

# 2006 Level 1 Sample Exam Volume 4

## Answers

6 A

Members who are investment managers should address the topic of diversification when drafting policies and procedures statements or manuals regarding fiduciary duties.

7 D

The term report is not confined to a traditional written research report; a report can be made by any means of communication.

8 C

Required verification procedures include both composite construction and whether the manager's classification of accounts as discretionary or nondiscretionary is proper.

9 B

The soft dollars should only be used to purchase research service; using soft dollars to purchase/compensate for referrals is not for the benefit of the client

14 B

The lognormal distribution is bounded on the left by zero; a normal distribution contains negative values.

19 B

In the short-run, mobile resources can be transferred easily from one use to another, while immobile resources have few alternative uses

20 B

As the amount of money held as currency declines, the reliability of money supply data is reduced

21 A

Agents can and do exercise their own judgment and, because agents cannot be completely monitored, agents have opportunities to serve their own ends instead of those of the principal.

22 A

According to the basic Keynesian model, an increase in government spending and/or a reduction in taxes will be magnified by the multiplier process and lead to an increase in aggregate demand.

23 B

Gross profit margin: Aro=51%; Burr=60%; Curtis=46%; Dobbie=55%

For Burr, inventory turnover is 5.2, cost of goods sold is \$10.4 million, gross profit is \$15.6 million, and the gross profit margin is 60%.

28 D

Capital leases require the recognition of the asset and an offsetting liability. The increase in assets would lower the return on assets

35 B

The rental income is an opportunity cost that reduces the annual operating cash flow from the project by \$30,000.

38 D

Earnings before interest and taxes is not altered by a change in capital structure; because expected sales are below the indifference point, earnings per share will be decreased if the company uses financial leverage.

39 D

A project's stand-alone risk, corporate risk, and market risk tend to be highly correlated

41 A

$(\text{Year-ending value} + 21.75) / 436 = 1.09$   
year-ending value = 453.49.

42 B

A securities market is defined as efficient if the cost of a transaction is minimal; this attribute is typically referred to as internal efficiency.

45 C

The growth rate of earnings and dividends is not used to estimate the required rate of return for the dividend discount model.

47 B

If put-call exists, the graph for a protective put looks like the graph for a long call and the graph for a covered call looks like the graph for a short put.

51 B

Compared to investing in a single hedge fund, the increased diversification resulting from an investment in a fund of funds reduces risk but also reduces expected return.

59.B

Any change in an asset that affects its fundamental risk factors will cause the asset to move along the security market line (SML); an increase in risk would result in an upward movement along the SML.