Question #1 of 46

Question ID: 1459425

Kim Lee is a research analyst at Superior Investments and is researching a biotech firm specializing in the analysis of "mad cow" disease. While touring company facilities and meeting with management, she learns that they believe they may have found a way to reverse the disease. Moreover, one manager conjectured, "Suppose that we reversed the disease in someone who didn't even have it? We might then be able to boost that individual's IQ into the stratosphere!" After returning to her office, Lee issues a research report describing the compound as an "IQ booster with huge potential." This statement:

A) is reasonable given the information she was provided by the company.

B) lacks a reasonable and adequate basis in fact.

C) is allowable but only if quoted verbatim from her conversations with management.

Explanation

Standard V(A) requires that a member have a "reasonable and adequate basis" before making an investment recommendation. Extrapolating on the basis of the conjecture of one member of the management team, without independent corroboration, is clearly in violation of this Standard. She is also in violation of Standard V(B) concerning the use of reasonable judgment regarding what is included or excluded in a communication with a client or prospective client.

(Module 71.7, LOS 71.b)

Question #2 of 46

Question ID: 1451409

Bill Fox, CFA, has been preparing a research report on New London Wire and Cable, one of his major investment clients. He had completed much of his analysis and had planned on having his report typed and bound today. Unfortunately, his briefcase was stolen while he ate breakfast, and he lost all his notes and working papers. The lost materials included his notes from management interviews, conversations with suppliers and competitors, dates of company visits, and his computer diskette containing much of his quantitative analysis. Fox's client needs this report tomorrow. In a panic, Fox called New London's vice president of finance and was faxed a copy of the company's most recent financial projections. Fox remembered that his own analysis showed that management's estimates were too high. He did not remember the exact amount, so he revised New London's figures downward 10%. Fox incorporated some charts and graphs on New London from a research report he received last week from a small regional research firm and some information from a Standard & Poor's reference work in his report, without reference to their sources. Fox has:

A) violated the requirement to have a reasonable basis for a recommendation, the prohibition against plagiarism, and the requirement to maintain appropriate records.

B) violated the requirement to have a reasonable basis for a recommendation and the prohibition against plagiarism.

C) violated none of the Standards.

Explanation

New London's report is potentially self serving, so Fox did not exercise diligence or have an adequate basis for his recommendation. In addition, Fox did not acknowledge his source of the charts and graphs. Finally, he did not maintain adequate records.

Question #3 of 46

Question ID: 1469308

Bob Hatfield, CFA, has his own money management firm with two clients. The accounts of the two clients are equal in value. It is Hatfield's opinion that interest rates will fall in the near future. Based upon this, Hatfield begins increasing the bond allocation of each portfolio. In order to comply with Standard V(B), Communication with Clients and Prospective Clients, the analyst needs to:

A) inform the clients of the change and tell them it is based upon an opinion and not a fact.

B) make sure that the change is identical for both clients.

C) perform both of these functions.

Explanation

According to Standard V(B), the analyst must inform the clients of the change and tell them it is based upon an opinion and not a fact. Making an identical change in two portfolios may be a violation of this standard if the needs of the clients are not identical.

Question #4 of 46

Question ID: 1459430

While copying some of her research materials at work, Mary Jones comes across a few incomplete research notes written by one of her colleagues. As a result of reading the notes, and without further review, Jones immediately changes one of her stock recommendations from sell to buy. Which of the following CFA Institute Standards has Jones violated?

A) Standard I(B), Independence and Objectivity. ✗

B) Standard V(A), Diligence and Reasonable Basis. ✓

C) Standard III(A), Loyalty, Prudence, and Care. ✗

Explanation

Jones has violated Standard V(A) by failing to exercise diligence and thoroughness.

(Module 71.7, LOS 71.b)

Question #5 of 46

Question ID: 1451423

Janice Melfi is a portfolio manager for Soprano Advisors. Soprano has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Soprano model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research—an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers use the model to assist them in making portfolio decisions, but, based on their own fundamental research, are allowed to purchase securities not recommended by the model. This fact is not disclosed to the clients, because the head of marketing does not think it is relevant. Which of the following statements regarding the portfolio manager's investment decisions is CORRECT?

A) Melfi is violating the Standards by using two investment processes that are in conflict with each other.

B) Soprano is violating the Standards by not disclosing the fundamental research aspect of the investment process.

C) There is no violation of the Standards.

Explanation

Soprano is violating the Standard on portfolio investment recommendations and actions by excluding relevant factors of the investment process. The fundamental research aspect is highly relevant to the process and should be disclosed to clients. It is acceptable for Melfi to use two investment processes that may be in conflict with each other and to use a process that was not developed by her.

Question #6 of 46

Question ID: 1469301

The following scenarios refer to recommendations made by two analysts.

- Jean King, CFA, is a quantitative analyst at Quantlogic, Inc. King uses computer-generated screens to differentiate value and growth stocks based on accounting numbers such as sales, cash flow, earnings, and book value. Based on her analysis of all domestically traded stocks in the U.S. over the past year, King concludes that value stocks as a class have underperformed growth stocks over that period. Using only this analysis, she recommends that account executives at Quantlogic sell all value stocks from the portfolios for which they have discretionary authority to trade and replace these stocks with growth stocks.
- James Capelli, CFA, is a fundamental analyst at Wheaton Capital Management, which focuses on regional stocks. His analysis of Branson Wireless includes the investment's basic characteristics such as information about historical earnings, ownership of assets, outstanding contracts, and other business factors. In addition to conducting both a general industry analysis and a company financial analysis, Capelli interviews key executives at Branson. Based on his analysis, he concludes that the company's future prospects are strong and issues a "buy" recommendation.

