

2010 Level 1 Sample Exam Volume 2

SS1-Ethics and Professional Standards

1 Eileen Fisher, CFA, has been a supervisory analyst at SL Advisors for the past ten years. Recently one of her analysts was found to be in violation of the CFA Institute Standards of Professional Conduct. Fisher has placed limits on the analyst's activities and is now monitoring all of his activities related to investment actions. Although SL Advisors did not have any compliance procedures up to this point, to avoid future violations Fischer has put in place procedures that exceed industry standards. Did Fisher violate any CFA Institute Standards of Professional Conduct?

- A. Yes.
- B. No, because she is taking steps to implement compliance procedures that are more than adequate.
- C. No, because she has taken steps to ensure that the violations will not be repeated by the analyst.

2 Joyce La Valle, CFA, is a portfolio manager at a global bank. La Valle has been told that she should use a specific vendor for equity investment research that has been approved by the bank's headquarters office. Because La Valle is located in a different country than the bank's headquarters, she is uncomfortable with the validity of the research provided by this vendor when it applies to her country and would like to use a local vendor on whom she has already conducted due diligence. Which of the following actions concerning the research vendor should La Valle take to avoid violating the CFA Institute Standards of Professional Conduct?

- A. Use the local vendor.
- B. Use the bank-approved research vendor.
- C. Use both the local and the bank-approved research vendors.

3 Colin Gifford, CFA, is finalizing a monthly newsletter to his clients who are primarily individual investors. Gifford includes the following information on a stock holding common to all accounts, Capricorn Technologies: "Based upon the next six months earnings of \$1.50 per share and a 10% increase in the dividend, the share price of Capricorn's stock will be \$22 per share by the end of the year." Concerning his stock analysis, the least appropriate action Gifford should take to avoid violating any CFA Institute Standards of Professional Conduct would be to:

- A. separate fact from opinion.
- B. identify the known limitations of the analysis.
- C. include a general recommendation about the market.

4 Yao Tsang, CFA, has a large percentage of his net worth invested in the Australian mining company Outback Mines, which he has held for many years. Tsang is in the process of moving to a new employer where he will be responsible for initiating research on U.S. domestic mining companies. Shortly after his move, Tsang is asked to complete a research report on Outback Mines. In order to meet the CFA Institute Standards of Professional Conduct concerning his stock holding, which of the following is the most appropriate action for Tsang to take?

- A. Disclose his stock holding to his employer and to clients.
- B. Sell his stock holdings to eliminate any potential conflict of interest.
- C. Refuse to write the report and ask his employer to assign another analyst to complete the analysis.

5 Teresa Avila, CFA, is a micro cap investment analyst at a hedge fund. The fund requires Avila to hold any securities that she recommends for the fund in her own account as well. The president of the fund has stated, "We require our analysts to eat their own cooking." Because Avila has such a small account, whenever she trades for her own portfolio she combines the transactions with those of the hedge fund so that she is sure to have her account aligned with the fund. Has Avila violated any CFA Institute Standards of Professional Conduct?

- A. No
- B. Yes, related to Misconduct
- C. Yes, related to Priority of Transactions

6 Ken Kawasaki, CFA, recently started his own investment management firm. At his new office, Kawasaki shares a building with a number of other professionals who are involved in the investment management business. Kawasaki makes arrangements with several of these professionals, including accountants and lawyers, to refer clients to each other. There is an expectation that an informal score is kept so that the referrals will equal out over time, so there are no cash payments. Kawasaki never mentions this arrangement to clients or prospective clients. Does Kawasaki's agreement with the other building occupants violate any CFA Institute Standards of Professional Conduct?

- A. No
- B. Yes, related to Referral Fees
- C. Yes, related to Communication with Clients

7 Stian Klun, CFA, is preparing a brochure to advertise his firm. The brochure includes the following disclosures:

"I am a CFA, which means that I am a member of the CFA Institute, which I believe constitutes the most elite group of professionals within the investment management

business. In order to become a CFA charterholder I had to complete a comprehensive program of study in the investment management field."

