

## 2008 Level 1 Mock Exam Volume 5

### SS1-Ethics and Professional Standards

1. According to the standards of practice Handbook, members must keep information about clients confidential unless the client:
- A. is deceased.
  - B. left for another firm
  - C. has not yet signed a contract.
  - D. is involved in illegal activities
4. Which of the following may claim compliance with the Global Investment performance standards (GIPS)?
- A. Financial planners.
  - B. Portfolio managers.
  - C. Portfolio consultants
  - D. Asset management firms.
5. The Global Investment Performance Standards (GIPS) were created to:
- A. Provide GIPS-compliant firms with a competitive edge.
  - B. Educate investors on misleading practices in performance measurement.
  - C. Ensure fair representation and full disclosure of performance information.
  - D. Impose CFA Institute Standards of professional Conduct on nonmembers.
7. According to the *standards of practice Handbook*, a member with supervisory responsibilities violates the CFA Institute Standards of Professional Conduct when:
- A. Delegating supervisory duties.
  - B. Failing to prevent violations of the law.
  - C. Filing to prevent violations of the CFA Code and standards.
  - D. Filing to establish and implement written compliance procedures.
9. Vera Abel, CFA, is the research director for ZigZag Investments. Abel discovers one of her top analysts trashing in stocks in advance of client transactions and repeatedly warns him that this activity is not appropriate. Does Abel violate any CFA Institute Standards of professional Conduct?
- A. No.
  - B. yes, with respect to fair dealing.

- C. yes, with respect to responsibilities of supervisors.
- D. yes, with respect to diligence and reasonable basis.

11. Jimmi Alvarez, CFA, is the founder of an investment advisory firm serving high net worth investors. For the past decade, Alvarez has invested his clients' money in mid-cap stocks. After much research, Alvarez determines that small-cap stocks are undervalued and moves a portion of all of his clients' assets into these stocks. Alvarez plans to inform his clients of this change with their year-end statements in three months. Has Alvarez violated any CFA Institute Standards?

- A. No.
- B. yes, with respect to misrepresentation.
- C. yes, with respect to diligence and reasonable basis.
- D. yes, with respect to communication with clients and prospective clients.

12. Scott Campbell, CFA, develops a complex quantitative model for selecting mortgage bonds. Campbell is careful to document in writing all assumptions in the model and his reasoning for the assumptions. Another firm offers Campbell a position leading the startup of a mortgage bond research department. In his new position, Campbell creates a similar model and supporting documents. Does Campbell violate any CFA Institute Standards?

- A. No.
- B. yes, with respect to record retention.
- C. yes, with respect to loyalty to employer..
- D. yes, with respect to preservation of confidentiality.

16. Hailey Donnelly works long hours as an investment analyst and is studying for Level I of the CFA Examination. She is concerned that she is not adequately prepared for the exam. Desperate to pass, Donnelly writes several formulas on a small piece of paper which she takes into the examination room. During the exam Donnelly realizes that she does not need the formulas. Has Donnelly violated any CFA Institute Standards?

- A. No.
- B. Yes, with respect to fair dealing.
- C. Yes, with respect to duty to employer.
- D. Yes, with respect to responsibilities as CFA Candidate.

18. A.L.Guzdar is a portfolio manger at Woodstock Investments (WI). Guzdar manages a billion-dollar hedge fund and two large mutual funds. Market declines cause significant losses for all of the accounts. Unable to find bids for certain thinly-traded stocks, Guzdar trades the stocks between the accounts to provide liquidity and pricing. Guzdar *least likely* violates the CFA Institute Standard relating to:

- A. Misconduct.
- B. Misrepresentation.

- C. Market manipulation  
D. Loyalty, prudence, and Care.

### SS2/3-Quantitative Methods

19. A money manager has \$1,000,000 to invest for one year. She has identified two alternative one-year certificates of deposit (CD) shown below:

	Compounding frequency	Annual interest rate
CD1	Quarterly	8.00%
CD2	Continuously	7.95%

Which CD has the highest effective annual rate (EAR) and how much interest will it earn?

