2009 Sample Exam 2 Questions

SS1-Ethics and Professional Standards

1. Ross Nelson, CFA, manages accounts for high net worth clients including his own family's account. He has no beneficial ownership in his family's account. Because Nelson is concerned about the appearance of improper behavior in managing his family's account, when his firm purchases a block of securities, Nelson allocates to his family's account only those shares that remain after allocation to his other client accounts. The fee for managing his family's account is based on his firm's normal fee structure. According to the Standards of Practice Handbook, Nelson's best course of action with regard to management of his family's account would be to:

A. Continue to manage his family's account but treat it like his other client accounts.
B. Discontinue management of his family's account and arrange for the account to be transferred to another firm.
C. Discontinue management of his family's account and arrange for the account to be transferred to another investment manager in his firm.

2. Several years ago Leo Peek, CFA, co-founded an investment club. The club has not actively traded the account for at least a year and does not plan to resume active trading of the account. Peek's employer requires an annual disclosure of employee stock ownership. Peek discloses all of his personal trading accounts, but does not disclose his holdings in the investment club. Which CFA Institute Standards of Professional Conduct has Peek violated?

A. Fiduciary duty.
B. Selective disclosure.
C. Conflicts of interest.

3. Madeline Smith, CFA, was recently promoted to senior portfolio manager. In her new position, Smith is required to supervise three portfolio managers. Smith asks for a copy of her firm's written supervisory policies and procedures, but is advised that no such policies are required by regulatory standards in the country where Smith works. According to the Standards of Practice Handbook, Smith's most appropriate course of action would be to:

A. Require that her firm adopt the CFA Institute Code of Ethics and Standards of Professional Conduct.
B. Require that the employees she supervises adopt the CFA Institute Code of Ethics and Standards of Professional Conduct.

C. Decline to accept supervisory responsibility until her firm adopts procedures to allow her to adequately exercise such responsibility.

4. Darden Crux, CFA, a portfolio manager at SWIFT Asset Management Ltd., calls a friend to join him for dinner. The friend, a financial analyst at Cyber Kinetics (CK) declines the invitation and explains that she is performing due diligence on Orca Electronics, a company that CK is about to acquire. After the phone call, Crux searches the Internet for any news of the acquisition but finds nothing. Upon verifying that Orca is on SWIFT's approved stock list, Crux purchases Orca's common stock and call options for selective SWIFT clients. Two weeks later, CK announces its intention to acquire Orca. The next day, Crux sells all of the Orca securities, giving the fund a profit of $3 million. According to the Standards of Practice Handbook, did Crux violate any CFA Institute Standards of Professional Conduct?

   A. No.
   B. Yes, because he traded on material nonpublic information.
   C. Yes, because he only purchased stock and options for selective clients, not all clients.

5. After extensive research, retired portfolio manager Justin Blake, CFA, purchased 20,000 shares of a small public company. He then posted messages on several Internet bulletin boards. The messages read, "This stock is going up once the pending patents are released. You would be crazy to sell anything below $3 in a few months from now. The stock is a buy at anything below $3. I just bought 20 K shares for my personal account. I have done some close research on these guys." According to the Standards of Practice Handbook, Blake most likely violated the Standard or Standards associated with:

   A. Conflicts of Interest and Integrity of Capital Markets.
   B. Integrity of Capital Markets, but not Conflicts of Interest.
   C. Neither Conflicts of Interest nor Integrity of Capital Markets.

6. According to the Global Investment Performance Standards (GIPS):

   A. Firms may not set minimum asset levels for portfolios to be included in a composite.
   B. Composite must be defined according to similar investment objectives and/or strategies
   C. Terminated portfolios must be excluded in the historical returns of appropriate composites.

7. Amanda Covington, CFA, works for McJan Investment Management. McJan employees must receive prior clearance of their personal investments in accordance with McJan's compliance procedures. To obtain prior clearance, McJan employees

must provide a written request identifying the security, the quantity of the security to be purchased, and the name of the broker through which the transaction will be made. As indicated below, Covington received prior clearance.

Security	Quantity	Broker	Prior Clearance
A	100	Easy Trade	Yes
B	150	Easy Trade	Yes

Two days after she received prior clearance, the price of Stock B had decreased so Covington decided to purchase 250 shares of Stock B only. In her decision to purchase 250 shares of Stock B only, did Covington violate any CFA Institute Standards of Professional Conduct?

A. No.
B. Yes, relating to her fiduciary duty to her employer.
C. Yes, relating to her employer's compliance procedures.

8. Miranda Grafton, CFA, purchased a large block of stock on behalf of specific accounts she managed. The stock realized a significant gain in value before the close of business, so Grafton reviewed her accounts again to determine where the block shares should be allocated. According to the Standards of Practice Handbook, Grafton's most appropriate action is to allocate the shares to:

   A. All accounts equally.
   B. All accounts for which she has discretionary authority.
   C. Only those accounts for which the block shares were originally intended.

