2006 Level 1 Sample Exam Volume 1

SS1-Ethics and Professional Standards

1. One day before submitting his resignation of employment, Tony Spain, CFA, contacted his two largest clients to tell them of his intention to join a new firm. Spain was careful not to ask the clients to join him with his new employer, but told the clients he would be giving his resignation and starting his new position the following day. According to the *Standards of practice Handbook*, Spain:

A. had a fiduciary duty to advise his clients of his impending departure.
B. breached his duty of loyalty to his employer by telling the clients of his impending departure.
C. breached his duty of loyalty to the clients by failing to advise the clients of his departure sooner, so the clients could assess the effect on their portfolios.
D. had a duty to disclose his impending departure to all clients, because the change is a matter that could be expected to impair his ability to provide investment advice or take investment action.

2. Jenkins Investment Advisors has been in existence since 1 January 1993, and has maintained composites since the inception of the firm. Jenkins has not been compliant with the Global Investment Performance Standards (GIPS), but wants to achieve compliance as of January 2006.For each of the firm's composite presentations, the minimum number of GIPS-compliant years that Jenkins must present is *closest* to:

A 1
B 5
C 10
D 13

3. George Moses, CFA, analyzes Technicorp for a brokerage company. Extensive study has led Moses to rate Technicorp common stock as a "hold," largely because of increasing competition in the industry. At a recent CFA Institute Society meeting, Moses discussed Technicorp's prospects with two other analysts. Although the other analysts did not give a reason, both said that Technicorp was about to experience rapid earnings growth. Immediately following the meeting, Moses issued a "buy" recommendation for Technicorp. According to the *Standards of Practice Handbook*, did Moses violate any CFA Institute Standards of Professional Conduct when he issued the "buy" recommendation?

A No
B Yes, because he copied the opinions of others.
C Yes, because he did not seek approval of the change from his supervisor.
D Yes, because he did not have a reasonable and adequate basis for his recommendation.

4 A CFA Institute member resides in Country A, where securities laws are more strict than CFA Institute Standards of Professional Conduct, and does all of his business in Country B, where

securities laws are less strict than CFA Institute Standards. The laws of Country A state that professional conduct is governed by the laws of the locality in which business is conducted. According to the Standards of Practice Handbook, the member has a duty to adhere to:

A the laws of country A
B the laws of Country B
C a basic standard of competence and diligence
D CFA Institute Standards of Professional Conduct

5 Wilfred Clark, CFA, accumulated several items of nonpublic information through contacts with computer companies. Although none of the information is "material" individually, Clark concluded, by combining the nonpublic information, that one of the companies will have unexpectedly high earnings in the coming year. According to the Standards of Practice Handbook, Clark:

A may not use the nonpublic information
B may use the nonpublic information at any time to make investment recommendations and decisions
C must make reasonable efforts to achieve immediate public dissemination of the nonpublic information
D may use the nonpublic information only after gaining approval from a supervisory analyst attesting to the information's nonmateriality.

6 Melanie Warren, CFA, manages the Beckman Company's pension fund, which substantially outperformed its benchmark last year. John Beckman is extremely pleased with the fund's performance and offered Warren and three of her friends an all-expenses-paid trip to the World Cup with accommodations at a nearby five-star resort. Prior to her trip, Warren described the details of the entire trip to her supervisor in writing. She subsequently completed the trip. According to the Standards of Practice Handbook, has Warren violated any CFA Institute Standards of Professional Conduct?

A No
B Yes, because she cannot accept gifts valued at over US$100 from clients.
C Yes, because accepting the gift will compromise her independence and objectivity.
D Yes, because she is not allowed to enter into additional compensation arrangements.

8 Susan Roberts, CFA, a portfolio manager for Howard Investment Counsel, received a call from Marvin Moore, an institutional broker. Moore called to recommend buying Megamove, an obscure common stock traded over-the counter, as a takeover candidate. In the past, Moore has demonstrated an ability to pick takeover candidates. If she buys the Megamove stock, is Roberts violating the CFA Institute Standard of Professional Conduct that relates to trading on material nonpublic information?

