to normalize the final carry to the originally agreed percentage. Therefore, the clawback provision protects the LP's from paying a carry on one investment, and then having a subsequent investment incur losses.

B is incorrect. The committed capital clause is related to the amount of capital that an investor commits to providing to a fund, which the fund can call upon as needed for investment purposes. This clause does not deal with the distribution of profits or the adjustment of incentive fees based on the fund's performance. Therefore, it does not directly address the scenario where managers are required to return incentive fees if the investors receive less than 80% of the profits.

C is incorrect. The loss reimbursement clause typically refers to a provision that might require the fund to reimburse investors for losses under certain conditions. However, this term does not specifically address the scenario of adjusting incentive fees based on the profit-sharing agreement between the investors and the managers. The clawback provision is the more accurate term for a mechanism that ensures managers return a portion of the incentive fees if the agreed-upon profit distribution criteria are not met.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.1252 A rate used as a benchmark for calculating incentive fees for management when the returns are above a specific benchmark rate is *most likely* called a/an:

A. Hard hurdle rate.

B. High water mark.

C. Incentive fee rate.

The correct answer is **A.**

A hard hurdle rate is when incentive fees are earned only on returns exceeding a pre-established benchmark.

B is incorrect. A high-water mark the highest value, net of fees, that a fund has reached in history. It reflects the highest cumulative return used to calculate an incentive fee.

C is incorrect. The incentive fee is fees paid to the general partner from the limited partner(s) based on realized net profits.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.1256 Which of the following alternative investment vehicles is the *least* transparent?

A. REITs.

B. Hedge funds.

C. Commodities futures.

The correct answer is **B.**

Private equity and hedge fund are the least transparent when it comes to publicly disclosing information.

A is incorrect. Real estate investment trusts (REITs) issue shares that trade publicly like shares of stock. They are therefore regulated and disclose their information to the public.

C is incorrect. Commodities futures are exchange traded and are therefore regulated and required to disclose information to the public.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.2007 A highly risk-averse investor with a long time horizon is *most likely* to invest in which type of alternative investment?

A. Commingled funds.

B. Global macro funds.

C. Market neutral funds.

The correct answer is **A.**

A highly risk-averse investor will typically avoid hedge funds. Real estate funds, such as a commingled fund, offer a hedge against unexpected inflation. Investors in commingled fund investments benefit from economies of scale and diversification.

B is incorrect. Global macro hedge funds are actively managed funds that attempt to profit from broad market swings caused by political or economic events.

C is incorrect. A market-neutral fund is a hedge fund that seeks a profit regardless of an upward or downward market environment, typically through the use of paired long and short positions or derivatives.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.2013 Commingled funds are *most likely* an example of:

A. Leveraged equity.

B. Free and clear equity.

C. Aggregation vehicles.

The correct answer is **C.**

Commingled funds are investment vehicles that combine money from multiple investors into a single fund, which is then managed by a professional investment manager. These funds are also referred to as pooled funds, collective investment funds, or simply "commingled" funds.

Commingled funds are considered aggregation vehicles because they pool the assets of multiple investors into a single fund, which can then be invested in a variety of different assets such as stocks, bonds, and real estate. This allows investors to achieve greater diversification and potentially higher returns than they would be able to achieve on their own.

A and B are incorrect. Leveraged equity involves borrowing money to invest in equity securities in order to amplify potential returns. Free and clear equity refers to equity ownership without any outstanding debt or encumbrances.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.3273 Which of the following is *most likely* a feature of alternative investments such as private equity funds and hedge funds compared to traditional investments?

A. Lower fees.

B. Active management.

C. High diversification within the alternative investment portfolio.

The correct answer is **B.**

Private equity funds and hedge funds are both alternative investment vehicles that use different strategies to generate returns that are not correlated with traditional investments such as stocks and bonds. These vehicles are typically managed by experienced investment professionals who employ active management strategies to identify investment opportunities and manage risk.

A and C are incorrect. In contrast to traditional investments, alternative investments such as private equity and hedge funds tend to have higher fees, as the investment managers must be compensated for their expertise and active management approach. Additionally, while diversification may be a component of alternative investment strategies, it is not necessarily a defining feature of these vehicles.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.3308 High water marks serve to:

A. Ensure that the fund achieves a specified hurdle rate.

B. Restrict the value of investments to a certain maximum.

C. Prevent investors from paying twice for the same performance.

The correct answer is **C.**

High water marks serve to prevent investors from paying twice for the same performance.

A is incorrect. High water marks reflect the highest cumulative return used to calculate an incentive fee, and it is the highest value, net of fees, that the fund has reached. However, the use of high water marks does not ensure that the fund achieves a specified hurdle rate. The hurdle rate is set based on a risk-free rate proxy plus a premium but may also be set as an absolute, nominal, or real return target.