According to CFA Institute Standards of Professional Conduct, did King and Capelli have a reasonable and adequate basis for making their recommendations?

A) Both King and Capelli have a reasonable basis for their recommendations.

B) Capelli has a reasonable basis for his recommendation, but King does not.

C) King has a reasonable basis for his recommendation, but Capelli does not.

Explanation

Capelli appears to have exercised diligence and thoroughness in making his recommendation. King's recommendation is not based on thorough quantitative work because the period used in her study is only one year. Also, her recommendation does not consider the client's specific needs and circumstances.

Question #7 of 46

Question ID: 1469310

Nicole Wise, CFA, is an analyst at Chicago Securities. She attends a meeting with management of one of the companies that she covers. During the meeting, management expresses great optimism about the company's recent acquisition of a new business. Wise is excited about these prospects and issues a research report that states that the company is about to achieve significant success with the new acquisition. Wise has:

A) not violated CFA Institute Standards of Professional Conduct because she had reasonable reason to believe that the statements in her report were true.

B) violated CFA Institute Standards of Professional Conduct because she did not check the accuracy of the statements that management made.

C) violated CFA Institute Standards of Professional Conduct because she misrepresented the optimism by turning it to certainty.

Explanation

Standard V(B), Communication with Clients and Prospective Clients. Members must distinguish between fact and opinion in the presentation of a research report or investment recommendation. Wise violated the standard because she misrepresented management's enthusiasm by turning it into certainty.

Question #8 of 46

Question ID: 1459452

In preparing research reports, which of the following is *least likely* required or recommended by the Code and Standards?

A) Attribute paraphrases and summaries of material prepared by others.

B) Maintain copies of materials that were relied on in preparing the research report.

C) Send all reports to the firm's legal counsel to ensure compliance with securities laws.

Explanation

Members do not need to send all reports to the firm's legal counsel to ensure compliance with securities laws.

(Module 71.7, LOS 71: V(B))

Question #9 of 46

Question ID: 1469304

Wes Smith, CFA, works for Advisors, Inc. In order to remain in compliance with Standard V(A), Diligence and Reasonable Basis, Smith may recommend a security in which of the following situations?

A) Advisors' research department recommends a stock.

B) For either of the reasons listed here.

C) Smith reads a favorable review of the security in a widely read periodical.

Explanation

Smith will be in violation if he acts solely on the basis of what he read in the periodical. Use of information within the firm can be relied upon unless the Smith has reason to believe the source lacks a sound basis.

Question #10 of 46

Question ID: 1469311

According to CFA Institute Standards of Professional Conduct, members are *least likely* required to:

A) analyze the investment's basic characteristics before recommending a specific investment to a broad client group.

B) distribute a detailed research report to clients with any recommendation.

C) make diligent efforts to determine whether third party research relied on is sound.

Explanation

Recommendations can be made in various contexts. For example, an analyst's firm may issue a list of buy recommendations or a brief recommendation that does not contain all the relevant details of the analysis, but clients must be informed that a full analysis supporting the recommendation is available. The other actions are required by the Standards.

Question #11 of 46

Question ID: 1459442

Peggy Green, CFA, is a research analyst following Brown Co. All the information she has gathered suggests the stock should be rated a weak "hold." During a recent lunch, Green overheard another analyst say that the stock should be rated a "buy." Green returns to her office and issues a "buy" recommendation. Green has *most likely* violated the Code and Standards by:

A) acting or causing others to act on material nonpublic information.

B) recommending an investment action without a reasonable basis.

C) failing to distinguish between fact and opinion.

Explanation

Standard V(A) Diligence and Reasonable Basis requires members and candidates to have a reasonable and adequate basis, supported by appropriate research and investigation, for their recommendations.

(Module 71.7, LOS 71: V(A))

Question #12 of 46

Question ID: 1459421

Cynthia Abbott, a CFA charterholder, is preparing a research report on Boswell Company for her employer, Capital Asset Management. Bob Carter, president of Boswell, invites Abbott and several other analysts to visit his company and offers to pay her transportation and lodging. Abbott pays for her own transportation and lodging, but while visiting the company, accepts an item of small value from Carter. Abbott does not disclose this gift to her supervisor at Capital when she returns. In the course of the company visit, Abbott overhears a conversation between Carter and his chief financial officer that the company's earnings per share (EPS) are expected to be $1.10 for the next quarter. Abbott was surprised that this EPS is substantially above her initial earnings estimate of $0.70 per share. Without further investigation, Abbott decides to include the $1.10 EPS in her research report on Boswell. Using the high EPS positively affects her recommendation of Boswell.

Which of the following statements about whether Abbott violated Standard V(A), Diligence and Reasonable Basis and Standard I(B), Independence and Objectivity is CORRECT? Abbott:

A) violated Standard V(A) but she did not violate Standard I(B).

B) did not violate Standard V(A) but she violated Standard I(B).

C) violated both Standard V(A) and Standard I(B).

Explanation

Abbott violated Standard V(A), Diligence and Reasonable Basis, because she did not have a reasonable and adequate basis to support the $1.10 EPS without further investigation. By including the $1.10 EPS in her report, she did not exercise diligence and thoroughness to ensure that any research report finding is accurate. If Abbott suspects that any information in a source is not accurate, she should refrain from relying on that information. Abbott did not violate Standard I(B), Independence and Objectivity, because the gift from Carter would not reasonably be expected to compromise her independent judgment.

