Question #1 of 7

Question ID: 1458804

Return and risk data on alternative investments may be affected by backfill bias if:

A) a firm's historical returns are included when it is added to an index. ✓

B) data only include currently existing firms. ✗

C) the incorrect distribution is used to model volatility. ✗

Explanation

Backfill bias refers to bias introduced by including the previous performance data for firms added to a benchmark index.

(Module 59.1, LOS 59.a)

Question #2 of 7

Question ID: 1462953

Indexes for alternative investments are *least likely* to exhibit:

A) backfill bias. ✗

B) time-period bias. ✓

C) survivorship bias. ✗

Explanation

Index returns for alternative investments are often subject to both backfill and survivorship bias. Time-period bias is a concern in hypothesis testing. (Module 59.1, LOS 59.a)

Question #3 of 7

Question ID: 1458809

Jem Capital is a hedge fund with $150 million of initial investment capital. The fund charges a 2% management fee based on assets under management at the end of the year and a 20% incentive fee. Incentive fees and management fees are calculated independently. In the first year, Jem Capital has a 25% return. What is an investor's after-fee return for the year?

A) 3.0%.

B) 17.5%.

C) 22.5%.

Explanation

Gross value end of year: $150 million × 1.25 = $187.5 million

Management fee: $187.5 million × 2% = $3.75 million

Incentive fee: ($187.5 million – $150 million) × 20% = $7.5 million

Total fees to Jem Capital: $11.25 million

The after-fee return: [(187.5 – 11.25) / 150] – 1 = 17.5%.

(Module 59.1, LOS 59.b)

Question #4 of 7

Question ID: 1458807

Which of the following risk measures is based on downside deviation?

A) Sortino ratio.

B) Sharpe ratio.

C) Treynor ratio.

Explanation

The Sortino ratio uses downside deviation as its risk measure. The Sharpe ratio uses standard deviation and the Treynor ratio uses beta.

(Module 59.1, LOS 59.a)

Question #5 of 7

Question ID: 1463677

A hedge fund has a 2-and-20 fee structure with a soft hurdle rate of 5% and a high water mark. Incentive fees are calculated net of management fees. The fund's gross return is 15% in Year 1, −10% in Year 2, and 30% in Year 3. Incentive fees for Year 3 will be:

A) less than 20% of the increase in value in Year 3 after management fees.

B) equal to 20% of the increase in value in Year 3 after management fees.

C) greater than 20% of the increase in value in Year 3 after management fees.

Explanation

Because the fund lost value in Year 2 and has a high water mark, incentive fees for Year 3 will be 20% of only the portion of the Year 3 gain that exceeds the previous highest value. (Module 59.1, LOS 59.b)

Question #6 of 7

Question ID: 1458806

Relatively infrequent valuations of private equity portfolio companies *most likely* cause:

A) average fund returns to be biased upward. ✗

B) standard deviations of fund returns to be biased upward. ✗

C) correlations of fund returns with equity returns to be biased downward. ✓

Explanation

Infrequent valuation results in downward bias in both standard deviations and correlations. (Module 59.1, LOS 59.a)

Question #7 of 7

Question ID: 1458810

Carr Funds is a hedge fund with $125 million of assets under management at the end of the prior year. The fund has a "1 and 10" fee structure. Incentive fees are calculated on gains net of management fees at the end of the year. In the current year, Carr Funds had a 5% gross return. An investor's after-fee return for the year is *closest* to:

A) 3.6%. ✓

B) –6.0%. ✗

C) 4.1%. ✗

Explanation

Gross value end of year: $125 million × 1.05 = $131.25 million

Management fee: $131.25 million × 1% = $1.3125 million

Incentive fee: ($131.25 – $125 – $1.3125) × 10% = $493,750

Total fees to Carr Funds = $1.3125 million + $493,750 = $1,806,250

The after-fee return: [($131.25 – $1.80625) / 125] – 1 = 3.56%.

(Module 59.1, LOS 59.b)