Klun is *least likely* to have violated the CFA Institute Standards of Professional Conduct related to referencing the:

- A. CFA Institute.
- B. CFA Program.
- C. CFA Designation.

8 Holly Baker, CFA, is explaining the CFA Institute Code of Ethics to a client. When Baker explains the disciplinary sanctions that the CFA Institute may impose, which of the following is a correct statement she could make? Sanctions include:

- A. fines for violations.
- B. revocation of membership.
- C. being banned from the industry.

9 The basic structure for enforcing the CFA Institute Code and Standards under its Professional Conduct Program is not formed by which of the following? The CFA Institute's:

- A. Bylaws
- B. Rules of Procedure
- C. Board of Governors

SS2/3-Quantitative Methods

10 Use the following values from a sample's t-distribution to establish a 95% confidence interval for the sample mean given a sample size of 10, a sample mean of 6.25, and a sample standard deviation of 12. Assume that the population from which the sample is drawn is normally distributed and the population variance is not known.

Degrees of freedom	p = 0.10	p = 0.05	p = 0.025	p = 0.01
9	1.383	1.833	2.262	2.821
10	1.372	1.812	2.228	2.764
11	1.363	1.796	2.201	2.718

The 95% confidence interval is closest to:

- A. a lower bound of -2.33 and an upper bound of 14.83.
- B. a lower bound of -2.20 and an upper bound of 14.70.
- C. a lower bound of -0.71 and an upper bound of 13.20.

11 Over the past four years, a portfolio experienced returns of -8%, 4%, 17%, and -12%. The geometric mean return of the portfolio over the four-year period is closest to:

- A. -0.37%.
- B. 0.25%.
- C. 8.99%.

12 The probability of event A is 40%. The probability of event B is 75%. The joint probability of AB is 40%. The probability that A or B occurs or both occur is closest to:

- A. 40%
- B. 75%
- C. 115%.

13 A consumer purchases an automobile using a loan. The amount borrowed is €30,000 and the terms of the loan call for the loan to be repaid over 5 years using equal monthly payments with an annual nominal interest rate of 8% and monthly compounding. The monthly payment (in €) is closest to:

- A. 608.29.
- B. 626.14.
- C. 700.00.

14 If the stated annual interest rate is 9% and the frequency of compounding is daily, the effective annual rate is closest to:

- A. 9.00%.
- B. 9.42%.
- C. 9.88%.

15 One is most likely to reject the null hypothesis when the p-value of the test statistic:

- A. is negative.
- B. exceeds a specified level of significance.
- C. falls below a specified level of significance.

16 The assertion that prices of securities tend to move in trends that persist for appreciable lengths of time is best described as an assumption of:

- A. technical analysis.
- B. weak-form efficiency.
- C. arbitrage pricing theory.

SS4/5/6-Economics

17 If the quantity demanded of pears falls by 4% when the price of apples decreases by 3%, then apples and pears are best described as:

- A. substitutes.
- B. complements.
- C. inferior goods.

18 Assume that at current production and consumption levels, a good exhibits price elasticity of demand equal to 1.20 and elasticity of supply equal to 1.45. The true economic consequences of taxes imposed on the seller of such a good are *most likely* borne:

- A. by the buyer.
- B. by the seller.
- C. partly by the buyer and partly by the seller.

19 Assume that a monopoly is charging a price higher than the price that would exist in pure competition. If the monopoly decides to increase the price even more, the deadweight loss to society will most likely.

- A. increase.
- B. decrease.
- C. remain the same.

20 Assume the U.S. Federal Reserve System (the Fed) has decided to lower interest rates in the economy. To carry out this policy, the Fed will most likely instruct the open market trading desk to:

- A. sell securities.
- B. buy securities.
- C. increase required reserve ratios.