(Module 71.7, LOS 71.b)

Question #13 of 46

Question ID: 1451421

An analyst finds a stock with historical returns that are not correlated with interest rate changes. The analyst writes a report for his clients that have large allocations in fixed-income instruments and emphasizes the observed lack of correlation. He feels the stock would be of little value to investors whose portfolios are composed primarily of equities. The clients with allocations of fixed income instruments are the only clients to see the report. According to Standard V(B), Communication with Clients and Prospective Clients, the analyst has:

A) not violated the Standard.

B) violated the Standard concerning fair dealings with all clients.

C) violated the article in the Standard concerning facts and opinions.

Explanation

Recommending a stock whose return is uncorrelated with interest rate changes is appropriate for the clients described in the problem. Emphasizing the lack of correlation is appropriate as long as the analyst makes no guarantees concerning the relationship in the future. Reporting historical correlation is a presentation of fact, and is not in violation. The analyst is free to show the report only to investors for whom the investment is appropriate.

Question #14 of 46

Question ID: 1451418

Janet Coleman, CFA, is preparing a research report on Union Power and Light. Due to deregulation, utility companies face increased competition. During the past year, three of the five utility companies in her region have cut their dividends by 50%, on average, to provide more internal funds for investment purposes. In a discussion with Union's chief executive officer, Coleman learned that Union expects to have a record amount of capital expenditures during the next year. Although Union subsequently issued a press release about its capital expenditure plans, it did not make any public statements about a change in dividend policy. Coleman reasons that the management of Union will be under pressure to cut its dividends within the next year to remain competitive. Coleman issues a research report in which she states:

"Union Power and Light will decrease its dividend from $2 to $1 a share by the second quarter. We expect that Union will strengthen its competitive position by using more internally generated funds to finance its investment opportunities. If investors buy the stock now at around $50 a share, their total return could exceed 20% on the stock."

Based on CFA Institute Standards of Professional Conduct, which of the following statements about Coleman's actions is *most accurate*?

A) Coleman violated the Standards because she used material nonpublic information.

B) Coleman did not violate the Standards.

C) Coleman violated the Standards because she failed to separate opinion from fact in her research report.

Explanation

Coleman is required to distinguish between facts and opinions in her research reports. Her statement that Union will decrease its dividend from $2 to $1 a share is a prediction, not a fact, and therefore should be distinguished clearly as an opinion.

Question #15 of 46

Question ID: 1469309

Roger Halpert, CFA, prepares a company research report in which he recommends a strong "buy." He has been careful to ensure that his report complies with the CFA Institute Standard on research reports. According to CFA Institute Standards of Professional Conduct, which of the following statements about how Halpert can communicate the report is *most correct*?

A) Halpert can transmit his report by computer on the internet. ✗

B) Halpert can make his report in person. ✗

C) Halpert can make his report in person, by telephone, or by computer on the internet. ✓

Explanation

A report can be made via any means of communication, including in-person recommendation, telephone conversation, media broadcast, and transmission by computer such as on the internet.

Question #16 of 46

Question ID: 1459460

Ethyl Redd recently joined Bloomington Investments as a research analyst. After spending an afternoon looking through the research team's archives, Redd is not sure Bloomington maintains the records that support the team's analysis and recommendations for the minimum 7-year period called for by Standard V(C), Record Retention. What is Redd's *most appropriate* course of action?

A) Decline to participate in any new research until she can verify that the firm is in compliance with the Standard. ✗

B) Keep her own copies of the relevant records and maintain them at home for a minimum 7-year holding period. ✗

C) Review the firm’s record retention procedures with her supervisor or compliance officer to ensure that they comply with the Standard, or suggest ways to bring them into compliance. ✓

Explanation

Standard V(C), Record Retention requires that members maintain all records supporting analysis, recommendations, actions, and all other investment related communications with clients and prospects. The recommended procedures for compliance with Standard V(C) state that the record-keeping requirement is generally the firm's responsibility. These records are the property of the firm, so Redd keeping her own copies at home could potentially violate Standard IV(A), Loyalty. Redd's best course of action is to review the firm's procedures with her supervisor and recommend any improvements that are necessary to bring them into compliance with Standard V(C).

(Module 71.7, LOS 71: V(C))

Question #17 of 46

Question ID: 1459422

Patricia Cuff is the chief financial officer and compliance officer at Super Selection Investment Advisors, an organization that has incorporated the CFA Institute Code of Standards into the firm's compliance manual. Karen Trader is a portfolio manager for Super Selection. Trader is friendly with Josey James, president of AMD, a rapidly growing biotech company. Trader has served on AMD's board of directors for the last three years. James has asked Trader to commit to a large purchase of AMD stock for Trader's clients' portfolios. Trader had previously determined that AMD was a questionable investment but agreed to reconsider. Her reevaluation deemed the stock to be overpriced, but Trader nevertheless decides to purchase for her portfolios. Which standard was *least likely* violated?

A) V(A) Diligence and Reasonable Basis.

B) III(A) Loyalty, Prudence, and Care.

C) III(B) Fair Dealing.

Explanation

Standard III(B) Fair Dealing is not directly applicable to this situation; that standard prohibits members and candidates from discriminating against any clients when disseminating recommendations or taking investment action. Trader has clearly violated standard III(A) Loyalty, Prudence, and Care, which requires that members and candidates act for the benefit of their clients and place their clients' interests before their own interests. Trader has also violated standard V(A) Diligence and Reasonable Basis, which requires members and candidates to have a reasonable and adequate basis for any investment recommendation or action.