- |    | Highest EAR | Interest earned |
|----|-------------|-----------------|
| A. | CD1         | \$81,902        |
| B. | CD1         | \$82,432        |
| C. | CD2         | \$82,746        |
| D. | CD2         | \$83,287        |

21. It is least appropriate to use the internal rate of return (IRR) rule to differentiate between mutually exclusive projects when either the projects' scale or cash flow timing, respectively, is:

- |   | Scale of projects | Cash flow timing |
|---|-------------------|------------------|
| A | Similar           | similar          |
| B | Similar           | Different        |
| C | Different         | Similar          |
| D | Different         | Different        |

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

	Date	Amount
Stock purchase(1)	15 January 2006	€ 86.00
Stock purchase(1)	15 January 2007	€ 94.00
Stock sale(2@106)	15 January 2008	€ 212.00

The stock does not pay a dividend. The money-weighted and time-weighted rates of return on the investment are closest to:

	money-weighted rate of return	time-weighted rate of return
A	11.02%	8.53%
B	11.02%	11.02%

C	11.60%	8.53%
D	11.60%	11.02%

31. The width of a confidence interval *most likely* will be smaller if the sample variance and number of observations, respectively, are:

	<u>Sample variance</u>	<u>Number of observations</u>
A.	Smaller	Smaller
B.	Smaller	Larger
C.	Larger	Smaller
D.	Larger	larger

33. Which of following is the *most likely* effect of an increase in output on the marginal cost in the short run?

	<u>At low levels of output?</u>	<u>At high levels of output?</u>
A.	Decrease due to economies from greater specialization	Decrease due to economies from greater specialization
B.	Decrease due to economies from greater specialization	Increase due to the law of diminishing returns
C.	Increase due to the law of diminishing returns	Decrease due to economies from greater specialization
D.	Increase due to the law of diminishing returns	Increase due to the law of diminishing returns

#### SS4/5/6-Economics

35. Key factors that influence the levels of structural and frictional unemployment in an economy, respectively, are:

	<u>Structural unemployment</u>	<u>Frictional unemployment</u>
A.	Changes in technology	Changes in technology
B.	Changes in technology	Unemployment compensation
C.	Unemployment compensation	Changes in technology
D.	Unemployment compensation	Unemployment compensation

36. Which of the following are the most likely effects of an increase in tax on interest income on the investment demand and interest rates, respectively?

	<u>Effect on investment demand</u>	<u>Effect on interest rates</u>
A.	No effect	No effect
B.	No effect	Increase
C.	Decrease	No effect

D.                      Decrease                      Increase

37. The best description of the elasticity of supply of renewable and nonrenewable natural resources, respectively, is:

	<u>Renewable resource</u>	<u>Nonrenewable resource</u>
A.	Perfectly elastic	Perfectly elastic
B.	Perfectly elastic	Perfectly inelastic
C.	Perfectly inelastic	Perfectly elastic
D.	Perfectly inelastic	Perfectly inelastic

38. For factors of production that differ in their supply elasticity, perfectly elastic or perfectly inelastic, the factor income is entirely:

	<u>Perfectly elastic supply</u>	<u>Perfectly inelastic supply</u>
A.	Economic rent	Economic rent
B.	Economic rent	Opportunity cost
C.	Opportunity cost	Economic rent
D.	Opportunity cost	Opportunity cost

39. Which of the following is the most likely effect of changes in inflation and/or unemployment on the Phillips curve?

- A. A change in the expected inflation causes a shift in both short-run and long-run Phillips curves.
- B. A change in the natural rate of unemployment causes a shift in both short-run and long-run Phillips curves.
- C. A change in the natural rate of unemployment causes a shift in the short-run but not the long-run Phillips curve.
- D. If inflation falls below it expected, unemployment falls below its natural rate and there would be a movement up along the short-run Phillips curve.