21 The supply curve for a particular factor of production with total income consisting solely of economic rent is most likely.

- A. vertical.
- B. horizontal.
- C. perfectly elastic.

22 The primary monetary policy goal of most major central banks is best characterized as:

- A. containing inflation.
- B. stimulating economic growth.
- C. maintaining low interest rates.

SS7/8/9/10-Financial Statement Analysis

23 Which of the following financial statement elements most accurately represents inflows of economic resources to a company?

- A. Gains
- B. Assets
- C. Revenues

24 To be recognized as a financial statement element under the International Financial Reporting Standards (IFRS) Framework for the Preparation and Presentation of Financial Statements, an element *most appropriately* needs to:

- A. have a cost or value that can be measured with reliability.
- B. normally be carried at historical cost, current cost, or fair market value.
- C. provide certainty that any future economic benefit associated with the item will flow to or from the enterprise.

25 Which of the following statements is most accurate?

- A. Treasury stock is non-voting and receives no dividends.
- B. Minority interest on the balance sheet represents minor positions that the company owns in other companies.
- C. A classified balance sheet arises when in an auditor's opinion the financial statements materially depart from accounting standards and are not presented fairly.

26 The following is selected data from a company's operations:

Net Income	\$100,000
Increase in Accounts Receivable	12,000
Increase in Accounts Payable	9,000
Depreciation and Amortization	6,000

The cash flow from operations (in \$) is closest to:

- A. 89,000.
- B. 105,000.
- C. 111,000.

27 Selected financial information for a company as of the end of the current year is presented below.

Accounts Receivable	\$513,347
Cash and Marketable Securities	\$520
Cash Ratio	0.03
Current Assets	\$23,100
Daily Cash Expenditures	\$277
Gross Profit Margin	0.28
Inventory Turnover	4.7
Number of Days of Payables	87
Quick Ratio	0.80
Revenues	\$41,500
Total Asset Turnover	0.82
Total Liabilities	\$44,000

If last year the current ratio, defensive interval, and operating cycle were 1.22, 54 days and 208 days, respectively, which of the following statements is most accurate? The company's:

- A. current ratio has decreased.
- B. defensive interval increased.
- C. operating cycle has decreased.

28 Which of the following is the least appropriate accounting treatment for marketable securities under IAS No. 39?

	Category	Measurement Method	Realized Gains & Losses Reported In
A.	Trading	Fair Value	Income Statement
B.	Available for Sale	Fair Value	Equity
C.	Held to Maturity	Amortized Cost	Income Statement

29 In a period of rising prices, when compared to a company that uses weighted average cost for inventory, a company using FIFO will *most likely* report higher values for its:

- A. return on sales.
- B. inventory turnover.
- C. debt-to-equity ratio.

30 Which of the following is the *least likely* reason as to why a firm's management would increase the value of a capital asset that had been previously written down?

- A. Management wants to increase ROE in future periods.

- B. The company is approaching the leverage limits of its borrowing agreement.
- C. Management is concerned that income for the current year will fall below levels expected by analysts.

31 A company incurred and capitalized €2 million of development costs during the year. These costs were fully deductible immediately for tax purposes, but the company is depreciating them over two years for financial reporting purposes. The company has a long history of profitability. When calculating the company's debt-to-equity ratio, the most appropriate way for an analyst to incorporate the differential tax treatment is to:

- A. include it in equity.
- B. include it in liabilities.
- C. not include it in either equity or liabilities.

32 Compared to classifying a lease as a financing lease, if a lessee reports the lease as an operating lease it will most likely result in a:

- A. lower return on assets.
- B. higher debt-to-equity ratio.
- C. lower cash from operations.

33 If a nonfinancial company securitizes its accounts receivables for less than their book value, the *most likely* effect on the financial statements is to increase:

- A. net income.
- B. cash from operations.
- C. cash from financing activities.