(Module 71.7, LOS 71.b)

Question #18 of 46

Question ID: 1459417

Amanda Brad, CFA, is a security analyst at UpTrend, Inc. During a routine visit to a beauty salon, she learns that a major cosmetic company, Lorean, is expected to present a revolutionary formula for facial cream. Brad buys Lorean stock for her portfolio and prepares a special report on the company. Brad also makes a call to Hillary Lang, CFA, another security analyst at UpTrend, to inform her about the news. Lang starts trading on her clients' portfolios. Brad's report states that given the on-going research activity at Lorean within the last months, investors can expect some successful new products and a sharp increase in the price of the stock. It is *most likely* that:

A) Lang violated the Standard concerning diligence and reasonable basis. ✓

B) Neither analyst violated the Standards. ✗

C) Brad violated the Standard concerning material nonpublic information. ✗

Explanation

Lang violated Standard V(A) Diligence and Reasonable Basis, which imposes the requirement to have a reasonable and adequate basis when making investment decisions for clients. Based only on what is given in the question, we have no reason to assume the information about Lorean is material and nonpublic.

(Module 71.7, LOS 71.b)

Question #19 of 46

Question ID: 1459420

Jim Crockett is a portfolio manager for Miami Advisors and reports to Vicki Tubbs, the Chief Investment Officer. Miami has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Miami model. The model is purely quantitative and takes a given set of client characteristics and universe of potential securities and forms a portfolio for the investor. Individual portfolio managers are responsible for selecting securities to fit into the model based on recommendations from the firm's research department and the managers' own judgment. Because of the specific nature of the inputs to the model, each manager is responsible for applying the model on his or her own computer. The basic philosophy of the process is thoroughly explained to clients. Crockett does not understand the basics of the model, but feels that since it provides pure quantitative output, he does not need to understand it. However, he misapplies the model for several of his clients. In reviewing some of Crockett's portfolios, Tubbs finds the errors and points them out to Crockett. Which of the following statements regarding Tubbs and Crockett is CORRECT?

A) Crockett has violated the Standards by not exercising diligence and thoroughness in making investment recommendations.

B) Tubbs has violated the Standards by failing to supervise adequately.

C) Crockett has violated the Standards by not considering the appropriateness and suitability of the investment for his clients.

Explanation

Crockett had a responsibility to know the model well enough to detect the mistakes that could occur from misapplication, so he violated the Standard of diligence and reasonable basis.

(Module 71.7, LOS 71.b)

Question #20 of 46

Question ID: 1469302

An analyst has found an investment with what appears to be a great return-to-risk ratio. The analyst double-checks the data for accuracy, keeps careful records, and is careful to not make any misrepresentations as he simultaneously sends an e-mail to all his clients with a "buy" recommendation. According to Standard V(A), Diligence and Reasonable Basis, the analyst has:

A) fulfilled all obligations.

B) violated the Standard by communicating the recommendation via e-mail.

C) violated the Standard if he does not verify whether the investment is appropriate for all the clients.

Explanation

If the analyst had been an investment manager, it would have been inappropriate for him to make a blanket recommendation for all of his clients without considering the unique needs of each. However, the analyst is merely stating that given the qualities of the investment, it is an attractive buy. He has kept adequate records, and made fair disclosure of his rating decision.

Question #21 of 46

Question ID: 1469305

Standard V(B), Communication with Clients and Prospective Clients, *least likely* requires members to:

A) disclose the general principles of investment processes used to analyze and select securities, and construct portfolios.

B) make clear buy or sell recommendations on the securities covered in research reports.

C) use reasonable judgment regarding the inclusion or exclusion of relevant factors in research reports.

Explanation

There is no obligation to make buy or sell recommendations on securities that are covered by research reports.

Question #22 of 46

Question ID: 1459446

Ted Riczek, CFA, is an independent investment advisor. Riczek often makes investment recommendations to clients based on research from several third-party sources. The Code and Standards *most likely* require Riczek to:

A) disclose to his clients the sources of any third-party research that supports his recommendations.

B) make a reasonable effort to verify that the third-party research is sound.

C) perform his own research rather than relying on third-party research.

Explanation

Standard V(A) Diligence and Reasonable Basis states that members and candidates who rely on third-party research must make reasonable efforts to ensure that the research has a sound basis. According to Standard I(C) Misrepresentation, if members and candidates use third-party research they should disclose this fact to clients, but the Standards do not require disclosure of the specific sources.

(Module 71.7, LOS 71: V(A))

Question #23 of 46

Question ID: 1451426

Lee Hurst, CFA, is an equity research analyst who has recently left a large firm to start independent practice. He is able to re-create several of his previous recommendation reports, based on his clear recollection of supporting documentation he compiled at his previous employer. He publishes the reports and obtains several new clients. Hurst is *most likely*:

A) not in violation of any Standard.

B) in violation of Standard V(A) Diligence and Reasonable Basis.

C) in violation of Standard V(C) Record Retention.

Explanation

Hurst is most likely in violation of Standard V(C) Record Retention because the supporting documentation is unavailable. He needs to recreate the supporting records based on information gathered through public sources or the covered company. He may have a reasonable basis for his recommendations and have been diligent in his analysis, but must reconstruct the records of this analysis before issuing the reports.