40. According to the feedback rule with productivity shocks, in order to stabilize the price level the *most likely* action by the Fed and the resulting effect on real GDP, respectively, are:

	<u>Fed's action</u>	<u>Effect on real GDP</u>
A.	Fed decreases the quantity of money	The real GDP declines
B.	Fed decreases the quantity of money	The real GDP remains constant
C.	Fed keeps the quantity of money constant	The real GDP declines
D.	Fed keeps the quantity of money constant	The real GDP remains constant

41. In a perfectly competitive environment, a firm achieves maximum profit at the level of production where marginal revenue and marginal revenue product of labor, respectively, are equal to:

	<u>Marginal revenue</u>	<u>Marginal revenue product of labor</u>
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A.	Average cost	Wage rate
B.	Average cost	Marginal product
C.	Marginal cost	Wage rate
D.	Marginal cost	Marginal product

42. In regulating a natural monopoly, the pricing rule most commonly adopted by a regulator, and its effect on firm's profit, respectively, are:

	Pricing rule	Effect on firm's profit
A.	Average cost pricing	The firm earns normal profit
B.	Average cost pricing	The firm incurs economic loss
C.	Marginal cost pricing	The firm earns normal profit
D.	Marginal cost pricing	The firm incurs economic loss

43. Which of the following is the most accurate description of the determination of interest rates?

- A. The real interest rate is determined in the money market.
- B. The nominal interest rate is determined in the capital market.
- C. The real interest rate equals the nominal interest rate minus the expected inflation rate.
- D. The nominal interest rate equals the real interest rate plus the unexpected inflation rate.

44. The short-run effect of an increase in aggregate demand as a result of increases in government purchases on price level and real GDP, respectively, are:

	Effect on price level	Effect on real GDP
A.	Increase	increase
B.	increase	No effect
C.	No effect	increase
D.	No effect	No effect

#### SS7/8/9/10-Financial Statement Analysis

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

A financial reporting system has two components: the establishing of the rules or standards, and the enforcing of the rules. The responsibility for those two components generally lies with which of the following bodies?

	Establishing the rules	Enforcing the rules
A.	Standard-setting bodies	Standard-setting bodies
B.	Standard-setting bodies	Regulatory authorities
C.	Regulatory authorities	Standard-setting bodies
D.	Regulatory authorities	Regulatory authorities

63. Assume U.S.GAAP (generally accepted accounting principles) applies unless otherwise noted. Differences between accrued revenue and expenses and cash flows result in the creation of assets and liabilities. Would each of the following revenue events result in the creation of an asset or a liability when the event originally occurs?

	Revenue is recognized before the cash is received.	Cash is received before the revenue is recognized.
A.	Asset	Asset
B.	Asset	Liability
C.	Liability	Asset
D.	Liability	Liability

64. Assume U.S.GAAP(generally accepted accounting principles) applies unless otherwise noted. Lazlo Ltd, a European-based telecommunications provider, follows IASB GAAP and capitalizes new product development costs. During 2007 they spent €25 million on new product development and reported an amortization expense related to a prior year's new product development of €10 million. Other information related to 2007 is as follows:

	In € millions
Net income	225
Average assets	1,875
Cash flow from operations	290

An analyst would like to compare Lazlo to U.S.-based telecommunications provider and has decided to adjust their financial statements to U.S. GAGP. Under U.S. GAAP, and ignoring tax effects, the return on assets (ROA) and cash flow from operations (CFO) for Lazlo would be closest to:

	ROA	CFO millions
A.	10.7%	€265
B.	10.7%	€ 275
C.	11.2%	€ 265
D.	11.2%	€ 275

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

Madison Inc. is planning a bond issue. They are considering issuing either a straight coupon bond or a coupon bond with warrants attached. The proceeds from either issue would be the same. What will be the effect on their interest expense and balance sheet liability if they issue the bonds with warrants as compared to the straight bonds? For the bonds with warrants the:

	Interest expense will be	Balance sheet liability will be
A.	Lower	Lower
B.	Lower	Higher
C.	Higher	Lower

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

Kim Lee, CFA, is trying to forecast net income for Robinson's Ltd, a chain of retail furniture outlets furniture outlets. He has prepared the following common sized data form their recent annual report and has estimated sales for 2008 using a forecasting model his firm developed for consumer goods.

