2009 Level I Mock Exam: Morning Session

The morning session of the 2009 Level I Chartered Financial Analyst® Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of 1.5 minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

Questions	**Topic**	**Minutes**
1-18	Ethical and Professional Standards	27
19-32	Quantitative Methods	21
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97-108	Fixed Income Investments	18
109-114	Alternative Investments	9
115-120	Portfolio Management	9
	Total:	**180**

Questions 1 through 18 relate to Ethical and Professional Standards.

1. Which of the following is a key characteristic of the Global Investment Performance Standards (GIPS)? The GIPS standards:

   A. rely on the integrity of input data.
   B. consist of required provisions for firms to follow to achieve best practice.
   C. must be applied with the goal of achieving excellence in performance presentation.

2. According to the *Standards of Practice Handbook*, a member who is an investment manager is *least likely* to breach his duty to clients by:

   A. disclosing confidential client information to the CFA Institute Professional Conduct Program.
   B. using client brokerage to purchase goods or services that are used in the investment decision-making process.
   C. consistently supporting management's recommendations by voting with management on proxies related to non-routine governance issues.

3. Carla Scott, CFA, is a portfolio manager for a company that manages investment accounts for wealthy individuals. Scott has no beneficial interest in any of the fee-paying accounts she manages, including her uncle's account. When shares in initial public offerings (IPOs) become available, Scott first allocates shares to all her other clients for whom the investment is appropriate; only if shares are still available does she purchase shares in her uncle's account, if the issue is appropriate for him. Scott provides each of her clients with full disclosure of her allocation procedures and has received each client's verbal consent to her allocation procedures. According to the *Standards of Practice Handbook*, does Scott's method of allocating oversubscribed IPOs violate any CFA Institute Standards of Professional Conduct?

   A. No.
   B. Yes, because she has breached her duty to her uncle.
   C. Yes, because she has not precleared and reported her Uncle's transactions.

4. Kim Li, CFA, is a portfolio manager for an investment advisory firm. Li delegates some of her supervisory duties to Janet Marshall, CFA, after educating Marshall on methods to prevent and detect violations of the firm's compliance procedures. Despite these efforts, Li discovers that an employee reporting to Marshall may have violated the procedures. According to the *Standards of Practice Handbook*, Li's *least likely* initial course of action must be to:

   A. suspend the employee.
   B. increase supervision of Marshall.
   C. initiate an investigation to determine the extent of the wrongdoing.

5. The *Standards of Practice Handbook* is *least likely* to require a member to disclose which of the following to clients and prospective clients?

   A. Underwriting relationships.
   B. Service on a publicly-traded company's board of directors.
   C. Obligation to abide by CFA Institute Code of Ethics and Standards of Professional Conduct.

6. A CFA charterholder is the Fund Manager for a non-profit organization. During a presentation regarding the restructuring of their investment portfolio's asset allocation, the Head of the Finance Committee questions the manager. As part of his response, the manager states, "I am a CFA charterholder, I know what I'm talking about, you should do what I say". According to the *Standards of Practice Handbook*, has the charterholder violated any of the CFA Institute Standards of Professional Conduct?

   A. No.
   B. Yes, Responsibilities as a CFA Institute Member.
   C. Yes, Communication with Clients and Prospective Clients.

7. A CFA candidate was responsible for developing presentations regarding New Vision Asset Managers' investment process and historical investment performance. When the candidate moved to another firm, he brought with him the presentation he developed for New Vision, changed the name of the company and presented it to a client of his new employer. The client asked the candidate if he had New Vision's permission to use their presentation. The candidate responded, "I created the presentation in my last month working there. It was, after my resignation, so it's mine to use. Besides the investment performance is what I achieved for my clients at New Vision." According to the *Standards of Practice Handbook*, the CFA candidate is *least likely* to have violated the CFA Institute Standards of Professional Conduct that relate to:

   A. Loyalty.
   B. Misrepresentation.
   C. Communication with Clients and Prospective Clients.

8. As the Managing Director of a commercial bank, a CFA charterholder sat in on a board meeting of a publicly listed company that the bank had lent a large sum of money. The purpose of the board meeting was to renegotiate the terms of the commercial loan due to the pending restructuring of the company. The next day all of the Managing Director's shares of the publicly listed company are sold on the stock exchange, the sell order having been given two days prior to the meeting. According to the *Standards of Practice Handbook*, the CFA charterholder was *least likely* in violation of which CFA Institute Standards of Professional Conduct?

   A. Disclosure of Conflicts.
   B. Priority of Transactions.
   C. Material Nonpublic Information.

9. In order to comply with the GIPS Standards, a firm must initially show GIPS-compliant history for a minimum of:

   A. five years, or since inception if the firm has been in existence for less than five years.
   B. two years, or since inception if the firm has been in existence for less than two years.
   C. three years, or since inception if the firm has been in existence for less than three years.