Question #24 of 46

Question ID: 1459428

Nancy Westfall is an individual investment advisor who uses mutual funds for her clients. She typically chooses funds from a list of 40 funds that she has thoroughly researched. The Craigs, a married couple that is a client, asked her to consider the Eligis fund for their portfolio. Westfall had not previously considered the fund because when she first conducted her research three years ago, Eligis was too small to be considered. However, the fund has now grown in value, and after doing thorough research on the fund, she finds the fund has suitable characteristics to be included in her acceptable list of funds. She puts the fund in the Craigs' portfolio but not in any of her other clients' portfolios. The fund ends up being the poorest performing fund in the Craigs' portfolio. Has Westfall violated any Standards? Westfall has:

A) violated the Standards by not having a reasonable and adequate basis for making the recommendation.

B) not violated the Standards.

C) violated the Standards by not dealing fairly with clients.

Explanation

Because Westfall performed the same degree of research as she did for the other funds on her list, she provided a reasonable and adequate basis for her recommendation. There is not enough information given about the Eligis fund and how it fits in with the other funds on Westfall's list to determine whether or not the standard on Fair Dealing was broken. It was the Craigs who wanted the Eligis fund and Westfall found it to be acceptable for them and thus added it to her list of acceptable funds. If the Eligis fund was found to possess unique characteristics that were not found in any of the other funds on Westfall's list and the Eligis fund was suitable for some of Westfall's other clients and Westfall hadn't added it to their portfolios after their periodic review then a violation of fair dealing would have occurred.

(Module 71.7, LOS 71.b)

Question #25 of 46

Question ID: 1459418

Graham Carson, CFA, is an investment advisor to Ron Grayson, a client with moderate risk tolerance and an investment horizon of 15 years. Grayson calls Carson to complain about two stocks in his account that have performed poorly. He feels that one stock was too risky for him as it paid no dividend and had a beta of 1.4. The other stock had a beta of 0.9 and paid a dividend of 3%, but financial regulators have indicated that the firm's reported earnings were incorrectly stated. Based on this information, Carson has *most likely*:

A) not violated the Standards. ✓

B) violated only the Standard on suitability. ✗

C) violated both the Standard on suitability and the Standard on diligence and reasonable basis. ✗

Explanation

Carson has not violated either Standard based on the information given. The suitability of an investment is to be determined based on the risk and return characteristics of the portfolio and not on the risk and return characteristics of each individual security. The fact that a security does not pay a dividend and has a beta higher than the market is not enough to determine its suitability in a portfolio context. The fact that regulators have called previously reported earnings into question does not necessarily mean that Carson's analysis was not diligent or that he did not have a reasonable basis for his selection of this security.

(Module 71.7, LOS 71.b)

Question #26 of 46

Question ID: 1115971

Susan Plumb is the supervisor of her firm's research department. Her firm has been seeking the mandate to underwrite Wings Industries' proposed secondary stock offering. Without mentioning that the firm is seeking the mandate, she asks Jack Dawson to analyze Wings common stock and prepare a research report. After reasonable effort, Dawson produces a favorable report on Wings stock. After reviewing the report, Plumb then adds a footnote describing the underwriting relationship with Wings and disseminates the report to the firm's clients. According to CFA Institute Standards of Professional Conduct, these actions are:

A) not a violation of any Standard.

B) a violation of Standard VI(A), Disclosure of Conflicts.

C) a violation of Standard V(A), Diligence and Reasonable Basis.

Explanation

The fact that the firm is seeking the mandate does not preclude the research department from performing analytical work on the security. As long as the final recommendation is based upon reasonable facts, not the desire to obtain the mandate, there is no violation.

Question #27 of 46

Question ID: 1459433

Don Wilson and Nadine Chavis, both CFA charterholders, are investment advisors at Uptown Securities. Wilson recommends that one of his clients buy Alpha Company based on research conducted by Uptown. Chavis recommends that one of her clients sell Alpha Company based on research conducted by another brokerage firm for general distribution. Both recommendations are consistent with each client's investment objectives and within the context of their entire portfolios. Neither Wilson nor Chavis has reason to suspect that any information contained in the research reports from these two sources is inaccurate or inadequately supported. According to Standard V(A) Diligence and Reasonable Basis, do Wilson and Chavis have a reasonable basis for making their investment recommendations?

A) Both of these advisors have a reasonable basis for their recommendations.

B) Neither of these advisors has a reasonable basis for their recommendations.

C) Only one of these advisors has a reasonable basis for his or her recommendation.

Explanation

Wilson and Chavis have a reasonable and adequate basis if they recommend an investment transaction based on sound research prepared by their firm or an independent third party.

(Module 71.7, LOS 71: V(A))

Question #28 of 46

Question ID: 1469306

Rhonda Meyer, CFA, is preparing a research report on Moon Ventures, Inc. In the course of her research she learns the following:

- Moon had its credit rating downgraded by a prominent rating agency 3 years ago due to sales pressure in the industry. The rating was restored 3 months later when the pressure resolved.
- Moon's insider trading has been substantial over the last 3 months. Holdings of Moon shares by officers, directors, and key employees were reduced by 50% during that period.

In Meyer's detailed report making a buy recommendation for Moon, both the credit rating downgrade and the insider trading were omitted from the report.

Meyer has:

A) not violated the Code and Standards in her report. ✗

B) violated the Code and Standards by not including the insider trading information and by not including the credit rating downgrade in her report. ✗

C) violated the Code and Standards by not including the insider trading information in her report. ✓

Explanation

Standard V(B), Communication with Clients and Prospective Clients, requires analysts to use reasonable judgment regarding the inclusion or exclusion of relevant factors in their research reports. It would not be unreasonable to exclude the temporary credit downgrade from 3 years earlier.

