Question #1 of 27

Question ID: 1458833

Which of the following is typically the *first general step* in the portfolio management process?

A) Specify capital market expectations.

B) Develop an investment strategy.

C) Write a policy statement.

Explanation

The policy statement is the foundation of the entire portfolio management process. Here, both risk and return are integrated to determine the investor's goals and constraints.

(Module 61.1, LOS 61.b)

Question #2 of 27

Question ID: 1480320

Open-end mutual funds differ from closed-end funds in that:

A) open-end funds issue shares that are then traded in secondary markets, while closed-end funds do not.

B) closed-end funds require active management, while open-end funds do not.

C) open-end funds stand ready to redeem their shares, while closed-end funds do not.

Explanation

Open-end funds redeem existing shares or issue new shares in accordance with investor demand. Closed-end fund shares are fixed in number and trade on exchanges as though they were common stock.

(Module 61.2, LOS 61.f)

Question #3 of 27

Question ID: 1458851

A pooled investment with a share price significantly different from its net asset value (NAV) per share is *most likely* a(n):

A) open-end fund.

B) exchange-traded fund.

C) closed-end fund.

Explanation

Closed-end funds' share prices can differ significantly from their NAVs. Open-end fund shares can be purchased and redeemed at their NAVs. Market forces keep exchange-traded fund share prices close to their NAVs because arbitrageurs can profit by trading when there are differences.

(Module 61.2, LOS 61.f)

Question #4 of 27

Question ID: 1458834

Which of the following would be assessed first in a top-down valuation approach?

A) Industry return on equity (ROE).

B) Fiscal policy.

C) Industry risks.

Explanation

In the top-down valuation approach, the investor should analyze macroeconomic influences first, then industry influences, and then company influences. Fiscal policy, as part of the macroeconomic landscape, should be analyzed first.

(Module 61.1, LOS 61.b)

Question #5 of 27

Question ID: 1462956

Which of the following pooled investment shares is *least likely* to trade at a price different from its NAV?

A) Closed-end mutual fund shares.

B) Open-end mutual fund shares.

C) Exchange-traded fund shares.

Explanation

Shares of open-end mutual funds trade at NAV. The others may deviate from NAV.

(Module 61.2, LOS 61.f)

Question #6 of 27

Question ID: 1458850

Which of the following statements about active and passive asset management is *most accurate*?

A) Active management has been gaining market share over time versus passive management.

B) Passive management's share of industry revenues is smaller than its share of assets under management.

C) Active management may use fundamental analysis, technical analysis, or a "smart beta" approach to outperform a chosen benchmark.

Explanation

Because fees for passive management are lower than fees for active management, passive management represents a smaller share of industry revenues than assets under management. Passive management has been gaining market share over time versus active management. Smart beta is a passive management strategy that focuses on a specific market risk factor.

(Module 61.2, LOS 61.e)

Question #7 of 27

Question ID: 1458841

Which of the following types of investors is likely to have the shortest investment horizon?

A) Foundation.

B) Life insurance company.

C) Property and casualty insurance company.

Explanation

Foundations and life insurance companies typically have long investment horizons. Property and casualty insurance companies typically have shorter investment horizons than life insurance companies because claims against their policies occur sooner on average.

(Module 61.1, LOS 61.c)

Question #8 of 27

Question ID: 1458845

In a defined contribution pension plan, investment risk is borne by the:

A) employee.

B) employer.

C) plan manager.

Explanation

In a defined contribution plan, the employee makes the investment decisions and assumes the investment risk.

(Module 61.1, LOS 61.d)

Question #9 of 27

Question ID: 1458846

In a defined benefit pension plan:

A) the employee is promised a periodic payment upon retirement.

B) the employee is responsible for making investment decisions.

C) the employer's pension expense is equal to its contributions to the plan.

Explanation

In a defined benefit pension plan, a periodic payment, typically based on the employee's salary, is promised to the employee upon retirement and the employer contributes to an investment trust that generates the principal growth and income to meet the pension obligation. The employees do not direct the investments in their accounts as they do in a defined contribution plan. Pension expense for a defined benefit plan has several components, including service cost, prior service cost, and interest cost, and depends on actuarial assumptions and the expected rate of return on plan assets.

(Module 61.1, LOS 61.d)

Question #10 of 27

Question ID: 1458842

Which of the following institutional investors is *most likely* to have low liquidity needs?

A) Property insurance company.

B) Bank.

C) Defined benefit pension plan.