34 When analyzing a company that prepares its financial statements according to U.S. GAAP, calculating the price/tangible book value ratio instead of the price/book value ratio is most appropriate if it:

- A. grows primarily through acquisitions.
- B. develops its patents and processes internally.
- C. invests a substantial amount in new capital assets.

SS11-Corporate Finance

35 A company's \$100 par value preferred stock with a dividend rate of 9.5% per year is currently priced at \$103.26 per share. The company's earnings are expected to grow at an annual rate of 5% for the foreseeable future. The cost of the company's preferred stock is closest to:

- A. 9.2%.
- B. 9.5%.
- C. 9.7%.

36 Which method of calculating the firm's cost of equity is most likely to incorporate the long-run return relationship between the firm's stock and the market portfolio?

- A. Dividend discount model approach
- B. Capital asset pricing model approach
- C. Bond-yield plus risk-premium approach

37 Which is most likely considered a secondary source of liquidity?

- A. Trade credit
- B. Liquidating long-term assets
- C. Centralized cash management system

38 A new inventory system that reduces average inventory without affecting sales will most likely reduce the:

- A. cost of goods sold.
- B. inventory turnover.
- C. cash conversion cycle.

39 A company currently has sales of €1.2 million and it makes the following forecasts for the next year:

Expected sales growth next year:	10%
Expected cost of goods sold as a proportion of sales:	75%
Expected salary, general, and administrative expenses as a proportion of sales:	10%

The expected gross profit for next year (in € millions) is closest to:

- A. 0.198.
- B. 0.300.
- C. 0.330.

SS13/14-Equity Investments

40 Assume a speculator enters into a margin purchase transaction with the following features:

Number of shares	500
Purchase price per share	\$28
Margin used	50%

Transaction costs for each order: buy or sell	\$50
Margin position holding period	6 months
Selling price per share	\$32
Interest on borrowed funds	8% per year

The return on the speculator's investment is closest to:

- A. 19.0%.
- B. 22.1%.
- C. 23.0%.

41 Diversifying a domestic equity portfolio by incorporating international equities is most beneficial if the correlation between domestic equities and the international equities is:

- A. low.
- B. high.
- C. greater than one.

42 A mispricing anomaly in securities markets is most likely to persist because of:

- A. data mining.
- B. behavioral biases.
- C. survivorship bias.

43 A cyclical stock is most accurately characterized as one:

- A. whose systematic risk is low or negative.
- B. whose rates of return are more volatile than the overall market.
- C. with a high probability of low or negative rates of return and a low probability of normal or high rates of return.

44 An analyst gathers the following data about a company.

Common stock, par value (Issued: 50,000 shares)	\$50,000
Additional paid-in capital	\$300,000
Retained earnings	\$150,000
Treasury stock (5,000 shares)	\$125,000

If the company's stock price per share is \$30, its price-to-book value is closest to:

- A. 2.64.
- B. 3.00.
- C. 3.60.

45 Using the arithmetic mean of the percent changes in prices of stocks in an index is most typically associated with:

- A. unweighted indexes.
- B. price-weighted indexes.
- C. value-weighted indexes.

SS17-Derivative Investments

46 If the volatility of returns on an underlying security increases, then:

- A. both call and put option prices increase.
- B. both call and put option prices decrease.
- C. call prices increase and put prices decrease.

47 Futures prices for five consecutive trading-days are provided in the table below. The initial margin requirement is set at \$6.00 per contract and the maintenance margin is \$3.60 per contract.

Day	Futures Price
0	\$120
1	118
2	117
3	119
4	123
5	125

If on day 0 a trader enters into a short position for 15 contracts, the ending balance for the margin account on day 5 is closest to:

- A. \$15.
- B. \$60.
- C. \$210.