10. Buta Singh, CFA, has a large extended family and manages the portfolios of several family members. Singh does not charge the family members a management fee, but receives a small percentage of each portfolio's profits. Singh accepts a position as portfolio manager for Bhotmange Investments to manage high net worth accounts. Because the family portfolios are not customary or normal client relationships, Singh does not inform his new employer of his side activity. Singh is *least likely* to have violated which CFA Institute Standard of Professional Conduct?

    A. Loyalty.
    B. Preservation of Confidentiality.
    C. Additional Compensation Agreements.

11. A CFA Candidate purchased copyrighted CFA exam preparatory study guide from a publisher. Two weeks prior to the exam, the Candidate lost the study guide so he photocopied a copy that his friend had purchased. According to the *Standards of Practice Handbook*, did the CFA Candidate *most likely* violate the CFA Institute Standards of Professional Conduct?

    A. Yes.
    B. No, because he had purchased his own copy.
    C. No, because both had purchased their own copies.

12. Crandall Temasek, CFA, filed for personal bankruptcy two years ago after incurring large medical expenses. He was hired recently as a portfolio manager. According to the CFA Institute Standards, must Temasek disclose his bankruptcy filing to his new employer?

    A. No.
    B. Yes, because he has a duty of loyalty to his employer.
    C. Yes, because bankruptcy represents a potential conflict of interest.

13. Sallie Lewis, CFA, is a research analyst covering the mining industry. Along with other analysts, Lewis visits the primary mine of Gold Rush Mines (GR). During the visit, a major piece of equipment fails and Lewis overhears an unidentified employee state that production will be stalled for six months. Lewis immediately files a sell recommendation on GR without any additional research. Has Lewis violated any CFA Institute Standards?

    A. No.
    B. Yes, with respect to diligence and reasonable basis.
    C. Yes, with respect to material nonpublic information.

14. Clive Bowers, CFA, is a portfolio manager at Burlington Advisors (BA). Bowers manages two mutual funds along with a number of individual accounts. All of the portfolios, including the mutual funds, have similar return objectives, risk tolerances, and tax constraints. When Bowers allocates shares from block trades he fills the mutual fund orders first and then allocates the remaining shares to the individual accounts based on their portfolio size. When allocating shares from block trades, does Bowers violate any CFA Institute Standards?

    A. No.
    B. Yes, with respect to fair dealing.
    C. Yes, with respect to priority of transaction.

15. Narupa Rhasta, CFA, is manager of the fast-growing individual account division of a bank and treats all clients equally. When the bank's research department issues a buy or sell recommendation on a security, she ensures that the recommended action is implemented in all accounts. Do Rhasta's investment actions violate any CFA Institute Standards?

    A. No.
    B. Yes, with respect to suitability.
    C. Yes, with respect to diligence and a reasonable basis.

16. Jimmy Lee, CFA, is an investment banker in a country with strict confidentiality laws. He is working on an acquisition for Panda Mining Co. (PMC). While performing due diligence, Lee notices that PMC has a number of questionable offshore partnerships. He investigates the legality of the partnerships and finds evidence of illegal activity. According to the Standards of Professional Conduct, Lee's *best* course of action would be to:

    A. alert CFA Institute.
    B. consult outside counsel.
    C. notify regulatory authorities.

17. Rene Whatcom, CFA, is an independent contractor who writes research reports for several investment publications. Whatcom refuses to sign contracts with exclusivity clauses. Whatcom sometimes revises work he submits to one publication and sends slightly altered versions of the report to additional publications. Does Whatcom violate any CFA Institute Standards?

    A. No.
    B. Yes, with respect to loyalty.
    C. Yes, with respect to disclosure of conflicts.

18. Angus Draper, CFA, is a senior portfolio manager and member of the investment committee at Tillahook Investments. Draper serves as a board member for several non-profit organizations. These commitments require eight workdays per month of Draper's time. Because he does not receive any form of compensation for these activities, Draper does not tell anyone at work about his board activities. Does Draper violate any CFA Institute Standards?

    A. No.
    B. Yes, with respect to conflict of interest.
    C. Yes, with respect to responsibilities of supervisors.

Questions 19 through 32 relate to Quantitative Methods

19. The yield to maturity on otherwise identical option-free bonds issued by the U.S. Treasury and a large industrial corporation is 6 percent and 8 percent, respectively. If annual inflation is expected to remain steady at 2.5 percent over the life of the bonds, the *most likely* explanation for the difference in yields is a premium due to:

    A. maturity.
    B. inflation.
    C. default risk.

20. A 24 year old is using the following information to plan her retirement:

Current age	24
Expected retirement age	68
Life expectancy	93
Current annual expenditures	$30,000
Expected inflation rate of current expenditures until retirement	3%
Expected return on investment	8%

She assumes her consumption expenditures will increase with the rate of inflation, 3 percent, until she retires. Upon retiring she will have end-of-year expenditures equal to her consumption expenditure at age 68. The minimum amount that she must accumulate by age 68 in order to fund her retirement is *closest* to:

    A. $928,000.
    B. $1,176,000.
    C. $1,552,000.

21. A project has the following expected cash flows:

Time	Cash Flow ($)
0	(125,000)
1	100,000
2	200,000

If the risk-free interest rate is 4 percent, expected inflation is 3 percent, the market risk premium is 8 percent and the Beta for the project is 1, the investment's net present value (NPV) is *closest* to:

A. $113,000.
B. $124,000.
C. $139,000.

22. An analyst gathers the following information about a common stock investment:

	Date	Amount €
Stock purchase	15 January 2008	48.00
Cash dividend received	14 July 2008	4.00
Stock sale	15 July 2008	54.00

The holding period return on the common stock investment is *closest* to:

A. 12.5%.
B. 20.8%.
C. 41.7%.

23. A 270-day U.S. Treasury bill with a face value of $100,000 sells for $96,500 when issued. Assuming an investor holds the bill to maturity, the investor's money market yield is *closest* to:

A. 3.63%.
B. 4.84%.
C. 4.93%.

24. An analyst gathered the following annual return information about a portfolio since its inception on 1 January 2003:

Year	Portfolio return
2003	8.6%
2004	11.2%
2005	12.9%
2006	15.1%
2007	–9.4%

The portfolio's mean absolute deviation for the five-year period is *closest* to:

A. 3.76%.
B. 6.83%.
C. 7.68%.

25. An analyst gathered the following information about a common stock portfolio:

Arithmetic mean return	14.3%
Geometric mean return	12.7%
Variance of returns	380
Portfolio beta	1.35

If the risk-free rate of return is 4.25 percent, then the coefficient of variation is *closest* to:

A. 0.52.
B. 1.36.
C. 1.53.

26. If an analyst estimates the probability of an event for which there is no historical record, this probability is *best* described as:

A. a priori.
B. empirical.
C. subjective.

27. Which of the following statements *best* describes the relationship between correlation and covariance? The correlation between two random variables is their covariance standardized by the product of the variables':

    A. variances.
    B. standard deviations.
    C. coefficients of variation.

28. Which of the following *best* describes the discrete uniform distribution? The discrete uniform distribution:

    A. has a finite number of specified outcomes.
    B. is based on the Bernoulli random variable.
    C. has an infinite number of unspecified outcomes.

29. According to the central limit theorem, a sampling distribution of the sample mean will be approximately normal *only* if the:

    A. sample size is large.
    B. underlying distribution is normally distributed.
    C. variance of the underlying distribution is known.

30. Which of the following is *least likely* to be a desirable property of an estimator?

    A. Efficiency
    B. Reliability
    C. Consistency

31. An analyst gathers the following information about the price-earnings (P/E) ratios for the common stocks held in a portfolio:

Interval	P/E range	Frequency
I	8.00 – 16.00	20
II	16.00 – 24.00	52
III	24.00 – 30.00	24
IV	30.00 – 38.00	14

The relative frequency for Interval II is *closest* to:

A. 47.27%.
B. 52.00%.
C. 65.45%.

32. Rent is $700.00 monthly and is due on the first day of every month. If the stated annual interest rate is 6 percent, the present value of a full year's rent payments is *closest* to:

A. $8,133.
B. $8,173.
C. $8,833.

Questions 33 through 44 relate to Economics

33. Demand for guest rooms in a resort hotel increases from 100 to 150 rooms per night when the nightly room rate increases from $150 to $200. The elasticity of supply of guest rooms in the resort hotel is *closest* to:

A. 0.72.
B. 1.40.
C. 1.50.

34. A recessionary gap is *more likely* to be observed when:

A. real GDP is above potential GDP.
B. real GDP is below potential GDP.
C. employment is above full-employment equilibrium.

35. Which of the following statements is *most* accurate in regard to the tax division between buyers and sellers of products with perfectly elastic demand?

A. Sellers pay the entire tax.
B. Buyers bear the entire tax burden.
C. Buyers and sellers share the tax burden.

36. A company compiles the following information:

Total revenue	$300,000
Value of buildings and machinery	
- At the beginning of the year	$300,000
- At the end of the year	$280,000
Cost of raw materials	$100,000
Wages paid during the year	$ 50,000
Normal profit for the year	$ 40,000

The company's economic profit is *closest* to:

A. $90,000.
B. $110,000.
C. $130,000.

37. In the short run, an increase in output at low levels of production will *most likely* cause:

A. an increase in the marginal cost due to the rising total fixed cost.
B. an increase in the marginal cost due to the law of diminishing returns.
C. a decrease in the marginal cost due to economies from greater specialization.

38. In regulating a natural monopoly, the *most* commonly adopted compromise pricing rule by a regulator is the:

A. total cost pricing rule.
B. average cost pricing rule.
C. marginal cost pricing rule.

39. Which of the following statements provides the *best* description of Nash equilibrium of two firms in the game of prisoners' dilemma?