A No
B Yes, because Roberts did not research the stock herself.

C Yes, because Roberts is acting on confidential information.
D Yes, because Moore is breaching fiduciary duty and receiving personal benefits as a result.

9 CFA Institute Standards of Professional Conduct prohibit CFA charterholders from making statements misrepresenting their qualifications, their firm's services, or the expected performance of any investment. Does this prohibition apply to:

	oral representations?	e-mail messages?
A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

SS2/3-Quantitative Methods

10 An analyst constructed the following hypothesis test:

H_0:b=0
H_1:b>0

The null hypothesis means that:

A the dependent variable is sensitive to changes in the independent variable.
B the independent variable is sensitive to changes in the dependent variable
C changes in the dependent variable do not explain changes in the independent variable.
D changes in the independent variable do not explain changes in the dependent variable.

11 A portfolio of non-dividend-paying common stocks earned a geometric mean return of 5 percent between 1 January 1996 and 31 December 2002. The arithmetic mean return for the same period was 6 percent. If the market value of the portfolio at the beginning of 1996 was $100,000, the market value of the portfolio at the end of 2002 was closest to:

A $135,000
B $140,710
C $142,000
D $150,363

12 With of the following statements about standard deviation is most accurate? Standard deviation:

A is the square of the variance.
B can be a positive number or a negative number.
C is denominated in the same units as the original data.
D is the arithmetic mean of the squared deviations from the mean.

13 An analyst developed the following probability distribution of the rate of return for a common stock:

Scenario	Probability	Rate of Return
1	0.25	0.08
2	0.50	0.12
3	0.25	0.16

The standard deviation of the rate of return is closest to:

A 0.0200
B 0.0267
C 0.0283
D 0.0400

14 A common stock with a coefficient of variation of 0.50 has a(n)

A variance equal to half the stock's expected return.
B expected return equal to half the stock's variance.
C expected return equal to half the stock's standard deviation.
D standard deviation equal to half the stock's expected return.

15 What are the mean and standard deviation of a standard normal distribution

	Mean	Standard deviation
A	0	0
B	0	1
C	1	0
D	1	1

16 The population mean and standard deviation of monthly net sales for a company are $100 million and $30 million, respectively, If monthly net sales are normally distributed, which of the following best describes the interval that would be expected to contain approximately 95 percent of the monthly net sales?

A $10 million to $190 million
B $30 million to $170 million
C $40 million to $160 million
D $70 million to $130 million

SS4/5/6-Economics

17 The crowding-out model suggests that persistent, large government budget deficits are most likely to be associated with a(n);

A increase in net exports
B decrease in private spending
C decrease in the real rate of interest
D decrease in demand for loanable funds

18 Based on historical data and assuming less-than-full employment, periods of sharp acceleration in the growth rate of the money supply tend to be associated initially with;

A periods of economic recession
B an increase in the velocity of money
C a rapid growth in gross domestic product
D reductions in real gross domestic product

21 Which of the following fiscal programs is least likely to act as an automatic stabilizer during periods of economic recession and boom?

A Progressive income tax
B Balanced federal budget
C Unemployment compensation
D Progressive corporate profit tax

22 For most products, the long-run price elasticity of demand is;

A. less than the short-run price elasticity of demand
B. greater than the short-run price elasticity of demand
C. more likely to increase than is the short-run price elasticity of demand
D. more likely to decrease than is the short-run price elasticity of demand

SS7/8/9/10-Financial Statement Analysis

23 Assume U.S.GAAP (generally accepted accounting principles) applies unless otherwise notes. Software development costs incurred before and after a product is proven economically feasible are;

A expensed both before and after
B capitalized both before and after
C expensed before and capitalized after
D capitalized before and expensed after

24 Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. A company's current ratio is 2.0. If the company uses cash to retire notes payable that are due within one year, would this transaction most likely increase or decrease the company's current ratio

and asset turnover ratio, respectively?