Question #29 of 46

Question ID: 1451411

A financial analyst and CFA Institute member sends a preliminary research report on a company to his supervisor. The supervisor approves the report, but then the analyst receives news that causes him to revise downward the earnings estimate of the company. The analyst resubmits the report to the supervisor with the new earnings estimate. The analyst soon finds out that the supervisor plans to release the first version of the report with the first earnings estimate without a reasonable and adequate basis. In response to this the analyst must:

A) only insist that the first report be followed up by a revision.

B) both insist that a follow up report be issued and take up the issue with regulatory authorities.

C) insist that the supervisor change the earnings forecast or remove his (the analyst's) name from the report.

Explanation

According to Standard V(A), Diligence and Reasonable Basis, the analyst must exercise diligence, independence, and thoroughness when performing investment analysis, making a recommendation, or taking investment action. The analyst should document the difference in opinion including any request to remove his or her name from the report.

Question #30 of 46

Question ID: 1451422

Joni Black, CFA, works for a portfolio management firm. Black is a partner of the firm and is primarily responsible for managing several large pension plans. Black has just finished a research report in which she recommends Zeta Corporation as a "Strong Buy." Her rating is based on solid management in a growing and expanding industry. She just handed the report to the marketing department of the firm for immediate dissemination. Upon returning to her desk she notices a news flash by CNN reporting that management for Zeta Corporation is retiring. Black wishes she did not recommend Zeta Corporation as a "Strong Buy," but believes the corporation is still a good investment regardless of the management. What course of action for Black is *best*? Black:

A) should revise the recommendation based on this new information.

B) should report the new information to her immediate supervisor so that they can determine whether or not the marketing department should send out the report as written.

C) may send out the report as written as long as a follow up is disseminated within a reasonable amount of time reflecting the changes in management.

Explanation

This question is related to Standard V(B) which states that CFA Institute members should use reasonable judgment regarding the inclusion or exclusion of relevant factors in research reports. The change in management was a relevant factor and must be disclosed before dissemination.

Question #31 of 46

Question ID: 1451407

An analyst writes a report and includes the forecasts of an econometric model developed by the firm's research department. The analyst identifies the source of the forecast and includes all the relevant statistics concerning the model. With respect to diligence and reasonable basis, the analyst has:

A) violated the Standards by not evaluating the model independently. ✗

B) complied with the Standards. ✓

C) violated the Standards by relying on model forecasts. ✗

Explanation

Members and candidates may reasonably rely on their firms' research departments for analysis and remain in compliance with Standard V(A) Diligence and Reasonable Basis.

Question #32 of 46

Question ID: 1451420

An analyst has several groups of clients who are categorized according to their specific needs. Compared to research reports distributed to all of the clients, reports for a specific group:

A) will definitely include more basic facts. ✗

B) may generally exclude more basic facts. ✓

C) will not be allowed because it violates the Standard III(B), Fair Dealing. ✗

Explanation

According to Standard V(B), an analyst can use reasonable judgment regarding the exclusion of some facts and should include more basic facts for reports to wider audiences. The key issue is that analysts should tailor their reports to the intended audience.

Question #33 of 46

Question ID: 1469303

Several years ago, Hilton and Ross, a full service investment firm, managed the initial public offering of eCom, Inc. Now, eCom wants Hilton and Ross to underwrite its secondary public offering. A senior manager at Hilton and Ross asks Brent Whitman, CFA, one of its equity analysts, to write a favorable research report on eCom to help make the underwriting a success. Whitman conducts a thorough analysis of eCom and concludes that the company has serious problems that do not suggest a favorable financial outlook. Nevertheless, Whitman writes a favorable report because he is fearful of losing his job. Hilton and Ross publicly distribute a report that only contains a buy recommendation and a brief description of the basic characteristics of eCom. Whitman has violated:

A) Both Standard I(B) Independence and Objectivity and Standard V(A) Diligence and Reasonable Basis. ✔

B) Standard I(B) Independence and Objectivity, only. ✘

C) Standard V(A) Diligence and Reasonable Basis only. ✘

Explanation

Whitman violated Standard V(A) Diligence and Reasonable Basis because he did not have a reasonable and adequate basis for issuing a favorable recommendation. Whitman violated Standard I(B) Independence and Objectivity because he did not act independently in issuing his recommendation but instead was influenced by senior management at Hilton and Ross.

Question #34 of 46

Question ID: 1469300

Preston Partners is an investment management firm that adopted the Code and Standards as part of its policy manual. Gerald Smithson, CFA, has recently added the stock of Utah Biochemical Company and Norgood PLC to all his client's investment portfolios. Shortly afterwards Utah Biochemical and Norgood announced a merger that increased the share price of both companies. Smithson contends he saw the president of Utah Biochemical dining with the chairman of Norgood, but did not overhear their conversation. Smithson researched both companies extensively and determined that each company was a good investment. He put in a block trade for shares in each company. Preston's policies were not clear in this area as he allocated the shares by starting with his largest client accounts and working down to the small accounts. Some of Smithson's clients were very conservative personal trust accounts, others were pension funds who had aggressive investment objectives. Which standard was NOT broken?

A) Standard III(C)—Suitability.

B) Standard IV(C)—Responsibilities of Supervisors.

C) Standard V(A)—Diligence and Reasonable Basis.

Explanation

Standard V(A)—Diligence and Reasonable Basis was not broken because Smithson conducted thorough and diligent research. Standard III(C)—Suitability, Smithson failed to consider the needs of his conservative and aggressive clients. Standard IV(C)—Responsibilities of Supervisors, Preston Partners didn't have policies explaining how to allocate shares among clients.