A. One firm complies and the other cheats.
B. Both firms cheat and each firm makes zero economic profit.
C. Both firms comply and each firm makes a positive economic profit.

40. The *best* characterization of the natural resources market is that:

   A. supply of a nonrenewable natural resource is perfectly inelastic and firms are price takers.
   B. price is determined by market demand in a renewable resources market and by supply in a nonrenewable resource market.
   C. supply of a renewable natural resource is perfectly elastic and the price is equal to the present value of the next period's expected price.

41. Based on supply-side effects, an increase in income tax will *most likely*:

   A. shift the demand curve for labor.
   B. decrease the full-employment quantity of labor.
   C. increase potential Gross Domestic Product (GDP).

42. A change in the natural rate of unemployment will *most likely* shift:

   A. the short-run but not the long-run Phillips curves.
   B. both the short-run and the long-run Phillips curves.
   C. neither the short-run nor the long-run Phillips curves.

43. Which of the following goals of monetary policy is *best* described to be the key goal?

   A. Price stability.
   B. Full employment.
   C. Moderating long-term interest rates.

44. The *least likely* reason why a firm in perfect competition is a price taker is because:

   A. buyers are well informed about prices of other firms.
   B. it can set its products’ price at or above the market price.
   C. it produces a very small portion of the total output of a particular good.

Questions 45 through 68 relate to Financial Statement Analysis

45. An analyst finds information about significant uncertainties affecting a company's liquidity, capital resources and results of operations in the:

    A. notes to the financial statements.
    B. balance sheet and income statement.
    C. management discussion and analysis.

46. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

    Which of the following is *least likely* to be classified as a financial statement element?

    A. Asset.
    B. Revenue.
    C. Net income.

47. An analyst prepares common-size balance sheets for two companies operating in the same industry. The analyst notes that both companies had the same proportion of current liabilities, long-term liabilities, and shareholders' equity and the following ratios:

	Company 1	Company 2
Current ratio	2.0	2.0
Cash ratio	0.3	0.3
Quick ratio	0.5	0.8

    The *most* reasonable conclusion is that, compared with Company 2, Company 1 had a:

    A. higher percentage of assets associated with inventory.
    B. higher percentage of assets associated with accounts receivable.
    C. lower percentage of assets associated with marketable securities.

48. If a company has a current ratio of 2.0, repaying $150,000 in short-term borrowing will *most likely* decrease:

A. the current ratio, but not the cash flow from operations.
B. the cash flow from operations, but not the current ratio.
C. neither the current ratio nor the cash flow from operations.

49. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

At the end of the year, a company sold equipment for $30,000 cash. The company paid $110,000 for the equipment several years ago and had recorded accumulated depreciation of $70,000 at the time of its sale. All else equal, the equipment sale will result in the company's cash flow from:

A. investing activities increasing by $30,000.
B. investing activities decreasing by $10,000.
C. operating activities being $10,000 less than net income.

50. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A company reports net income of $800,000 for the year. The table below indicates selected items which were included in net income and their associated tax status.

	Included in determining Net Income	**Tax Status**
Depreciation Expense	$70,000	$90,000 allowed for tax purposes
Dividend Income	$120,000	Dividends not taxable
Fine related to environmental damage	$100,000	Not deductible for tax purposes
R&D Expenditures	$50,000	$20,000 allowed for tax purposes

The company's tax rate is 35 percent. The company's current income taxes payable (in $) is *closest* to:

A. 206,500.
B. 276,500.
C. 360,500.

51. An analyst gathers the following annual information ($ millions) about a company that pays no dividends and has no debt:

Net income	45.8
Depreciation	18.2
Loss on sale of equipment	1.6
Decrease in accounts receivable	4.2
Increase in inventories	3.4
Increase in accounts payable	2.5
Capital expenditures	7.3
Proceeds from sale of stock	8.5

The company's annual free cash flow to equity ($ millions) is *closest* to:

A. 53.1.
B. 58.4.
C. 61.6.

52. Which of the following statements *best* describes the level of accuracy provided by a standard audit report with respect to errors? The audited financial statements are:

A. fully assured to be free of material errors.
B. reasonable assured to be free of all errors.
C. reasonable assured to be free of material errors.

53. Making any necessary adjustments to the financial statements to facilitate comparison with respect to accounting choices is done in which step of the financial statement analysis framework?

A. Collect data.
B. Process data.
C. Analyze/interpret the processed data.

54. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

For the most recent year a manufacturing company reports the following items on their income statement:

Interest expense	$62,500
Loss on disposal of fixed assets	$50,000
Realized gain on sale of available-for-sale securities	$17,750

Which of the items is classified as an operating item in the company's income statement?