B is incorrect. High water marks specify the highest value that the fund has reached. This measure will be reset each time the value of the fund increases. However, it does not restrict the value of investments made in the fund.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.3326 Which of the following statements *most accurately* highlights risk measurement issues associated with alternative investments?

A. Sortino ratios are meaningless.

B. Sharpe ratios tend to be underestimated.

C. Standard deviation may not be a relevant measure of risk.

The correct answer is **C.**

Standard deviation is not a relevant and reliable measure of risk given the illiquid nature of assets. The illiquid nature means that estimates, rather than observable transaction prices, may be used for valuation purposes thereby understating the volatility of returns. In addition, standard deviation ignores the diversification impact for a broad portfolio of managers and alternative investments.

A is incorrect. The Sortino ratio is an appropriate measure of performance given that it uses downside deviation rather than standard deviation as a measure of risk. Downside risk measures focus on the left-hand side tail of the return distribution where losses occur. A measure of downside risk is preferred for alternative investments as returns tend to be leptokurtic, negatively skewed.

B is incorrect. Sharpe ratios may not be the appropriate risk-return measure for alternative investments. These measures will be overstated due to the combined effect of smoothed (inflated) returns and an understated volatility of returns.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.3329 In contrast to traditional investments, alternative investments:

A. Generate absolute returns.

B. Have a broad manager specialization.

C. Have historically demonstrated low mean returns.

The correct answer is **A.**

Alternative investments are investments that are not traditional investments, such as stocks, bonds, and cash. Alternative investments can include private equity, hedge funds, real estate, commodities, and other assets. One of the key differences between traditional and alternative investments is the way they generate returns.
Traditional investments generally aim to generate relative returns, which means their goal is to outperform a benchmark, such as a stock index or bond index. In contrast, alternative investments generally aim to generate absolute returns, which means their goal is to achieve a positive return regardless of market conditions or benchmark performance.

B is incorrect. While alternative investments can be managed by specialized managers, such as hedge fund managers or private equity managers, they can also be managed by generalist managers or institutional investors.

C is incorrect. The performance of alternative investments can vary widely depending on the specific investment strategy, asset class, and market conditions. While some alternative investments may have lower mean returns than traditional investments, others may have higher mean returns or be able to generate returns with lower volatility or lower correlation to traditional investments.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.3333 The average Sharpe ratio of an investor's portfolio increased following the inclusion of alternative investments in a portfolio dominated by traditional investments. Which of the following factors is *least likely* attributed to the increase in the risk-return measure?

A. Account leverage.

B. Illiquidity premium.

C. Lack of transparency.

The correct answer is **C.**

The increase in the portfolio's Sharpe ratio due to the inclusion of alternative investments can be attributed to illiquidity premiums, account leverage, and/or active managers' exploitation of less efficiently priced assets that serves to increase mean returns of alternative investments.

A is incorrect. Account leverage can contribute to an increase in the Sharpe ratio by amplifying the returns of an investment portfolio. Leverage involves using borrowed funds to increase the potential return on investment. While it also increases the risk, if the returns generated from leveraged investments exceed the cost of borrowing, the overall returns of the portfolio can increase without a proportionate increase in perceived risk (standard deviation), thus potentially improving the Sharpe ratio. However, it's important to note that excessive leverage can lead to significant losses and increase the risk beyond acceptable levels.

B is incorrect. The illiquidity premium refers to the higher expected returns that investors demand for investing in assets that are not easily sold or converted into cash without a significant loss in value. Alternative investments, such as private equity, hedge funds, and real estate, often come with higher illiquidity premiums compared to traditional investments like stocks and bonds. This premium can contribute to higher overall returns for the portfolio, improving the Sharpe ratio, assuming the increase in returns is not fully offset by an increase in risk (as measured by standard deviation).

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.3901 Which of the following is *least likely* a category of alternative investments?

A. Collectible.

B. Infrastructures.

C. Supranational bonds.

The correct answer is **C.**

Supranational bonds are not typically classified as alternative investments. They are bonds issued by multinational organizations such as the World Bank or the International Monetary Fund (IMF) and are considered part of the traditional fixed-income investment category.

A is incorrect. Collectibles, such as art, antiques, and rare items, are considered alternative investments. These investments do not fall under traditional categories like stocks, bonds, or cash and are known for their unique value and potential for appreciation over time.

B is incorrect. Infrastructures, such as investments in transportation systems, utilities, and other physical assets, are also classified as alternative investments. These investments are characterized by their long-term horizons and their role in providing essential services.

Q.4196 Which of the following is *most likely* an advantage of co-investing in alternative investments?Co-investing:

A. allows for reduced management fee compared to direct investing.

B. requires more complex due diligence compared to direct investing.

C. allows the investor to access the fund's process and procedures.

The correct answer is **C.**

When an investor co-invests with a fund, they gain insights into the fund's investment process and procedures, which can help build knowledge and expertise in the alternative asset class. This can make it easier for the investor to transition to direct investing in the future, as they will have already gained some experience and familiarity with the investment process.