Question #35 of 46

Question ID: 1469298

Steven Wade, CFA, writes an investment newsletter focusing on high-tech companies, which he distributes by e-mail to paid subscribers. Wade does not gather any information about his clients' needs and circumstances. Wade has developed several complex valuation models that serve as the basis for his recommendations. Each month, his newsletter contains a list of "buy" and "sell" recommendations. He states that his recommendations are suitable for all types of portfolios and clients. Because of their proprietary nature, Wade does not disclose, except in general terms, the nature of his valuation models. He conducted numerous statistical tests of these models and they appear to have worked well in the past. In his newsletter, Wade claims that subscribers who follow his recommendations can expect to earn superior returns because of the past success of his models.

Wade violated all of the following CFA Institute Standards of Professional Conduct EXCEPT:

A) Standard I(C), Misrepresentation.

B) Standard III(B), Fair Dealing.

C) Standard V(B), Communication with Clients and Prospective Clients.

Explanation

Wade did not violate Standard III(B), Fair Dealing, because this situation does not indicate that he failed to deal fairly and objectively with all clients when disseminating his newsletter containing investment recommendations.

Wade violated Standard V(B), Communication with Clients and Prospective Clients, because he failed to include all relevant factors behind his recommendations. Without providing the basis for his recommendations, clients cannot evaluate the limitations or the risks inherent in his recommendations.

Wade violated Standard I(C), Misrepresentation, because his claims about gaining superior expected returns are misleading to potential investors.

Question #36 of 46

Question ID: 1451349

Maggie McCarthy is an individual investment advisor who uses mutual funds for her clients. She typically chooses from a list of 40 funds that she has thoroughly researched. The Figgs, a married couple that are a client, asked her to consider the Boilermaker fund for their portfolio. McCarthy had not previously considered the fund because when she first conducted her research three years ago, Boilermaker was too small to be considered. However, the fund has now grown in value, and after doing thorough research on Boilermaker, she found the fund was by far the most outstanding large company value fund in her list of funds. She puts the fund in the Figgs' portfolio, and in all new clients' portfolios, but not in any of her other clients' portfolios. Her reasoning is that her existing clients were comfortable with their current holdings, and she did not want to risk disturbing their comfort. Has McCarthy violated any Standards? McCarthy has:

A) not violated the Standards. ✗

B) violated the Standards by not dealing fairly with clients. ✓

C) violated the Standards by not having a reasonable and adequate basis for making the recommendation. ✗

Explanation

The fund should have been considered for the existing clients' portfolios. There may have been reasons not to add the fund to their portfolios, such as tax consequences or a lack of suitability, but disturbing their comfort is not sufficient.

Question #37 of 46

Question ID: 1459441

An analyst notices that for most years that a given class of assets has an abnormally high rate of return, the asset class often has an abnormally low rate of return the next year. Based upon this information, according to Standard V(A), Diligence and Reasonable Basis, the analyst can recommend:

A) an increased allocation of Treasury bills (T-bills) for all portfolios of assets that have increased dramatically in the previous year.

B) short selling assets that have had a good previous year to all clients.

C) neither of these choices.

Explanation

An analyst should not make a recommendation based only upon a statistical anomaly. Furthermore, none of the other choices would be appropriate. Clients with low risk tolerance should not short sell assets. The analyst cannot make a recommendation to all clients because each client has different characteristics and portfolios. The one answer that may have some merit is to increase the allocation of T-bills in portfolios that have had recent, dramatic increases. This would be for the purposes of maintaining a balanced portfolio. But the decision to rebalance must be made on a case-by-case basis and not for all portfolios.

(Module 71.7, LOS 71: V(A))

Question #38 of 46

Question ID: 1451415

An analyst finds a stock that has had a low beta given its historical return, but its total risk has been commensurate with its return. When writing a research report about the stock for clients with well-diversified portfolios, according to Standard V(B), Communication with Clients and Prospective Clients, the analyst needs to mention:

A) the relationship of the historical beta and return only.

B) both the historical beta and total risk and return.

C) the relationship of the historical total risk to return only.

Explanation

Using reasonable judgment, an analyst may exclude certain factors from research reports. Since the report will be delivered to clients with well-diversified portfolios, total risk is not as important as beta. Given that the total risk has been only commensurate with historical return, furthermore, then the analyst is not negligent by not mentioning it.

Question #39 of 46

Question ID: 1459429

Question #39 of 46

Question ID: 1459429

Steve Jones is a portfolio manager for Gregg Advisors. Gregg has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Gregg model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research—an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. Jones thoroughly understands the model and uses it with all of his clients. Jones is:

A) not violating the Standards either in purchasing stocks without a thorough research basis or in not disclosing all alterations of the model to clients. ✓

B) violating the Standards in not disclosing all alterations of the model to clients, but not in purchasing stocks without a thorough research basis. ✗

C) violating the Standards in purchasing stocks without a thorough research basis and in not disclosing all alterations of the model to clients. ✗

Explanation

Jones and Gregg are using reasonable judgment in not continually disclosing all of the alterations of the model. It is acceptable to use a pure quantitative model as a sole basis for purchasing stocks, as long as it is thoroughly researched.

(Module 71.7, LOS 71.b)

Question #40 of 46

Question ID: 1451412

Patricia Hoolihan is an individual investment advisor who uses mutual funds for her clients. She typically chooses funds from a list of 40 funds that she has thoroughly researched. The Burns, a married couple that are a client, asked her to consider the Hawkeye fund for their portfolio. Hoolihan had not previously considered the fund because when she first conducted her research three years ago, Hawkeye was too small to be considered. However, the fund has now grown in value, and cursory research uncovers no fundamental flaws with the fund. She puts the fund in the Burns' portfolio but not in any of her other clients' portfolios. The fund ends up being the best performing fund on her list. Hoolihan has:

A) violated the Standards by not having a reasonable and adequate basis for making the recommendation. ✓

B) not violated the Standards.