A. Interest expense.
B. Loss on disposal of fixed assets.
C. Realized gain on sale of available-for-sale securities.

55. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

The following information is available from the accounting records of a company as at 31 December 2008 (all figures in $ thousands):

Account:	**$**
Accounts payable	20
Accounts receivable	82
Bank loan, due on demand	44
Cash	12
Income taxes payable	5
Inventory	47
Investments accounted for by the equity method	112
Loan payable, due 30 June 2010	50
Deposits from customers for deliveries in 2009	8

The working capital for the company (in $ thousands) is *closest* to:

A. 64.
B. 72.
C. 176.

56. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

    During late December 2008 Company A acquires a small competitor, Company B. During the evaluation of the acquisition it is determined that the customer lists of Company B have a fair value of $50,000. Company A has spent $15,000 during the year updating and maintaining its own customer lists. What will be the value of the customer list intangible asset on Company A's 31 December 2008 consolidated financial statements?

    A. $15,000.
    B. $50,000.
    C. $65,000.

57. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

    A company has equipment with an original cost of $850,000, accumulated amortization of $300,000 and 5 years of estimated remaining useful life. Due to a change in market conditions the company now estimates that the equipment will only generate cash flows of $80,000 per year over its remaining useful life. The company's incremental borrowing rate is 8 percent. Which of the following statements concerning impairment and future return on assets (ROA) is *most* accurate? The asset is:

    A. impaired and future ROA increases.
    B. impaired and future ROA decreases.
    C. not impaired and future ROA increases.

58. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

On 1 January 2008 a company enters into a lease agreement to lease a piece of machinery as the lessor with the following terms:

Annual lease payment due 31 December	$50,000
Lease term	5 years
Estimated useful life of the machine	6 years
Estimated salvage value of the machine	$0
Carrying value (cost) of leased asset	$160,000
Implied interest rate on lease	8%
The firm is reasonably assured of the collection of the lease payments.	

Which of the following *best* describes the classification of the lease on the company's financial statements for 2008?

A. Operating lease.
B. Sales type lease.
C. Direct financing lease.

59. Which of the following is the *most* useful to an analyst assessing the credit worthiness of a company? Information related to:

A. operating cash flow.
B. the scale and diversity of a company's operations.
C. operational efficiency of the company's operations.

60. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A company acquires some new depreciable assets. Which of the following combinations of estimated salvage value and useful life will *most likely* produce the highest net profit margin?

A. low salvage value estimates and long average lives.
B. high salvage value estimates and long average lives.
C. high salvage value estimates and short average lives.

61. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

An analyst gathers the following information about a company ($ millions):

	2008	**2007**
Sales	283.5	234.9
Year-end inventory (LIFO inventory method)	81.4	53.7
LIFO reserve	36.4	21.8
Cost of goods sold (LIFO)	203.9	167.3

If the company uses the FIFO inventory method instead of LIFO, the company's 2008 gross profit margin is *closest* to:

A. 22.9%.
B. 29.8%.
C. 33.2%.

62. Which of the following will *most likely* be an incentive for management to underreport earnings?

A. Meeting analysts' expectations.
B. Contract negotiations with unions.
C. Meeting restrictive debt covenants.

63. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A company uses the LIFO inventory method, but most of the other companies in the same industry use FIFO. Which of the following *best* describes one of the adjustments that would be made to the company's financial statements to compare it with other companies in the industry? The amount reported for the company's ending inventory should be:

A. increased by the ending balance in its LIFO reserve.
B. decreased by the ending balance in its LIFO reserve.
C. increased by the change in its LIFO reserve for that period.

64. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

An analyst gathers the following information about a company:

Average market price per share of common stock during the year	$40
Exercise price per share for options on 50,000 common shares	$50
Exercise price per share for warrants on 20,000 common shares	$30

Using the treasury stock method, the number of incremental shares used to compute diluted earnings per share is *closest* to:

A. 5,000.
B. 15,000.
C. 20,000.

65. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

At the beginning of the year, a lessee company enters into a new lease agreement that is correctly classified as a finance lease, with the following terms:

Annual lease payments due at the end of the year	$100,000
Lease term	5 years
Appropriate discount rate	12%
Depreciation method	straight-line basis
Estimated salvage value	$0

With respect to the effect of the lease on the company's financial statements in the first year of the lease, which of the following is *most* accurate? The reduction in the company's:

A. pretax income is $72,096.
B. cash flow from financing is $56,742.
C. cash flow from operations is $72,096.

66. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

The following information relates to a profitable company that offers a warranty on a new product introduced in 2008:

Accrued warranty expenses for the warranty in 2008	$300,000
Actual expenditures for repairs under the warranty in 2008	$200,000

If the company's tax rate is 35 percent, which of the following *most* accurately describes the deferred tax recorded in 2008 with respect to the new product warranty?