A is incorrect. Reduced management compared to direct investment is not necessarily an advantage of co-investing, as direct investor avoids paying regular management fees to an external manager.

B is incorrect. Direct investing may require more complex due diligence than co-investing as the investor lacks the assistance of a fund investor.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.4197 Which of the following is *most likely* a practical investment method suitable for an investor inexperienced in investment and conducting due diligence?

A. Co-investing

B. Direct investing

C. Fund investing

The correct answer is **C.**

Fund investing involves investing in a professionally managed fund that pools money from multiple investors and invests in a diversified portfolio of assets. This can be a good option for inexperienced investors because they do not have to conduct their own due diligence on individual investments. Instead, the fund manager makes the investment decisions and manages the portfolio on behalf of the investors. This can provide a level of diversification, risk management, and expertise that may be difficult for inexperienced investors to achieve independently.

A is incorrect. Co-investing may not be the best option for inexperienced investors, as they would still be responsible for conducting their due diligence on individual investments.

B is incorrect. Direct investing can also be challenging for inexperienced investors, as they need the knowledge, expertise, and resources to research and analyze individual investment opportunities. Therefore, fund investing is likely the most suitable option for an inexperienced investor looking to invest in alternative assets.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.4198 Which of the following alternative investment method is *most likely* considered both direct and indirect forms of investment?

A. Co-investing

B. Direct investing

C. Fund investing

The correct answer is **A.**

Co-investing involves investing alongside a fund manager or other investors in a specific investment opportunity. In this sense, co-investing is a direct form of investment, as the investor invests directly in the underlying asset alongside the other investors.

However, co-investing can also be considered an indirect form of investment, as the investor invests in the investment opportunity through the fund or other investment vehicle. This means that the investor is not directly responsible for managing the investment and may have limited control over the investment decisions.

B is incorrect. Direct investing is typically considered a purely direct form of investment, as the investor invests directly in the underlying asset without the involvement of a fund or other investment vehicle.

C is incorrect. Fund investing is typically considered an indirect form of investment, as the investor invests in the fund or other investment vehicle, which invests in a diversified portfolio of assets.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.4199 Which of the following statements is *least likely* accurate regarding alternative investment methods?

A. In co-investing, investors can invest both directly and indirectly in an asset.

B. Direct investments often involve huge and complex investors who can compete directly with fund managers to reach profitable assets.

C. The level of due diligence in fund investing is more complex than in direct investing.

The correct answer is **C.**

In general, the level of due diligence required for direct investing is typically higher than that needed for fund investing. This is because direct investors are responsible for conducting their due diligence on individual investments and managing their portfolios. In contrast, fund investors rely on the expertise of the fund manager to make investment decisions and manage the portfolio.

A is incorrect. Co-investing allows investors to invest both directly and indirectly in an asset.

B is incorrect. Direct investments can require significant resources and expertise to identify and execute profitable investment opportunities, and large institutional investors may have an advantage in this regard.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.4200 Which of the following is *least likely* accurate regarding partnership structure in alternative investments?

A. The general partner (GP) bears limited liability in case of adverse investment events.

B. The number of limited partners (LPs) in a fund may be limited, and they play passive roles in the fund.

C. Partnership agreements (LPAs) and side letters help to manage principal-agent conflict between the GPs and LPs.

The correct answer is **A.**

The general partner (GP) usually bears unlimited liability for the partnership’s debts and obligations. This is because the GP is responsible for managing the partnership and making investment decisions and assumes greater risk than the limited partners (LPs). On the other hand, LPs have limited liability and are only liable for the amount of their investment in the partnership.

B is incorrect. Limited partners (LPs) are investors in a partnership who contribute capital to the partnership but do not participate in the management of the partnership. The number of LPs in a fund may be limited depending on the terms of the partnership agreement. LPs typically play passive roles in the fund by leaving the management and decision-making to the general partner (GP).

C is incorrect. Principal-agent conflicts can arise in a partnership when the general partner (GP) acts in their interest instead of the interest of the limited partners (LPs). Limited partnership agreements (LPAs) and side letters are legal agreements that outline the terms and conditions of the partnership and can include provisions that address potential conflicts of interest. These agreements can help manage principal-agent conflicts and ensure that the GP acts in the best interest of the LPs.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4201 Which of the following statements *most likely* describes the deal-by-deal type of waterfall in alternative investments?

A. The performance fee is paid on per deal, which is advantageous to the general partners (GPs).

B. The performance fee is paid on a per-deal basis, which is advantageous to the limited partners (LPs).

C. Distributions are made to the limited partners (LPs) until their initial investment is recouped and the hurdle rate has been met, which benefits the LPs.