	Current ratio	Asset turnover ratio
A	Increase	Increase
B	Increase	Decrease
C	Decrease	Increase
D	Decrease	Decrease

25 Assume U,S, GAAP (generally accepted accounting principles) applies unless otherwise noted. Two companies are identical except for substantially different dividend payout ratios. After several years, the company with the lower dividend payout ratio is most likely to have;

A a lower stock price
B a higher debt/equity ratio
C faster growth of earnings per share
D slower growth of earnings per share

26 On 1 Januray, 2003, a company entered into a 10-year capital lease agreement that required an annual payment of $150,000 at the end of each year. For the year ended 31 December 2004, the company reported earnings before interest and taxes of $370,000, During 2004, the company had no interest-bearing debt outstanding. If the appropriate lease-relate interest rate is 8 percent, the company's interest coverage ratio for 2004 was closest to;

A 3.1
B 3.4
C 4.6
D 4.9

27 Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst applied the DuPont System to the following data for a company;

Equity turnover	4.2
Net profit margin	5.5%
Total asset turnover	2.0
Dividend payout ratio	31.85

Using the DuPont System, the company's return on equity is closest to;

A 1.3%
B 11.0%
C 23.1%
D 63.6%

28 Assume U,S, GAAP (generally accepted accounting principles) applies unless otherwise noted. After selling $20,000 of accounts receivable with full recourse, a company's balance sheet is as follows;

Current assets	$100,000
Fixed assets	100,000
Total assets	$200,000
Total liabilities	$120,000
Stockholder's equity	80,000
Total liabilities and equity	$200,000

None of the receivables has been collected After adjusting relevant account for the effects of the off-balance-sheet financing. The company's total debt-to-equity ratios is closest to:

A 1.20
B 1.25
C 1.75
D 2.00

29 Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst gathered the following information about a company for a fiscal year;

Cash paid for land	$30,000
Depreciation expense	$10,000
Cash paid for salaries	$60,000
Cash paid to suppliers	$40,000
Cash collected from customers	$150,000
Cash paid for interest to bondholders	$20,000
Cash collected for sale of equipment	$75,000

If the company is not subject to income taxes, the net cash flow from operations for the fiscal year is closest to;

A $20,000
B $30,000
C $50,000
D $75,000

30 Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. During a period of rising price levels and rising inventory quantities, the financial statements of a company using FIFO instead of LIFO for inventory accounting will show;

A. lower total assets and lower net income.
B. lower total assets and higher net income
C. higher total assets and lower net income
D. higher total assets and higher net income

31 Assume U,S, GAAP (generally accepted accounting principles) applies unless otherwise noted. Deltax Corp, a highly profitable company, purchased a new asset on 1 January 2002 for $1,000,000. The following information applies to the asset;

- For financial statements purposes, straight-line depreciation over 10 years with no salvage value.
- For tax purposes, three-year MACRS depreciation class with first year MACRS factor=0.333
- Tax rate=40%

The effect of the asset purchase on Deltax's deferred tax liability for 2002 is closest to a:

A $233,000 decrease
B $93,200 decrease
C $93,200 increase
D $233,000 increase

32 Assume U,S, GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst gathered the following information about a ccompany whose fiscal year ends on 31 December;

- Net income for the year was $10.5 million
- Preferred stock dividends of $2 million were paid for the year.
- Common stock dividends of $3.5 million were paid for the year.
- 20 million shares of common stock were outstanding on 1 January 2002.
- The company issued 6 million new shares of common stock on 1 April 2002.
- The capital structure does not include any potentially dilutive convertible securities, options, warrants, or other contingent securities.

The company's basic earnings per share for 2002 was closest to;

A $0.35
B $0.37
C $0.43
D $0.46

33 Assume U,S, GAAP (generally accepted accounting principles) applies unless otherwise noted. When analyzing a company's leverage and liquidity, an analyst should consider deferred tax liabilities on a company's balance sheet;

A as equity
B as long-term debt
C as short-term debt
D on a case by case basis

34 Assume U,S, GAAP (generally accepted accounting principles) applies unless otherwise noted. If prices have been rising, what is the most likely effect of a LIFO liquidation on a company's:

	Cash flow?	Gross profit margin?
A	Increase	Increase
B	Increase	Decrease
C	Decrease	Increase