48 A forward rate agreement (FRA) expiring in 30 days, for which the underlying is 90-day LIBOR, is quoted at 4.5% by a dealer. Assume an investor shorts the contract and the dealer goes long for a notional principal of \$15 million. If at the expiration of the FRA the rate on 90-day LIBOR is 4.0%, the investor is *most likely* to:

- A. pay the dealer \$6,229.
- B. pay the dealer \$18,564.
- C. receive from the dealer \$18,564.

SS18-Alternative Investments

49 Which of the following statements does not describe an advantage of investing in hedge funds through a fund of funds? Funds of funds provide:

- A. an increase in expected return through diversification.
- B. expertise in selecting funds and conducting due diligence.
- C. access to successful funds that may otherwise be closed to new investors.

50 In estimating the value of inactively traded securities of a closely held corporation, the comparable market value of a publicly traded company is used as a base to calculate the:

- A. control premium.
- B. marketability discount.
- C. minority interest discount.

51 An index provider has created a new investable index that tracks the hedge fund industry. Any fund that follows a long/short equity strategy can enter the index. The index provider places new constituents in the index at the end of each year and incorporates the fund's track record in the database. Which of the following is not a bias that might distort the historical performance of the index?

- A. Backfilling bias
- B. Self-selection bias
- C. Tracking error bias

SS15/16-Fixed Income Investments

52 Of the following, the most direct disadvantage of investing in a prepayable security relative to an otherwise identical option-free security is:

- A. increased default risk.
- B. lower interest payments.
- C. decreased price appreciation.

53 An investor fears that economic conditions will worsen and the market prices of her corporate bonds will decrease more than her government bonds. The investor's fear is best described as a fear of:

- A. default risk.
- B. downgrade risk.

C. credit spread risk.

54 What sort of risk does the bid-ask spread most closely measure?

- A. Default risk
- B. Inflation risk
- C. Liquidity risk

55 On January 1st of the year, an investor purchases \$100,000 in par value of a new Treasury Inflation Protection Security (TIPS) issue that has a 2.5% coupon rate. The annual rate of inflation over the first 6 months of the year is 4.0% and the annual rate of inflation for the second 6 months of the year is 3.0%. The amount of coupon interest paid to the investor after the second 6 months of the year is closest to:

- A. \$1,275.
- B. \$1,294.
- C. \$1,339.

56 Suppose a level payment, fixed-rate, fully amortizing mortgage loan for \$220,000 is obtained with a term of 15 years, a mortgage rate of 6.0% with monthly compounding, and a monthly payment of \$1,856.49. Assuming that the borrower does not prepay or default, the principal that is repaid during the first 3 months is closest to:

- A. \$0.
- B. \$2,281.
- C. \$3,667.

57 The primary motivation for creating a collateralized mortgage obligation (CMO) is best described as the desire to redistribute which risk of investment in residential mortgages?

- A. Default risk
- B. Interest rate risk
- C. Prepayment risk

SS12-Portfolio Management

58 The optimal portfolio on the efficient frontier is likely to be:

- A. more risky for investors with flatter utility curves.
- B. more risky for investors with steeper utility curves.
- C. the same for all investors irrespective of their utility curves.

59 The following table shows data for the stock of JKU and a market-index.

Expected return of JKU	$E(R_{JKU})$	15%
Expected return of market index	R_M	12%
Risk free rate	RFR	5%
Standard deviation of market index returns	σ_M	15%
Covariance coefficient between JKU and market index	$COV_{JKU,M}$	0.0225

Based on the capital asset pricing model (CAPM), JKU is most likely.

- A. overvalued.
- B. undervalued.
- C. properly valued.

60 An individual indicates that the current value of his portfolio, including unrealized gains, is sufficient to pay for his daughter's university tuition based on current costs. However, his daughter will not start university for another ten years and tuition costs are expected to keep rising each year. In establishing the policy statement for this investor, the most appropriate investment objective is:

- A. tax minimization.
- B. capital appreciation.
- C. capital preservation.