The correct answer is **A.**

In the deal-by-deal (also called American) waterfall, performance fees are accumulated on per-deal methods. This makes the GP receive payments before LPs get their rates of return (hurdle rate) on the fund and initial investments; hence, it benefits the GPs.

B is incorrect. It contradicts option A.

C is incorrect. It describes the whole-of-fund waterfall. The whole-of-fund waterfall method ensures that the LPs receive their initial investment back and are compensated for the risk they take by investing in the fund before the GP receives any profits.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4227 Which of the following *accurately* represents a similarity between the hedge and private equity funds?

A. Both are structured as partnerships.

B. The initial investment has to be repaid before the fund manager earns an incentive fee.

C. Investors pay a management fee based on the assets under management at the end of a period.

The correct answer is **A.**

Both hedge funds and private equity funds are commonly structured as partnerships, with the fund manager serving as the general partner and the investors serving as limited partners. The partnership structure provides a number of benefits, including limited liability for the limited partners and flexibility in terms of fund management and investment strategy.

B is incorrect. This is a characteristic that is specific to private equity funds but not hedge funds. In a private equity fund, the general partner typically earns an incentive fee, known as carried interest, after the limited partners have received a certain minimum return on their investment, known as the hurdle rate.

C is incorrect. Both hedge funds and private equity funds charge management fees, but the way these fees are calculated can vary. Hedge fund managers typically charge a management fee based on the total assets under management at the end of a period, as the statement suggests. Private equity, on the other hand, often charges management fees based on committed capital, especially during the initial investment period, and later it could be based on the invested capital.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4326 Which of the following statements is *least likely* a characteristic of alternative investments?

A. Alternative investments are typically found in less efficient markets.

B. Alternative investments are typically short-term, liquid investments.

C. Alternative investments offer greater diversification potential and higher expected returns.

The correct answer is **B.**

Alternative investments are not short-term, liquid investments. This is one of the key characteristics that distinguish them from traditional investments such as stocks and bonds. Alternative investments, which include assets like real estate, private equity, hedge funds, and commodities, are generally illiquid and require a longer investment horizon. This is due to several factors, including restrictions on withdrawals, the nature of the underlying assets, and the lack of a secondary market.

The illiquidity of alternative investments can pose challenges for investors who need to access their capital quickly. However, it can also provide opportunities for higher returns, as investors are often compensated for taking on illiquidity risk. Therefore, while alternative investments can offer diversification benefits and potentially higher returns, they are not typically short-term, liquid investments.

A is incorrect. Alternative investments are typically found in less efficient markets. This is another characteristic that distinguishes them from traditional investments. Less efficient markets can provide opportunities for skilled managers to exploit pricing inefficiencies and generate higher returns. However, they can also pose additional risks, including information asymmetry and higher transaction costs.

C is incorrect. Alternative investments offer greater diversification potential and higher expected returns. This is one of the reasons why investors consider adding them to their portfolios. The returns from alternative investments are often less correlated with those from traditional asset classes, which can help to reduce portfolio risk. Furthermore, because alternative investments often involve more complex strategies and less efficient markets, they have the potential to deliver higher returns.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.4327 Given the unique characteristics of alternative investments, which of the following investor types is *most likely* to allocate a larger share of their portfolio to alternative investments?

A. Individual investors with short-term financial goals.

B. Small businesses looking for quick returns on investment.

C. Large pension funds, sovereign wealth funds, and not-for-profit endowments.

The correct answer is **C.**

Large pension funds, sovereign wealth funds, and not-for-profit endowments are most likely to allocate a larger share of their portfolio to alternative investments. These types of investors typically have long investment horizons, significant capital, and the ability to withstand periods of illiquidity, which aligns well with the characteristics of alternative investments.
Alternative investments often require large capital outlays and have long investment horizons, which can be a barrier for individual investors and small businesses. Additionally, these types of investors often have the resources and expertise to understand and manage the complex risks associated with alternative investments. They also benefit from the low correlation of returns with traditional asset classes, which can help to diversify their portfolios and reduce overall risk.
A is incorrect. Individual investors with short-term financial goals are less likely to allocate a larger share of their portfolio to alternative investments. These types of investments often require a long investment horizon and can be illiquid, which may not align with the needs of investors with short-term financial goals.

B is incorrect. Small businesses looking for quick returns on investment are also less likely to allocate a larger share of their portfolio to alternative investments. These types of investments often require large capital outlays and have long investment horizons, which may not align with the needs of small businesses looking for quick returns.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.4328 Which of the following is *least likely* typically considered an alternative investment category?