D	Decrease	Decrease

36 An investment project, with the same risk as the company, has an internal rate of return of 12 percent and a positive net present value of $25 million. If the projected cash inflows are reinvested at the company's weighted average cost of capital, the realized return from the project should be;

A 12 percent
B less than 12 percent
C greater than 12 percent
D less than the company's weighted average cost of capital

SS11-Corporate Finance

37 A company's management gathered the following information about an expansion project that has a five-year useful life;

Project cost	$80,000
Shipping and installation cost	$20,000
Increase in net working capital	$10,000
Annual project earnings before depreciation and taxes	$25,000
Annual project depreciation	$20,000
Company's marginal tax rate	30%

The company expects to recover half of the net working capital at the end of the project's life but expects the project to have no salvage value. The project's initial investment outlay and final year total cash flow, respectively, are closest to:

	Initial investment outlay	Final year total cash flow
A	$100,000	$22,500
B	$100,000	$28,500
C	$110,000	$22,500
D	$110,000	$28,500

38 A company's dividend policy is based on a strict residual model. All other factors being equal, if the company's dividend payout decreased from 50 percent in 2001 to 20 percent in 2002, the company most likely experienced;

A a decrease in investment opportunities
B an increase in investment opportunities
C no change in investment opportunities, but an increase in the targeted debt-to-assets
D no change in investment opportunities, but an increase in the weighted average cost of capital.

SS13/14-Equity Investments

39 The following information (per share) applies to a company's preferred stock

Current price	$47.00
Par value	$50.00
Annual dividend	$3.50

If the company's marginal corporate tax rate is 34 percent, the company's after-tax cost of preferred stock is closest to;

A 4.62%
B 4.91%
C 7.00%
D 7.45%

40 An analyst gathered the following data about common stocks J,K, and L, which together form a value-weighted index;

	31 December 2001		31 December 2002	
Stock	Price	Shares outstanding	Price	Shares outstanding
J	$40	10,000	$50	10,000
K	$30	6,000	$20	12,000*
L	$50	9,000	$40	9,000

*Two-for --one stock split
The value-weighted index (base index=100) at the end of 2002 is closest to;

A 92.31
B 93.64
C 106.80
D 108.33

41 An analyst gathered the following information about a common stock;

Annual dividend per share	$2.10
Risk-free rate of return	7%
Risk premium for the stock	4%

If the stock's annual dividend is expected to remain at $2.10, the value of the stock is closest to;

A $19.09
B $30.00
C $52.50
D $70.00

42 A company's return on equity is greater than its required rate of return on equity. The earnings multiplier (P/E) for that company's common stock is most likely to be positively related to the;

A market risk premium
B risk-free rate of return

C company's earnings retention ratio
D stock's Capital Asset Pricing Model beta

43 An analyst gathered the following information about a company;

2001 net sales	$10,000,000
2001 net profit margin	5%
2002 expected sales growth	-15.0%
2002 expected profit margin	5.4%
2002 expected common stock shares outstanding	120,000

The company's expected earnings per share for 2002 is closest to;

A$3.26
B $3.72
C $3.83
D $4.17

44 Which of the following statements about "short selling" of common stock is *most* accurate?

A. A short position may be hedged by writing call options
B. A short position may be hedged by purchasing put options
C. short sellers may be subject to margin calls if the stock price increases.
D. Common stocks that pay large dividends should be sold short before the ex-dividend date and bought afterward to take advantage of the large price decline in a short time period

45 A market anomaly refers to;

A. an exogenous shock to the market that is sharp but not persistent.
B. a price or volume event that is inconsistent with historical price or volume trends.
C. a trading or pricing structure that interferes with efficient buying and selling of securities
D. Price behavior that differs from the behavior predicted by the Efficient Market Hypothesis

SS17-Derivative Investments

46 In futures trading, the minimum level to which an equity position may fall before requiring additional margin is the;

A initial margin
B variation margin
C cash flow margin.
D maintenance margin

47 An investor pays $2 for a put option a $95 exercise price. If at the expiration of the put option the stock is selling for $91,the profit or loss on the long put position would be a:

A loss of $4.
B loss of $2
C profit of $2
D profit of $4

48 The current price of an asset is 75 A three-month, at-the-money American call option on the asset has a current value of 5,. At what value of the asset will a covered call writer break even at expiration of the call option?