C) violated the Standards by not dealing fairly with clients.

Explanation

Despite the fact the addition of the fund was successful, Hoolihan acted improperly in not conducting the same degree of research as she did for the other funds on her list.

Question #41 of 46

Question ID: 1451405

An analyst receives a research report from a colleague. The colleague's report has an elaborate table with performance data on publicly traded stocks. The colleague says the data in the table consists of measures provided by Standard & Poor's. The analyst finds the table a useful reference for a report she is writing. She uses several pieces of data from the table. The analyst is potentially in violation of:

A) no particular standard because this is appropriate activity.

B) Standard I(C), Misrepresentation, concerning the use of the work of others.

C) Standard V(A), Diligence and Reasonable Basis, if she does not first verify the data in the table is accurate.

Explanation

Since the data in the table supposedly comes from Standard & Poor's, a recognized data source, the analyst does not have to cite the source of the data. However, the analyst needs to use reasonable care and verify that the data is accurate by going back to the source. Had the analyst printed the table prepared by her colleague without acknowledgement, the analyst would have violated Standard I(C), Misrepresentation.

Question #42 of 46

Question ID: 1451424

The Konkol Company implements a new methodology for portfolio valuation that is licensed to them by ABC Statistics. Konkol complies with the CFA Institute Code and Standards by:

A) not discussing the new methodology with clients because there is no need to, as it will not change their risk and yield preferences.

B) discussing the new methodology with clients only when a change in the security selection process is involved.

C) discussing the new methodology with the clients, in its entirety.

Explanation

Standard V(B), Communication with Clients and Prospects, requires any change in the scope, valuation methodology, or focus of the portfolio to be discussed with clients.

Question #43 of 46

Question ID: 1469299

Victor Logan is a portfolio manager for McCoy Advisors, and Jack Brisco is the Director of Research for McCoy. Brisco has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the McCoy model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. Brisco frequently alters the model based on rigorous research—an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. Logan has conducted very thorough research on his own, using the same process that Brisco uses to validate his findings. Logan feels the model is missing some key elements that would further reduce the list of acceptable securities to purchase, however, Brisco has refused to look at Logan's research. Frustrated by this, Logan applies his own version of the model, with the justification that he is still only purchasing securities on the buy list. Because of the conflict with Brisco, he does not disclose the use of the model to anyone at McCoy or to clients. Which of the following statements regarding Logan and Brisco is CORRECT? Logan is:

A) not violating the Standards by applying his version of the model, but is violating the Standards by not disclosing it to clients. Brisco is not violating the Standards. ✓

B) violating the Standards by applying his version of the model and by not disclosing it to clients. Brisco is not violating the Standards. ✗

C) violating the Standards by applying his version of the model and by not disclosing it to clients. Brisco is violating the Standards by failing to consider Logan's research. ✗

Explanation

Because the research is thoroughly conducted, and Logan has authority to make individual security selection decisions, Logan is not violating the Standards by applying his model. However, Logan is violating the Standard on communication with clients and prospective clients by excluding relevant factors of the investment process. The use of his model is an important aspect of the investment process and should be disclosed to clients. Brisco is not violating the Standards by not considering Logan's research.

Question #44 of 46

Question ID: 1459448

Bertrand Greene, CFA, is preparing a report on Blanding, Inc. Blanding's earnings have increased in each of the last six years by an average of 11.8%. Based on his analysis, Greene projects that Blanding's earnings will increase by 12.5% in each of the next two years. When he refers to this projection in his report, Greene will violate the Code and Standards if he states:

A) "Blanding's earnings have been compounding at approximately 11.8% annually." ✗

B) "Blanding's earnings will grow at 12.5% annually in each of the next two years." ✓

C) "We expect Blanding's earnings growth to increase to 12.5% annually in the next two years." ✗

Explanation

Standard V(B) Communication with Clients and Prospective Clients requires members to distinguish between fact and opinion. "Blanding's earnings will grow at 12.5% annually in each of the next two years" violates the Standard by stating an uncertain future outcome as a fact. Preceding the statement with a qualifier such as "We expect..." identifies the forecast as an opinion.

(Module 71.7, LOS 71: V(B))

Question #45 of 46

Question ID: 1459437

A client calls his money manager and asks the manager to liquidate a large portion of his assets under management for an emergency. The manager warns the client of the risk of selling many assets quickly but says that he will try to get the client the best possible price. This is a violation of:

A) none of the Standards listed here. ✓

B) Standard III(C), Suitability.

C) Standard V(A), Diligence and Reasonable Basis.

Explanation

The money manager has done his duty. He has warned the client of the risk and made no explicit promises concerning what he can and cannot do.

(Module 71.7, LOS 71: V(A))

Question #46 of 46

Question ID: 1469307

In the preparation of a research report, a CFA Institute member may emphasize certain matters, touch briefly on others, and omit some altogether:

A) provided that the analyst both has a reasonable basis and is unconstrained by the Mosaic theory.

B) provided that the analyst has a reasonable basis for his or her actions.

C) under no circumstances.

Explanation

According to Standard V(B), the analyst must use reasonable judgment in identifying relevant factors when communicating with clients and prospects. The Mosaic theory does not apply here.