A. Real estate.

B. Private equity.

C. Government bonds.

The correct answer is **C.**

Government bonds are not typically considered an alternative investment category. Alternative investments are typically characterized by their complexity, lack of regulation, limited liquidity, and the potential for high returns. They are often used by investors to diversify their portfolios and hedge against market volatility. Government bonds, on the other hand, are considered traditional investments.
They are issued by governments to raise capital and are backed by the full faith and credit of the issuing government. They are highly regulated, relatively simple to understand, and offer a fixed rate of return. Government bonds are also highly liquid, meaning they can be easily bought and sold in the market. Therefore, they do not possess the characteristics typically associated with alternative investments.
A is incorrect. Real estate is also considered an alternative investment. It involves investing in physical properties, such as residential, commercial, or industrial real estate. Like private equity, real estate investments can be illiquid and require a long-term commitment, but they can also offer high potential returns and serve as a hedge against inflation.

B is incorrect. Private equity is considered an alternative investment. It involves investing in companies that are not publicly traded on a stock exchange. Private equity investments are typically illiquid and require a long-term commitment, but they can offer high potential returns.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.4331 A tech company has developed new software that has the potential to revolutionize the industry. The company has secured a patent for this software. Under which category of Alternative Investments would this patent *most likely* fall?

A. Real Assets.

B. Commodities.

C. Infrastructure.

The correct answer is **A.**

The patent for the software developed by the tech company would fall under the category of Real Alternative Assets. Real assets are physical or tangible assets that have value due to their substance and properties. Real assets include precious metals, commodities, real estate, agricultural land, oil and natural gas, and other natural resources. In the context of financial investment, real assets are considered as an alternative investment class that includes all tangible assets.
The Real Assets category includes intellectual property rights such as patents, copyrights, and trademarks. In this case, the patent secured by the tech company for its new software is an intellectual property right that protects the company's exclusive right to use and profit from its invention. This patent has value and can be considered a real asset, but it does not fall under the categories of commodities or infrastructure, which are other types of real assets.
B is incorrect. Commodities are basic goods used in commerce that are interchangeable with other goods of the same type. Commodities include agricultural products, fuels, and metals. A patent for software does not fall under this category because it is not a basic good used in commerce and it is not interchangeable with other goods of the same type.

C is incorrect. Infrastructure refers to the basic physical systems of a business or nation, such as transportation, communication, sewage, water, and electric systems. A patent for software does not fall under this category because it is not a basic physical system.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.4332 An investor is considering diversifying their portfolio by investing in alternative investments such as real estate properties or hedge funds. He understands that these types of investments often have a long-term nature and lack liquidity, requiring specialized knowledge for evaluation and management. Given this, the investor is aware that they will be heavily dependent on the decisions of the manager over extended periods. In this context, what is the most crucial factor that the investor *most likely* needs to consider before making such an investment?

A. The investor's ability to quickly liquidate the investment.

B. The investor's understanding of market trends and risk management.

C. The investor's ability to anticipate higher returns from the investment.

The correct answer is **B.**

The most crucial factor that the investor needs to consider before making an investment in alternative investments such as real estate properties or hedge funds is their understanding of market trends and risk management. Alternative investments are complex and often require specialized knowledge for evaluation and management. They are also typically illiquid and long-term in nature, which means that the investor will be heavily dependent on the decisions of the manager over extended periods.
Therefore, it is crucial for the investor to have a good understanding of market trends and risk management to make informed decisions and manage the risks associated with these investments. This understanding will also help the investor assess the performance of the manager and make necessary adjustments to their investment strategy if needed.
A is incorrect. By their nature, alternative investments are often illiquid and long-term, which means that the investor should be prepared to hold onto the investment for an extended period. If the investor's primary concern is liquidity, then alternative investments may not be the best choice for them.

C is incorrect. While the potential for higher returns is one of the reasons why investors consider alternative investments, it should not be the most crucial factor in the decision-making process. The potential for higher returns is often accompanied by higher risks, and without a good understanding of market trends and risk management, the investor may end up losing their investment.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.4333 Which of the following strategies can less sophisticated alternative investment investors *most likely* employ in order to align the interests of the manager with their own?

A. They can invest only in low-risk assets to ensure minimal losses.

B. They can insist on managing their investments themselves without any professional help.

C. They can negotiate a fee structure where the manager's compensation is tied to the performance of the investment.

The correct answer is **C.**

Less sophisticated investors, such as retail investors, can align the interests of the manager with their own by negotiating a fee structure where the manager's compensation is tied to the performance of the investment. This is known as a performance-based fee structure. It incentivizes the manager to perform well because their compensation is directly linked to the success of the investment.
This aligns the manager's interests with those of the investor, as both parties benefit from a well-performing investment. This strategy is often employed by investors who lack the knowledge or time to manage their investments themselves. It allows them to leverage the expertise of professional investment managers or financial advisors while ensuring that these professionals are motivated to achieve the best possible results.
A is incorrect. Investing only in low-risk assets to ensure minimal losses is not a strategy that aligns the interests of the manager with those of the investor. While it may reduce the risk of financial loss, it does not incentivize the manager to perform well. Furthermore, investing only in low-risk assets may limit the potential for high returns, which could be detrimental to the investor's financial goals.