Explanation

A defined benefit pension plan has less need for liquidity than a bank or a property and casualty insurance company. Banks have high liquidity needs because assets may have to be sold quickly if depositors withdraw their funds. Property and casualty insurance companies need to keep liquid assets to meet claims as they arise.

(Module 61.1, LOS 61.c)

Question #11 of 27

Question ID: 1458835

In the top-down approach to asset allocation, industry analysis should be conducted before company analysis because:

A) an industry's prospects within the global business environment are a major determinant of how well individual firms in the industry perform.

B) most valuation models recommend the use of industry-wide average required returns, rather than individual returns.

C) the goal of the top-down approach is to identify those companies in non-cyclical industries with the lowest P/E ratios.

Explanation

In general, an industry's prospects within the global business environment determine how well or poorly individual firms in the industry do. Thus, industry analysis should precede company analysis. The goal is to find the best companies in the most promising industries; even the best company in a weak industry is not likely to perform well.

(Module 61.1, LOS 61.b)

Question #12 of 27

Question ID: 1458847

Promised payments to pension beneficiaries are a responsibility of the plan sponsor in:

A) a defined benefit plan only.

B) a defined contribution plan only.

C) both a defined benefit plan and a defined contribution plan.

Explanation

In a defined benefit plan the promised payments to beneficiaries are a responsibility of the firm sponsoring the plan. In a defined contribution plan no fixed payments are promised to beneficiaries.

(Module 61.1, LOS 61.d)

Question #13 of 27

Question ID: 1458836

Which of the following actions is *best* described as taking place in the execution step of the portfolio management process?

A) Choosing a target asset allocation.

B) Developing an investment policy statement.

C) Rebalancing the portfolio.

Explanation

The three major steps in the portfolio management process are (1) planning, (2) execution, and (3) feedback. The planning step includes evaluating the investor's needs and preparing an investment policy statement. The execution step includes choosing a target asset allocation, evaluating potential investments based on top-down or bottom-up analysis, and constructing the portfolio. The feedback step includes measuring and reporting performance and monitoring and rebalancing the portfolio.

(Module 61.1, LOS 61.b)

Question #14 of 27

Question ID: 1458832

The portfolio approach to investing is *best* described as evaluating each potential investment based on its:

A) fundamentals such as the financial performance of the security issuer.

B) potential to generate excess return for the investor.

C) contribution to the investor’s overall risk and return.

Explanation

The portfolio approach to investing refers to evaluating individual investments based on their contribution to the overall risk and return of the investor's portfolio. Evaluating potential investments on a standalone basis, such as by analyzing their fundamentals or their potential to generate excess return, does not describe the portfolio approach to investing.

(Module 61.1, LOS 61.a)

Question #15 of 27

Question ID: 1458852

A pooled investment fund buys all the shares of a publicly traded company. The fund reorganizes the company and replaces its management team. Three years later, the fund exits the investment through an initial public offering of the company's shares. This pooled investment fund is *best* described as a(n):

A) event-driven fund. ✗

B) private equity fund. ✓

C) venture capital fund. ✗

Explanation

A private equity fund or buyout fund is one that acquires entire public companies, takes them private, and reorganizes the companies to increase their value. An event-driven fund is a hedge fund that invests in response to corporate events such as mergers or acquisitions. Venture capital funds invest in start-up companies.

(Module 61.2, LOS 61.f)

Question #16 of 27

Question ID: 1458830

In the Markowitz framework, an investor should *most appropriately* evaluate a potential investment based on its:

A) effect on portfolio risk and return. ✓

B) expected return. ✗

C) intrinsic value compared to market value. ✗

Explanation

Modern portfolio theory concludes that an investor should evaluate potential investments from a portfolio perspective and consider how the investment will affect the risk and return characteristics of an investor's portfolio as a whole.

(Module 61.1, LOS 61.a)

Question #17 of 27

Question ID: 1458843

Endowments and foundations typically have investment needs that can be characterized as:

A) long time horizon, high risk tolerance, and low liquidity needs.

B) long time horizon, low risk tolerance, and high liquidity needs.

C) short time horizon, low risk tolerance, and low liquidity needs.

Explanation

Endowments and foundations invest for the long term to provide ongoing funding for a specific purpose or charitable cause. They typically have relatively low cash payout rates as a percentage of total assets. Their investment needs are best characterized as long time horizons, low liquidity needs, and high risk tolerance.