	2008 forecast	2007 actual	2006actual
Sales \$ millions	2,250	2,150	1,990
Sales as % of sales		100%	100%
Cost of goods sold		45%	45%
Operating expenses		40.00%	40.00%
Interest expense		3.72%	4.02%
Restructuring expense		0%	7.2%
Pre-tax margin		11.28%	3.78%
Taxes (35%)		3.95%	1.32%
Net income		7.33%	2.46%

The capital structure of the company has not changed. The projected net income (in \$ millions) for 2008 is closest to:

- A. 110.1
- B. 162.8
- C. 164.9
- D. 167.4

### SS11-Corporate Finance

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

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

The required rate of return for the project is 13%. The net present value (NPV) and profitability index for the project, respectively, are closest to:

	NPV	Profitability index
A.	€ 14.85	1.15
B.	€ 14.85	1.30
C.	€ 29.78	1.15
D.	€ 29.78	1.30



**SS13/14-Equity Investments**

79. Hari Raju, CEO of Securities Tracking Associates (STA), is thinking of devising a new index for the Indian stock market. He does not, however, like an index that requires adjustment for stock splits. Given this preference, Raju would be *least likely* to develop which of the following types of indexes?

- A. Style index
- B. Un-weighted index
- C. Price-weighted index
- D. Value-weighted index

80. Two industries, A and B, have the following values for N-firm concentration ratio and Herfindahl Index:

Industry	3-firm concentration ratio	Herfindahl index
A	40%	0.095
B	75%	0.1938

Given this, which of the following statements is most accurate?

- A. Industry A can be characterized as oligopolistic competition.
- B. Firms in Industry A would have a greater coordination than firms in Industry B.
- C. Industry A has a larger number of equivalent firms than Industry B.
- D. Product differentiation strategy would be more appropriate for firms in Industry B than for firms in Industry A.

81. Chenchil's India Trading Co. (CITC), an importer-exporter of specialty goods and garments, has operations in Asia, Europe, and North America. Marc Twinsing, CFA, a balanced fund manager, is considering adding CITC's stock to his portfolio and he has compiled the following information:

	CITC	Industry Average
Weighed average cost of capital(WACC)	14%	12%
Return on assts (ROA)	20%	15%
Dividend Yield	0%	1.2%
Consensus estimate of stock's value	\$53	N/A
Current price of CITC's stock	\$50	N/A

Based on his analysis Twinsing's most likely conclusions about the company and its stock, respectively, would be:

	That CITC company is a:	That CITC's stock is a
A	Growth company	Growth stock

B	Growth company	Speculative stock
C	Speculative company	Growth stock
D	Speculative company	Speculative stock

83. Metiu Metev, an analyst with Sofia Equity Researchers, has gathered the following information about Balkan Steel Mills (BSM):

Current year's operating free cash flow	BGN 5 million
Cost of equity capital	15%
Weighted average cost of capital	12.4%
Estimated long-term growth rate	6%

Given this information, metev's best estimate of BSM's intrinsic value (in BGN millions) would be closest to:

- A. 55.56 million
- B. 58.89 million
- C. 78.13 million
- D. 82.81 million

84. Geo Telecommunications Inc. is a fast growing company with a double-digit growth rate that is expected to continue for three more years. In his pursuit of valuing the company's stock, Dimitar Nenkov, a free-lance equity analyst, has compiled the following data about the company:

Current year's free cash flow to equity	€ 20 million
Growth rate in free cash flow during the next three years	30% in years 1 and 2 20% in year 3
Growth rate in free cash flow for year 4 and beyond	8%
Weighted average cost of capital	12%
Cost of equity capital	15%
Number of outstanding shares	50 million

Based on the above information, Nenkov's best estimate of the value per share for Geo Telecommunications would be closest to:

- A. € 9.72.
- B. € 10.13
- C. € 17.17.
- D. € 17.57

86. In a country that is experiencing neoclassical growth with increasing savings rate, investors can expect which of the following:

	Higher dividends?	Higher dividend growth?
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A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

87. Which of the following is the *least likely* characteristic of a call market? A call market is a:

- A. primary market
- B. secondary market
- C. market with participation by small number of active investors-traders.
- D. Market in which buy-sell orders are cleared at a single equilibrium price.

88. In computing free cash flow to equity, adjustment is needed for payments made to which of the following capital providers?

	<u>Debt holders</u>	<u>Preferred stockholders</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

89. An equity investment in a producer firm would be more attractive at what levels of the bargaining power of buyers and suppliers, respectively?