B is incorrect. Insisting on managing their investments themselves without any professional help is not a viable strategy for less sophisticated investors. This is because they may lack the necessary knowledge, skills, and experience to effectively manage their investments. Without professional help, they may make poor investment decisions, which could result in significant financial losses.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4334 In the context of alternative investments, which of the following *most likely* describes why an investor might choose to invest in real estate, private equity, hedge funds, or commodities?

A. They can be sold off instantly like a stock, providing quick returns.

B. They do not require any specialized knowledge for evaluation and management.

C. They can potentially offer higher expected returns and help diversify the investor's portfolio.

The correct answer is **C.**

Alternative investments such as real estate, private equity, hedge funds, or commodities can potentially offer higher expected returns and help diversify the investor's portfolio. These types of investments are often less correlated with traditional asset classes like stocks and bonds, which can help to reduce portfolio risk through diversification. Additionally, because they often require specialized knowledge for evaluation and management, they can provide opportunities for skilled managers to generate excess returns.
A is incorrect. Alternative investments such as real estate, private equity, hedge funds, or commodities are typically not as liquid as stocks and cannot be sold off instantly. These types of investments often require a longer-term commitment and may have restrictions on withdrawals or sales.

B is incorrect. Alternative investments often require specialized knowledge for evaluation and management. This is one of the reasons why investors may be more reliant on manager decisions when investing in these types of assets. The complexity and unique characteristics of these investments often require a deep understanding of the specific market, industry, or asset class.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.

Q.4335 An investor is considering diversifying their portfolio by including alternative investments. In this context, which of the following strategies would *most likely* be appropriate for the investor to ensure that the investment strategy aligns with their objectives and risk tolerance?

A. Defer strategy or risk assessment after investment.

B. Outsourcing the investment process to a professional without understanding their investment strategy.

C. Either taking control of the investment process or outsourcing it to a professional, ensuring that the investment strategy aligns with their objectives and risk tolerance.

The correct answer is **C.**

Either taking control of the investment process or outsourcing it to a professional, ensuring that the investment strategy aligns with their objectives and risk tolerance is the most appropriate strategy for an investor considering diversifying their portfolio with alternative investments. This approach allows the investor to maintain control over their investment strategy, whether they choose to manage the investments themselves or delegate this responsibility to a professional.
It ensures that the investment strategy aligns with their objectives and risk tolerance, which is crucial for successful investment management. This approach also allows the investor to monitor the performance of the investments and make adjustments as necessary, which can help to mitigate the potential risks associated with alternative investments. It is a proactive and informed approach to investment management that can help to maximize returns and minimize risks.
A is incorrect. Investing in alternative investments without any strategy or risk assessment is not a suitable approach for managing these types of investments. Alternative investments can be complex and risky, and it is important for investors to have a clear understanding of these risks and how they align with their investment objectives and risk tolerance. Investing without a strategy or risk assessment can lead to poor investment decisions and potential losses.
B is incorrect. Outsourcing the investment process to a professional without understanding their investment strategy is also not a suitable approach. While outsourcing can provide access to professional expertise and potentially improve investment outcomes, it is important for the investor to understand the investment strategy being used. This understanding allows the investor to ensure that the strategy aligns with their objectives and risk tolerance and to monitor the performance of the investments. Without this understanding, the investor may be exposed to unnecessary risks and potential losses.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.4336 If a hedge fund has a hurdle rate of 8%, what does this *most likely* imply?

A. The fund needs to earn at least 8% before the investors can receive their returns.

B. The fund needs to earn at least 8% before the manager can invest in new opportunities.

C. The fund needs to earn at least 8% before the manager can receive their performance fee.

The correct answer is **C.**

A hurdle rate in the context of a hedge fund is a minimum rate of return that the fund must achieve before the fund's manager can receive a performance fee. Therefore, if a hedge fund has a hurdle rate of 8%, it means that the fund needs to earn at least 8% before the manager can receive their performance fee.
This mechanism is designed to align the interests of the fund manager and the investors. It ensures that the manager is rewarded for generating returns that exceed a certain threshold, thereby incentivizing the manager to perform well. The hurdle rate is typically set at a level that is considered to be a reasonable return on investment, taking into account the risk profile of the fund and market conditions.
A is incorrect. The hurdle rate does not determine when the investors can receive their returns. Investors typically receive returns from a hedge fund based on the fund's performance and the terms of their investment agreement, regardless of whether the fund has met its hurdle rate.