9. Jiro Sato, CFA, deputy treasurer for May College, manages the Student Scholarship Trust. Sato issued a Request for Proposals (RFP) for domestic equity managers. Pamela Peters, CFA, a good friend of Sato, introduces him to representatives from Capital Investments, who submitted a proposal. Sato selected Capital as a manager based on the firm's excellent performance record. Shortly after the selection, Peters, who had outstanding performance as an equity manager with another firm, accepted a lucrative job with Capital. Which of the CFA charterholders violated CFA Institute Standards of Professional Conduct?

   A. Sato violated Standards.
   B. Peters violated Standards.
   C. Neither violated Standards.

SS2/3-Quantitative Methods

10. Compared to a normal distribution, a lognormal distribution is least likely to be:

A. Skewed to the left.
B. Skewed to the right.
C. Useful in describing the distribution of stock prices.

11. A fundamental analyst studying 100 potential companies for inclusion in her stock portfolio uses the following three screening criteria:

Screening Criterion	Number of Companies meeting the screen
Market-to-Book Ratio >4	20
Current Ratio >2	40
Return on Equity >10%	25

Assuming that the screening criteria are independent, the probability that a given company will meet all three screening criteria is closest to:

A. 2.0%.
B. 8.5%.
C. 20.0%.

12. An analyst determines that only 60 percent of all U.S. pension funds have holdings in hedge funds. In evaluating this probability, a random sample of 50 U.S. pension funds is taken. The number of U.S. pension funds in the sample of 50 that have hedge funds in their portfolio would most accurately be described as a:

A. Binomial random variable.
B. Bernoulli random variable.
C. Continuous random variable.

13. An energy analyst forecasts that the price per barrel of crude oil five years from now will range between USD$175 and USD$205. Assuming a continuous uniform distribution, the probability that the price will be less than USD$180 five years from now is closest to:

A. 5.6%.
B. 16.7%.
C. 44.4%.

14. An analyst gathered the following information about the performance of three categories of mutual funds over the same time period:

Mutual Fund Category	Standard Deviation	Sharpe Ratio
1	18.9%	0,23

2	15.4%	0.35
3	12.8%	0.27

If the returns from all funds were normally distributed, the mutual fund category that minimizes the probability of earning less than the risk-free rate of return is most likely category:

A. 1.
B. 2.
C. 3.

15. Using Chebyshev's inequality, what is the proportion of observations from a population of 250 that must lie within three standard deviations of the mean, regardless of the shape of the distribution?

A. 67%
B. 89%
C. 99%

16. An analyst gathers the following information about a portfolio's performance over the past ten years:

Mean annual return	12.8%
Mean excess return	7.4%
Standard deviation of annual returns	15.7%
Portfolio beta	1.2

The Sharpe ratio is closest to:

A. 0.06
B. 0.47
C. 0.82

SS4/5/6-Economics

17. Which of the following types of unemployment is most likely to be associated with an economy in which many workers have been made obsolete by changing technology?

A. Cyclical
B. Frictional
C. Structural.

18. The primary difference between the McCallum rule and the Taylor rule is that the

McCallum rule:

A. Adjusts the federal funds rate to target the inflation rate.
B. Adjusts the growth rate of the monetary base to target the inflation rate.
C. Makes the quantity of money grow at the growth rate of potential GDP.

19. Which of the following is least likely to resolve or reduce the principal-agent problem in organizations?

A. Ownership
B. Long-term contracts
C. Professional management

20. A company determines that the quantity demanded of a product increases by 5 percent when price is reduced by 10 percent. That product's price elasticity of demand is most accurately described as:

A. elastic.
B. inelastic.
C. perfectly elastic.

21. Challenges to implementing a discretionary fiscal stimulus in a timely manner are least likely to include the:

A. Government payments for unemployment benefits.
B. Need to convince lawmakers that action must be taken.
C. Inability of policymakers to forecast a recession precisely.

22. If a regulatory agency intervenes to reduce prices, a natural monopoly will most likely expand output to the level where:

A. Average cost equals price.
B. Average cost equals marginal revenue.
C. Marginal cost equals marginal revenue.

23. According to the International Financial Reporting Standards framework, which of the following qualities of accounting information is least likely to improve the reliability of accounting information?

A. Neutrality
B. Consistency
C. Substance over form

SS7/8/9/10-Financial Statement Analysis

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

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

Year ended 31 December	2008	2007
Sales	322.8	320.1
Net income	27.2	26.8
Cash flow from operations	15.3	38.1

During 2008 the company most likely decreased the:

A. Proportion of sales made on a cash basis.
B. Inventory, anticipating lower demand for its products in 2009.
C. Proportion of interest-bearing debt relative to trade accounts payable.

25. Due to global oversupply in the micro-chip industry, a company wrote down its 2008 inventory by 4.0 million from €12.0 million. The next year, due to a change in competitive forces in the industry, the market price of these chips rose sharply to 10 percent above their original 2008 value.

If the company prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), its inventory (in €–millions) will most likely be reported at:

A. 8
B. 12
C. 13.2

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

A company accrued wages of $2,000 and collected accounts receivable of $10,000. Which of the following is the most likely effect of these two transactions on the company?