A. Deferred tax asset of $35,000.
B. Deferred tax asset of $65,000.
C. Deferred tax liability of $35,000.

67. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

At the beginning of the year, a company issues a $1,000 face value, semiannual coupon, bond with an 8 percent coupon rate maturing in 10 years. The annual market rate of interest at issuance was 12 percent. The initial liability recorded for this bond is *closest* to:

A. $771.
B. $774.
C. $1,000.

68. Financial reporting standards are *most likely* enforced by:

A. both standard-setting bodies and regulatory bodies.
B. regulatory authorities, such as the SEC and IOSC, only.
C. standard-setting bodies, such as the FASB and IASB, only.

Questions 69 through 78 relate to Corporate Finance

69. A large corporation accepts a project which generates no revenue and has a negative net present value. The project *most likely* is classified in which of the following categories?

    A. Replacement project.
    B. New product or service.
    C. Regulatory or environmental project.

70. A company recently opened a limestone quarry at a location outside its traditional service area. Because limestone is a major ingredient in concrete, if the quarry is successful the company plans to build a ready-mix concrete plant at the same location. The investment in the concrete plant is *best* described as:

    A. an externality.
    B. project sequencing.
    C. an example of investment synergy.

71. An analyst determines the following cash flows for a capital project:

Year	0	1	2	3	4	5
Cash flow (€)	-100	30	40	40	30	20

The required rate of return for the project is 13 percent. The net present value (NPV) of the project is *closest* to:

A. €14.85.
B. €60.00.
C. €214.85.

72. An analyst gathers the following information about the capital structure and before-tax component costs for a company. The company's marginal tax rate is 40 percent.

Capital component	Book Value (000)	Market Value (000)	Component cost
Debt	$100	$80	8%
Preferred stock	$20	$20	10%
Common stock	$100	$200	12%

The company's weighted average cost of capital (WACC) is *closest* to:

A. 8.55%.
B. 9.95%.
C. 10.80%.

73. A company is considering issuing a 10-year, option-free, semiannual coupon bond with a 9 percent coupon rate. The bond is expected to sell at 95 percent of par value. If the company's marginal tax rate is 30 percent, then the after-tax cost of debt is *closest* to:

A. 6.30%.
B. 6.86%.
C. 9.80%.

74. A company plans to issue nonconvertible, noncallable, fixed-rate perpetual preferred stock with a $6 annual dividend. The preferred stock is expected to sell for $40. If the company's marginal tax rate is 30 percent, then the cost of preferred stock is *closest* to:

A. 6.67%.
B. 10.5%.
C. 15.0%.

75. An analyst gathers the following information about a company and the market:

Current market price per share of common stock	**€32.00**
Most recent dividend per share paid on common stock	**€2.40**
Expected dividend payout rate	40%
Expected return on equity (ROE)	15%
Beta for the common stock	1.5
Expected return on the market portfolio	12%
Risk-free rate of return	4%

Using the dividend discount model approach, the cost of common equity for the company is *closest* to:

A. 16.0%.
B. 16.5%.
C. 17.2%.

76. A company is investigating the purchase of a banker's acceptance (BA). The $1,000,000 face value BA has 150 days to maturity and is quoted at 4.05 percent on a discount-basis yield. If the company's marginal tax rate is 25 percent, then the money market yield on the BA is *closest* to:

A. 3.13%.
B. 4.12%.
C. 4.18%.

77. Regarding corporate governance, which of the following is *most likely* a reason for concern when evaluating the compensation committee? The compensation committee:

A. includes members of executive management.
B. purchases shares on the open market to fund stock option commitments.
C. discloses information about compensation paid to executives and board members.

78. Which of the following is *least likely* classified as a takeover defense?

A. Greenmail.
B. Cumulative voting.
C. Golden parachutes.

Questions 79 through 90 relate to Equity Investments

79. In securities exchange markets, a member who executes stop loss or stop buy orders when the specified price occurs is *most likely* a:

    A. specialist.
    B. registered trader.
    C. commission broker.

80. An analyst gathers the following data for a company to estimate the expected growth rate of dividends and use it as an input for valuing the company's common stock.

Return on Assets	10%
Profit Margin	5 %
Financial Leverage	1.67
Payout Ratio	25%

    The company's expected growth rate is *closest* to:

    A. 4.2%.
    B. 6.3%.
    C. 12.5%.

81. Which of the following statements about the short sale of a stock is *least* accurate?

    A. The short seller must pay any dividends due to the lender of shares.
    B. A stop buy order would enable a short seller to minimize potential losses.
    C. Short sales involve time limits for returning the shares borrowed to the lender.

82. An analyst gathers the following data to determine the attractiveness of the company's common stock:

Dividends per share in 2002	$2
Dividends per share in 2008	$3
Expected return on the market	17%
Expected nominal risk-free return	9%
Stock's beta	1.8
Stock's market price as of 1 January 2009	$19

Using the constant growth dividend discount model, the stock's intrinsic value is *closest* to:

A. $12.82.
B. $18.29.
C. $19.57.

83. Value Line Index, an unweighted index, uses which of the following methods in the computation of the holding period returns of underlying stocks?