B is incorrect. The hurdle rate does not dictate when the manager can invest in new opportunities. The manager's ability to invest in new opportunities is typically determined by the fund's investment strategy and the availability of investable funds, not by the achievement of a certain rate of return.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4337 In the context of alternative investment structures, what does the clawback provision *most likely* imply in the event of poor fund performance? If the fund performs poorly in subsequent years:

A. the manager can reclaim some of the investors' returns.

B. the manager can reclaim some of the investors' initial investment.

C. the investors can reclaim some of the manager's performance fee.

The correct answer is **C.**

A clawback provision in the context of alternative investment structures is indeed a mechanism designed to protect the interests of investors. Specifically, it implies that if the fund performs poorly in subsequent years, the investors can reclaim some of the manager's performance fee. This is because the performance fee is typically based on the fund's profits, and if these profits are not sustained, the investors have the right to reclaim a portion of the fee that was previously paid to the manager.

This provision ensures that the manager's interests are aligned with those of the investors, as it incentivizes the manager to not only generate high returns but also to maintain these returns over time. It also provides a measure of protection for investors, as it allows them to recover some of their losses in the event of poor fund performance.

A is incorrect. Similarly, a clawback provision does not imply that the manager can reclaim some of the investors' returns if the fund performs poorly in subsequent years. Again, this would be contrary to the purpose of the clawback provision, which is to protect the interests of the investors. The manager's compensation is typically tied to the fund's performance, and if the fund performs poorly, it is the manager's compensation, not the investors' returns, that should be affected.

B is incorrect. A clawback provision does not imply that the manager can reclaim some of the investors' initial investment if the fund performs poorly in subsequent years. This would be contrary to the purpose of the clawback provision, which is to protect the interests of the investors, not the manager.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4339 In the context of a private equity fund structured as a limited partnership, which of the following is *most likely* the LPs?

A. Competing private equity firms.

B. Employees of the private equity firm.

C. Pension funds, endowments, or wealthy individuals.

The correct answer is **C.**

Pension funds, endowments, or wealthy individuals could potentially be the Limited Partners (LPs) in a private equity fund structured as a limited partnership. LPs are typically passive investors who provide capital to the fund but do not participate in its management. They are attracted to private equity funds because of the potential for high returns, and they are typically institutional investors with large amounts of capital to invest, such as pension funds and endowments, or high-net-worth individuals.

These investors are willing to accept the illiquidity and risk associated with private equity investments in exchange for the potential for high returns. The terms of their investment, including their share of the profits and losses of the fund, are set out in the partnership agreement.

A is incorrect. Competing private equity firms are unlikely to be LPs in a private equity fund. While it is theoretically possible, it would be unusual for a competing firm to invest in a fund managed by another firm, as this could create conflicts of interest and competitive issues. Furthermore, private equity firms typically raise their own funds and make their own investments, rather than investing in funds managed by other firms.

B is incorrect. Employees of the private equity firm are typically not LPs in the fund. While they may have a financial interest in the success of the fund, they are more likely to be involved in its management as part of the General Partner (GP), which has unlimited liability and makes the investment decisions for the fund.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4340 In the context of a limited partnership agreement (LPA), which of the following statements is *most likely* to be true regarding adjustments to LP terms in an LPA? Adjustments to LP terms are:

A. frequently made to increase the profit percentage of the GP.

B. never made as they are legally binding and cannot be changed.

C. sometimes made to address the unique legal, regulatory, or reporting requirements of a specific investor.

The correct answer is **C.**

Adjustments to Limited Partnership (LP) terms in a Limited Partnership Agreement (LPA) are sometimes made to address the unique legal, regulatory, or reporting requirements of a specific investor. An LPA is a flexible document that can be tailored to meet the specific needs and requirements of the partners involved. While the basic structure of the partnership and the distribution of profits and losses are typically set out in the LPA, there may be circumstances where adjustments are necessary.
For example, a specific investor may have unique legal or regulatory requirements that need to be accommodated. In such cases, the terms of the LPA can be adjusted to meet these requirements. This flexibility is one of the key advantages of LPs as a form of investment vehicle. It allows for a high degree of customization to meet the specific needs of the partners involved.
A is incorrect. Adjustments to LP terms are not frequently made to increase the profit percentage of the General Partner (GP). While it is possible for the GP to negotiate a higher profit percentage, this would typically require the agreement of all the Limited Partners (LPs). It is not a common occurrence and would not be a typical reason for adjusting the terms of an LPA.

B is incorrect. While it is true that the terms of an LPA are legally binding, they are not immutable. They can be changed if all the partners agree to the changes. Therefore, it is not accurate to say that adjustments to LP terms are never made as they are legally binding and cannot be changed.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4341 What does the "most favored nation" clause *most likely* ensure in the context of the side letter agreement between the GP and LP? It ensures that:

A. the LP will always receive the highest possible returns on their investment.

B. the clause ensures that the LP has the right to forgo a contractual capital contribution at any time.

C. any more favorable or additional terms negotiated outside of the LPA with other investors will also apply to a particular LP.