	<u>Bargaining power of buyers</u>	<u>Bargaining power of suppliers</u>
A.	Low	Low
B.	Low	High
C.	High	Low
D.	High	High

### SS17-Derivative Investments

92. A futures trader goes long one futures contract at \$450. The settlement price 1 day before expiration is \$500. On expiration day, the future is trading at \$505. The least likely way the futures will lock in her profits on expiration is:

- A. Take delivery of the underlying asset and pay \$500 to the short.
- B. Close out the futures position by selling the futures contract at \$505
- C. Take delivery of the underlying asset and pay the expiration settlement price to
- D. Cash settle the futures and receive the difference between \$400 and the expiration settlement price.

94. The effects on the price of a call option from an increase in volatility and an increase in interest

rates are:

	<u>Increase in volatility</u>	<u>Increase in interest rates</u>
A.	Decrease	Increase
B.	Increase	Increase
C.	Increase	Decrease
D.	Increase	No impact

### SS15/16-Fixed Income Investments

103. Fred Perry, CFA, purchased \$100,000 of a newly issued Treasury inflation protection security based on the following characteristics and information.

Issuance date:	January 1, 2008
Issuance price:	\$1,000
Maturity:	10 years
Auction set real rate:	2.00%
Interest payable:	Annually
CPI-U (Applicable inflation index)	5.00% (annual rate)

The coupon payment at the end of one year is closest to:

- A. \$2,000
- B. \$2,100
- C. \$5,000
- D. \$7,000

104. A portfolio manager is considering investing a portion of her fixed income portfolio in a security whose cash flows are dependent on an underlying pool of mortgages. The portfolio consists of Treasury bonds, corporate bonds and Ginnie Mae pass-through security. The rules of the CMO state that Tranche A is the first to receive monthly principal. By investing in Tranche B of the CMO, the portfolio manager will most likely reduce portfolio:

- A. credit risk
- B. inflation risk
- C. sovereign risk
- D. prepayment risk

105. Hub Global, Inc, has issued two classes of debt securities to finance its operations, a first mortgage bond and debenture bonds. All else equal, will the default and recovery rates of the debenture likely be higher than the first mortgage bond?

	<u>Default rate</u>	<u>Recovery rate</u>
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A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

106. Which of the statements is least accurate?

- A. Central banks need to ensure that they follow markets rather than guide them.
- B. Central banks can obtain an assessment of expected interest rates from bond markets.
- C. Goods and labor markets provide central banks with information about risks to price stability.
- D. Central banks should clearly communicate their strategies with financial markets and avoid surprises.

108. An 8% coupon option-free bond maturing in 12 years is currently trading at a premium. Assuming market rates remain stable, over a period of 5 years, the value of the bond will most likely:

- A. increase
- B. decrease
- C. remain constant.
- D. increase or decrease depending on changes in volatility.

### SS18-Alternative Investments

109. Which real estate valuation approach is most likely to use slope coefficients derived from a statistical analysis to estimate the value of a property?

- A. cost approach
- B. income approach
- C. sales comparison approach
- D. discounted after-tax cash flow approach

111. An investor would most likely expect commodities to have correlations with traditional stock or bond investments and inflation that are:

	Correlation with traditional stock or bond investments	Correlation with inflation
A	Positive	Positive
B	Positive	Negative
C	Negative	Positive
D	Negative	Negative

### SS12-Portfolio Management

116. The final step in the portfolio management process is most likely to include:

- A. investment research
- B. portfolio construction
- C. Evaluation of portfolio performance.
- D. Evaluation of investor's investment knowledge.

117. The second step of the portfolio management process is least likely to include examining:

- A. Historical trends.
- B. Current social conditions.
- C. Projected financial forecasts.
- D. Current and projected political conditions.

119. When compared to investors living in a country with high inflation, investors living in a country with generous state pensions will most likely have allocations to equities and fixed income investments, respectively, that are:

	<u>Equities</u>	<u>Fixed income</u>
A	Lower	Lower
B	Lower	Higher
C	Higher	Lower
D	Higher	Higher

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

Asset	Weight%	Expected return E(R)	Expected standard deviation E( $\sigma$ )
X	60	11%	5%
Y	40	7%	4%

If the covariance of returns for the two assets equals 0.75, then the expected return and expected standard deviation of the portfolio are closest to:

	<u>Expected return</u>	<u>Expected standard deviation</u>
A	8.6%	4.3%
B	8.6%	18.7%
C	9.4%	4.3%
D	9.4%	18.7%