(Module 61.1, LOS 61.c)

Question #18 of 27

Question ID: 1458849

MAL Investments is an asset management company that consists of three subsidiaries: one that focuses on mid-cap value stocks, one that focuses on alternative assets, and one that focuses on long-term emerging market sovereign debt. MAL is *most accurately* described as a:

A) full-service asset manager.

B) multi-boutique firm.

C) specialist asset manager.

Explanation

A multi-boutique firm is a holding company that includes a number of different specialist asset managers.

(Module 61.2, LOS 61.e)

Question #19 of 27

Question ID: 1458837

The top-down analysis approach is *most likely* to be employed in which step of the portfolio management process?

A) The planning step.

B) The execution step.

C) The feedback step.

Explanation

Top-down analysis would be used to select securities in the execution step.

(Module 61.1, LOS 61.b)

Question #20 of 27

Question ID: 1458854

Which of the following pooled investments is *least likely* to employ large amounts of leverage?

A) Private equity buyout fund.

B) Venture capital fund.

C) Global macro hedge fund.

Explanation

Hedge funds and buyout firms typically employ high leverage to acquire assets. Venture capital typically involves an equity interest.

(Module 61.2, LOS 61.f)

Question #21 of 27

Question ID: 1462955

In a defined contribution pension plan, investment risk is borne by the:

A) employee.

B) plan sponsor.

C) fund manager.

Explanation

Defined contribution pension plans require the plan sponsor (the employer) to make payments to the employees' retirement accounts throughout the duration of their employment. Once payments are made by the sponsor, the sponsor's obligation is fulfilled and the investment risk is borne by the employees.

(Module 61.1, LOS 61.d)

Question #22 of 27

Question ID: 1458838

Identifying a benchmark for a client portfolio is *most likely* to be part of the:

A) execution step.

B) feedback step.

C) planning step.

Explanation

Identification of the client's benchmark would be established in the planning step, to allow assessment of performance in the feedback step.

(Module 61.1, LOS 61.b)

Question #23 of 27

Question ID: 1458839

The execution step in the portfolio management process is *most likely* to include:

A) asset allocation and security analysis.

B) performance measurement and portfolio rebalancing.

C) preparation of an investment policy statement.

Explanation

The three major steps in the portfolio management process are planning, execution, and feedback. Asset allocation and security analysis are components of the execution step, as is portfolio construction. Preparation of an investment policy statement is a component of the planning step. Portfolio monitoring and rebalancing, as well as performance measurement and reporting, are part of the feedback step.

(Module 61.1, LOS 61.b)

Question #24 of 27

Question ID: 1458853

A mutual fund that invests in short-term debt securities and maintains a net asset value of $1.00 per share is *best* described as a:

A) balanced fund. ✗

B) bond mutual fund. ✗

C) money market fund. ✓

Explanation

Money market funds invest primarily in short-term debt securities and are managed to maintain a constant net asset value, typically one unit of currency per share. A bond mutual fund typically invests in longer-maturity securities than a money market fund. A balanced fund invests in both debt and equity securities.

(Module 61.2, LOS 61.f)

Question #25 of 27

Question ID: 1458844

The investment needs of a property and casualty insurance company are *most likely* different from the investment needs of a life insurance company with respect to:

A) liquidity needs. ✗

B) risk tolerance. ✗

C) time horizon. ✓

Explanation

Property and casualty insurance companies typically have shorter investment horizons than life insurance companies. Both types of insurance companies typically have low risk tolerance and relatively high liquidity needs.

(Module 61.1, LOS 61.c)

Question #26 of 27

Question ID: 1458831

The ratio of an equally weighted portfolio's standard deviation of return to the average standard deviation of the securities in the portfolio is known as the:

A) diversification ratio.

B) relative risk ratio.

C) Sharpe ratio.

Explanation

The diversification ratio is calculated by dividing a portfolio's standard deviation of returns by the average standard deviation of returns of the individual securities in the portfolio (sometimes calculated as the average annualized standard deviation of portfolio securities selected at random over the historical measurement period).

(Module 61.1, LOS 61.a)

Question #27 of 27

Question ID: 1458840

High risk tolerance, a long investment horizon, and low liquidity needs are *most likely* to characterize the investment needs of a(n):

A) defined benefit pension plan.

B) bank.

C) insurance company.

Explanation

A defined benefit pension plan typically has a long investment time horizon, low liquidity needs, and high risk tolerance. Insurance companies and banks typically have low risk tolerance and high liquidity needs. Banks and property and casualty insurers typically have short investment horizons.

(Module 61.1, LOS 61.c)