The correct answer is **C.**

In the context of private equity investments, a "most favored nation" clause in a side letter agreement between a General Partner (GP) and Limited Partner (LP) ensures that any more favorable or additional terms negotiated outside of the Limited Partnership Agreement (LPA) with other investors will also apply to a particular LP. This clause is designed to protect the interests of the LP by ensuring that they are not disadvantaged relative to other investors.

If the GP negotiates more favorable terms with another investor after the LPA has been signed, the "most favored nation" clause requires the GP to offer the same terms to the LP. This can include more favorable fee arrangements, information rights, or other terms. The "most favored nation" clause is a common feature in side letters and is an important tool for LPs to ensure that they receive the best possible terms in their investment.

A is incorrect. The "most favored nation" clause does not ensure that the LP will always receive the highest possible returns on their investment. The returns on a private equity investment are determined by the performance of the underlying investments, not by the terms of the LPA or any side letter agreement.

B is incorrect. The "most favored nation" clause does not give the LP the right to forgo a contractual capital contribution at any time. The obligation to make capital contributions is typically set out in the LPA and cannot be unilaterally waived by the LP. The "most favored nation" clause only ensures that the LP receives the same favorable terms as other investors, it does not give them the right to alter their contractual obligations.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (c): Describe investment ownership and compensation structures commonly used in alternative investments.

Q.4360 If an investor is seeking to invest alongside a venture capital firm in a promising startup, which of the following is *most likely* form of private equity investment is he considering?

A. Co-Investment.

B. Direct Investment.

C. Indirect Investment.

The correct answer is **A.**

In a co-investment, an investor partners with a lead sponsor, such as a venture capital firm, to invest in a specific opportunity. The lead sponsor sources, structures, and executes the transaction, while the co-investor provides additional capital. This allows the co-investor to participate directly in the investment alongside the lead sponsor.
Co-investments are often used in private equity and venture capital deals, where they allow investors to gain exposure to specific assets or companies rather than a diversified portfolio. In this case, the investor is seeking to invest alongside a venture capital firm in a promising startup, which is a typical example of a co-investment.
B is incorrect. A direct investment would involve the investor investing directly in a single, specific asset, such as a startup company. However, in this case, the investor is not investing directly, but rather partnering with a venture capital firm to make the investment. Therefore, this is not a direct investment.

C is incorrect. An indirect investment would involve the investor investing through a fund-of-funds vehicle that holds stakes in various other private funds. This is similar to a mutual fund, where the investor does not invest directly in the underlying assets but rather in the fund that holds those assets. In this case, the investor is not investing through a fund-of-funds but rather partnering with a venture capital firm to invest directly in a startup. Therefore, this is not an indirect investment.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (b): Compare direct investment, co-investment, and fund investment methods for alternative investments.

Q.4393 Which of the following investment structures is *most likely* similar to the structure of REITs and private real estate funds in terms of allowing investors to contribute or redeem capital throughout the life of the fund?

A. Hedge Funds.

B. Mutual Funds.

C. Exchange-Traded Funds (ETFs).

The correct answer is **B.**

Mutual Funds are the most similar to the structure of REITs and private real estate funds in terms of allowing investors to contribute or redeem capital throughout the life of the fund. Mutual funds, like REITs and private real estate funds, are structured as open-end funds. This means that they do not have a fixed number of shares. Instead, the fund issues new shares to investors when they buy in and redeems shares when investors want to sell.

This structure allows for a great deal of flexibility for investors, as they can enter and exit the fund at any time. This is similar to REITs and private real estate funds, which also allow investors to contribute or redeem capital throughout the life of the fund. The open-end structure of these investment vehicles is designed to accommodate the liquidity needs of investors, making them suitable for a wide range of investment strategies and objectives.

A is incorrect. Hedge Funds are not similar to the structure of REITs and private real estate funds. Hedge funds are typically structured as limited partnerships or limited liability companies, and they do not allow investors to contribute or redeem capital at any time. Instead, hedge funds usually have specific periods during which investors can enter or exit the fund, often with restrictions and penalties for early withdrawal. This is a significant difference from the open-end structure of REITs and private real estate funds.

C is incorrect. Exchange-traded funds (ETFs) are not the most similar to the structure of REITs and private real estate funds. While ETFs do offer a high degree of liquidity, they are structured as open-end funds but trade on an exchange like a stock. This means that their shares are not directly redeemable with the fund but must be bought and sold on the open market. This is a key difference from the structure of REITs and private real estate funds, which directly issue and redeem shares with investors.

CFA Level I, Alternative Investments, Learning Module 1: Alternative Investment Features, Methods and Structures. LOS (a): Describe features and categories of alternative investments.