A. Geometric mean.
B. Arithmetic mean.
C. Value-weighted mean.

84. The behavior of investors who put more money into a failure that they feel responsible for, rather than into a success, is *most* accurately described as:

A. escalation bias.
B. confirmation bias.
C. overconfidence bias.

85. An analyst gathers the following data about a company:

Stock price	$40
Stock's required return	12%
Consensus estimate of next year's dividend	$2.00
Company's return on equity	10%

Using the dividend discount model, the company's dividend payout ratio is *closest* to:

A. 5%.
B. 30%.
C. 70%.

86. Which of the following attributes is *least likely* to be associated with the characteristics of a well functioning securities market?

A. Market depth.
B. Wide bid-ask spreads.
C. Rapid adjustment of prices to new information.

87. The *best* description of the measure of cash flow to use when estimating the total value of a firm is the operating free cash flow:

A. prior to interest payments on debt.
B. prior to interest payments on debt but after deducting funds needed for capital expenditures.
C. after adjustment for payments to debt holders, but before dividend payments to common stockholders.

88. Which of the following is the *least likely* source of unreliability of a pricing anomaly?

A. Data mining.
B. Arbitrage activity.
C. Nonsynchronous trading.

89. The *best* characterization of the strong-form of efficient market hypothesis (EMH) with respect to the information set is that it encompasses:

    A. both weak-form and semistrong-form hypotheses.
    B. neither weak-form nor semistrong-form hypothesis.
    C. the semistrong-form but not the weak-form hypothesis.

90. Among a company's price to earnings (P/E), price to sales (P/S), and price to cash flow (P/CF) ratios, it is *most* accurate to state that P/E ratios are generally more stable from period to period than:

    A. P/S ratios but not P/CF ratios.
    B. P/CF ratios but not P/S ratios.
    C. neither P/S ratios nor P/CF ratios.

Questions 91 through 96 relate to Derivative Investments.

91. A series of interest rate put options that expire on different dates but have the same exercise rate is *best* defined as a (n):

    A. interest rate cap.
    B. interest rate floor.
    C. interest rate collar.

92. The party making the fixed-rate payment under a swap contract could also have to make the variable payment on that contract if the payments are related to a (n):

    A. equity swap.
    B. currency swap.
    C. interest rate swap.

93. An investor establishes a short position in a futures contract on Day 0 when the price per contract is $100. The investor deposits $5 per contract to meet the initial margin requirement. The maintenance margin requirement per contract is $3. The Day 1 settlement price that would require the investor deposit additional funds on Day 2 equal to $4 per contract is *closest* to:

A. $96.
B. $103.
C. $104.

94. Two parties agree to a forward contract to deliver the S&P 500 Index at a price of $375,000 in 2 months time. When the forward contract expires, the price of the S&P 500 Index is $350,000 but the long party is unable to pay the cash settlement. The short party is *most likely* obligated to:

A. Default on the forward contract
B. Do nothing until the long makes payment
C. Accept delivery of S&P 500 stocks from the long

95. A European bank wants to short a 1x3 forward rate agreement on Euribor. A dealer provides the bank with a quote of 1.75 percent. The bank agrees to enter the FRA with the dealer. At contract maturity, what Euribor rate would *most likely* result in the European bank receiving a payment from the dealer?

A. 60-day Euribor at 1.70%
B. 60-day Euribor at 1.80%
C. 90-day Euribor at 1.65%

96. According to put-call parity, a synthetic put contains a:

A. long position in the call.
B. long position in the underlying.
C. short position in the risk-free bond.

Questions 97 through 108 relate to Fixed Income Investments.

97. The spread between the yields on a Ginnie Mae passthrough security and a comparable Treasury security is *best* explained by:

    A. credit risk.
    B. prepayment risk.
    C, reinvestment risk.

98. Which of the following provides the *most* flexibility for the bond issuer?

    A. Put provision.
    B. Call provision.
    C. Sinking fund provision.

99. An annual-pay bond has a yield to maturity of 5.00 percent. The bond-equivalent yield of the annual-pay bond is *closest* to:

    A. 4.94%.
    B. 5.00%.
    C. 5.06%.

100. An analyst gathered the following information:

Periods	Years	Annual Par Yield to Maturity BEY (%)	Theoretical Spot rate BEY (%)	Six-month Forward Rates BEY (%)
1	0.5	3.00	3.00	3.00
2	1.0	3.30	3.30	3.61
3	1.5	3.50	3.51	3.91
4	2.0	3.90	3.92	5.15

The value of a single, default-free cash flow of $50,000 at the end of Period 4 is *closest* to:

A. $46,265.
B. $46,299.
C. $46,316.

101. The zero-volatility spread (Z-spread) is a measure of the spread off:

A. all points on the spot curve.
B. all points on the Treasury yield curve.
C. one point on the Treasury yield curve.

102. If an institutional investor wants to borrow money for 30 days to finance a bond purchase, which of these is *most likely* to be the lowest loan rate available?