A 70
B 75
C 80
D 85

SS18-Alternative Investments

49 Closed-end investment companies generally;

A buy shares back from investors who want to sell
B have net asset values equal to their market prices
C sell additional shares only through the secondary market
D have the market price of their shares determined by supply and demand.

50 Using the following data and the direct capitalization approach, an analyst estimated the market value of an income-producing property t be $2,750,000

Annual gross potential rental income	$400,000
Annual property operating expenses	$100,000
Annual Vacancy and collection losses	$50,000

To estimate the market value of the property, the analyst used a capitalization rate closest to

A 9.1%
B 10.9%
C 12.7%
D 14.6%

SS15/16-Fixed Income Investments

51 A fixed income portfolio manager wants to take advantage of a forecast decline in interest rates over the next several months. Which of the following combinations of maturity and coupon rate would most likely result in the largest increase in portfolio value?

	Maturity	Coupon rate

A	2015	10%
B	2015	12%
C	2030	10%
D	2030	12%

52 Which of the following statements about the value of a call option at expiration is least accurate?

A A short position in the call option can result in a loss if the stock price exceeds the exercise price.
B A short position in the call option has a zero value for all stock prices equal to or less than the exercise price.
C The value of a long position in the call option equals zero or the stock price minus the exercise price, whichever is higher.
D The value of a long position in the call option equals zero or the exercise price minus the stock price, whichever is higher.

53 Interest rate sensitivity for bonds with embedded options is *most accurately* measured by:

A convexity
B effective duration
C modified duration
D Macaulay duration

54 An analyst gathered the following spot rates;

Time(Years)	Annual spot rate
1	15.0%
2	12.5%
3	10.0%
4	7.5%

The one-year forward rate two years from now is closest to;

A -4.9%
B 5.2%
C 10.1%
D 15.7%

55 A newly issued ten-year option-free bond is valued at par on 1 June 2000.The bond has an annual coupon of 8.0 percent. On 1 June 2003, the bond has a yield to maturity of 7.1 percent. The first coupon is reinvested at 8.0 percent and the second coupon is reinvested at 7.0 percent. The future price of the bond on 1 June 2003 is closest to;

A 100.0% of par
B 102.5% of par
C 104.8% of par

D 105.4% of par

56 Omega Corp, has outstanding a $100 million, 9 percent coupon bond issue that is refund protected until 1 July 2010.This issue;

A is noncallable
B is call protected until 1 July 2010
C currently may be redeemed with funds from general operations.
D currently may be redeemed but only if refunded by an issue with a lower cost.

57 The embedded option that is least likely to be a benefit to the issuer of debt securities is the;

A floor on a floater
B right to call the issue
C accelerated sinking fund provision
D right of the underlying borrowers in a pool of loans to repay an amount in excess of the scheduled principal payment

SS12-Portfolio Management

58 In the context of the security market line (SML), which of the following statements best characterizes the relationship between risk and the required rate of return for an investment?

A The slop of the SML indicates the risk per unit of return for a given individual investor
B A parallel shift in the SML occurs in response to a change in the attitudes of investors
C A movement along the SML shows a change in the risk characteristics of a specific investment, such as a change in its business risk or financial risk.
D A change in the slope of the SML reflects a change in market conditions, such as ease or tightness of monetary policy or a change in the expected rate of inflation.

59 The nominal risk-free rate of return during a given period is best described as the return that compensates investors for the;

A time value of money only
B time value of money and the uncertainty of the return only
C time value of money and the expected rate of inflation only
D time value of money, the expected rate of inflation, and the uncertainty of the return

60 The efficient frontier is best defined as the set of portfolios that has;

A the minimum risk for every level of return
B proportionally equal units of risk and return
C the maximum excess rate of return for every given level of risk

D the maximum return for each level of beta based on the capital asset pricing model