A. Term repo rate
B. Call money rate
C. Broker loan rate

103. The option adjusted spread (OAS) is *best* described as the:

A. Z-spread minus the option cost.
B. Z-spread plus the cost of the option.
C. value of the security's embedded option.

104. If interest rates are expected to decline, an investor can earn a higher coupon interest rate by purchasing a(n):

A. callable bond.
B. inverse floater.
C. floater with a floor.

105. The duration of a fixed-income portfolio is *best* interpreted as the:

A. first derivative of the price function for the bonds in the portfolio.
B. percentage change in the portfolio's value if interest rates change by 100 basis points.
C. weighted average number of years to receive the present value of the portfolio's cash flows.

106. Relative to the duration/convexity approach, a shortcoming of the full value approach to measuring the interest rate risk of a bond portfolio is that it:

A. is relatively time consuming.
B. cannot be used for stress testing.
C. ignores the impact of embedded options.

107. A portfolio manager uses her valuation model to estimate the value of a bond as 125.482. Using the same model, she estimates that the value would increase to 127.723 if interest rates fell 30 bps and would decrease to 122.164 if interest rates rose 30 bps. Using these estimates, the effective duration of the bond is *closest to*:

A. 2.22.
B. 7.38.
C. 14.77.

108. If a bond is trading at 96.829 with a yield to maturity of 4.53 percent and duration equal to 5.38, its price value of a basis point (PVBP) is *closest* to:

A. 0.0439.
B. 0.0521.
C. 0.0538.

Questions 109 through 114 relate to Alternative Investments.

109. Exchange traded funds (ETFs) are affected by trading risk, which is most likely to:

A. expose investors to counterparty credit risk.
B. result in prices that differ from Net Asset Value (NAV).
C. provide investment results that do not correspond to the price and yield performance of their respective indexes.

110. When using the net income approach (NOI) in real estate valuation, if inflation is passed through, then the appraisal price will *most likely*:

A. increase.
B. decrease.
C. remain unchanged.

111. An investor evaluates an apartment complex using the income approach. Recent sales in the area consist of an apartment complex and an office building. The data on the apartment complex and the recently sold properties are provided below. All income and expenses are annual.

Gross potential rental income	$288,000
Estimated vacancy and collection losses	5%
Insurances and taxes	$25,000
Utilities	$16,000
Repairs and maintenance	$26,000
Depreciation	$32,000
Interest on proposed financing	$27,000

The NOI of the apartment complex under consideration is *closest* to:

A. $147,600.
B. $174,600.
C. $206,600.

112. An analyst collects the following data:

	Apartment Complex Under Consideration	**Apartment Complex Recently Sold**	**Office Building Recently Sold**
Net Operating Income (NOI)	$250,000	$91,000	$480,000
Sales price		$700,000	$3,000,000

Based on the data provided, the appraisal price of the apartment complex under consideration is *closest* to:

A. $1,562,500.
B. $1,724,138.
C. $1,923,077.

113. When a commodity market is in contango, the roll yield is *most likely*:

A. zero.
B. positive.
C. negative.

114. For a commodity if futures prices are above the spot price, then the market is *most likely* to be:

A. in contango.
B. in backwardation.
C. trading at a premium.

Questions 115 through 120 relate to Portfolio Management.

115. An analyst collected the following data for an asset:

Possible Rate of Return (Percent)	Probability
-10%	0.20
-5	0.30
10	0.40
25	0.10

The variance of returns for the asset are *closest* to:

A. 121.
B. 188.
C. 213.

116. An analyst gathered the following information about a portfolio comprised of two assets:

Asset	Weight (%)	Expected Return	Expected Standard Deviation
X	75	11%	5%
Y	25	7%	4%

If the correlation of returns for the two assets equals 0.75, and the risk-free interest rate 1 percent, then the expected standard deviation of the portfolio is closest to:

A. 3.07%.
B. 4.23%.
C. 4.55%.

117. An analyst has gathered monthly returns for two stock indexes A and B:

Month	Returns for Index A	Returns for Index B
1	-6.4%	-6.2%
2	6.6%	19.0%
3	12.9%	-7.7%
4	3.2%	4.0%

The covariance between Index A and Index B is *closest* to:

A. 10.37.
B. 13.82.
C. 19.64.

118. A completely diversified portfolio will *most likely* result in the elimination of:

A. systematic variance.
B. unsystematic variance.
C. both systematic and unsystematic variance.

119. Beta can be viewed as:

A. a measure of unsystematic risk.
B. covariance of an asset with the market portfolio.
C. correlation coefficient with the market portfolio.

120. For an investor borrowing money at the risk-free interest rate to invest in the market portfolio, the estimated rate of return of his portfolio is *most likely* to:

A. increase.
B. decrease.
C. remain unchanged.