A. Net income will increase.
B. Current ratio will decrease.
C. Cash from operations will decrease.

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

A company had 100,000 common shares outstanding on 1 January 2008. The company has no plans to issue additional shares or purchase Treasury shares during the year, but is planning either a two-for-one stock split or a 100 percent stock dividend on 1 July. The number of shares used to determine earnings per share, at 31 December 2008 will be closest to:

A. 200,000 for both the stock split and the stock dividend.
B. 200,000 for the stock split and 150,000 for the stock dividend.
C. 150,000 for the stock split and 200,000 for the stock dividend.

28. Which of the following is a constraint as defined in the International Financial Reporting Standards (IFRS) Framework for the Preparation and Presentation of Financial Statements?

A. Neutrality
B. Timeliness
C. Going concern

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

Which of the following transactions will most likely result in a decrease in a company's current ratio? The:

A. Recording of a warranty expense.
B. Recording of revenue before cash is received.
C. Payment of an insurance policy for the following year.

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

A cash flow statement where the cash from operations was prepared under the direct method will most likely contain which of the following account titles?

A. Cash received from customers
B. Increase in accounts receivable
C. Cash received from accounts receivable collections.

31. Is the reversal of an inventory writedown permitted under U.S. GAAP and International Financial Reporting Standards (IFRS)?

A. No, under both.
B. Yes, under both.

C. Yes under IFRS, but not under U.S.GAAP.

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

All else equal, compared with using the straight-line method of depreciation, using an accelerated method of depreciation in the early years of an asset's life would most likely result in a decrease in the firm's:

A. Asset turnover ratios.
B. Shareholders' equity
C. Cash flow from operations.

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

During a period of declining prices, a company using the LIFO inventory method instead of FIFO will most likely report:

A. Lower current assets and higher gross income
B. Higher current assets and lower gross income
C. Higher current assets and higher gross income

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

An analyst gathers the following information ($ millions) about four companies operating in the same industry:

Company	Annual Depreciation Expense	Accumulate Depreciation
1	10.8	58.9
2	27.8	80.3
3	33.6	128.8

Although the companies have different levels of sales and assets, they are all experiencing sales growth at about the same rate and use the same type of equipment in the manufacturing process. All four companies also use the same depreciation method. Which company is least likely to require major capital expenditures in the near future? Company:

A. 1.
B. 2.
C. 3.

SS11-Corporate Finance

35. An analyst gathers the following information about the 2008 actual results for a company and its projected sales, cost of goods sola, and assets for 2009:

	2008 actual	2009 projected
Sales	£9,000,000	£9,900,000
Cost of goods sold	£3,000,000	£3,450,000
Total assets	£4,500,000	£4,450,000
Current assets	£1,800,000	
Current liabilities	£1,200,000	

Based on the projected sales increase, the best estimate of 2009 projected current assets is closest to:

A. £1,890,000
B. £1,980,000
C. £2,070,000

36. Which of the following independent situations would most likely be of greatest concern to an investor when reviewing a potential investment's corporate governance practices and policies?

A. Without obtaining prior management approval, the Board hired external consultants to advise them about recent environmental legislative changes related to the company.
B. As part of his compensation package, one director received a bonus for identifying a potential merger candidate. The company is currently negotiating a merger with that company.
C. One of the directors is the president of a major supplier to the company, but he recuses himself from Board decisions related to the product technologies his company suppliers.

37. A company is planning a new issue of $100 par preferred stock with a 12 percent dividend. The preferred stock can be sold for $95 per share and the company must pay flotation costs of 5 percent of the market price. Assuming a marginal tax rate of 40 percent, the after-tax cost of the preferred stock is closest to:

A. 8.0%
B. 12.6%
C. 13.3%

38. An analyst gathered the following information about a company that expects to fund its

capital budget without issuing any additional shares of common stock:

Source of Capital	Capital Structure Proportion	Marginal After-tax Cost
Long-term debt	50%	6%
Preferred stock	10%	10%
Common equity	40%	15%

Net present values of three independent projects	
Warehouse project	$426
Equipment project	$0
Product line project	-$185

If no significant size or timing differences exist among the projects and the projects all have the same risk as the company, which project has an internal rate of return that exceeds 10 percent?

A. All three projects.
B. The warehouse project only.
C. The warehouse project and the equipment project.

39. The post-audit performed as part of the capital budgeting process is least likely to:

A. Improve a firm's operations.
B. Produce concrete ideas for future investments
C. Force management to revise the original forecast to match actual results.

SS13/14-Equity Investments

40. Fundamental analysis most likely requires the analyst to engage in:

A. Extrapolating historical data
B. Performing aggregate market analysis.
C. Detecting the beginning of price movements that lead to new equilibrium prices.

41. A large manufacturing company is in a competitive industry. It has above-average investment opportunities and its return on investments has been above the required rate of return. The firm retains a large portion of earnings to fund its superior investment projects. The company is best characterized as a:

A. Growth company
B. Cyclical company
C. Speculative company

42. A security market with price continuity is most accurately characterized as a market in which:

A. Assets can be bought or sold quickly with minimal transaction costs.
B. Prices change rapidly from one transaction to the next in response to new information.
C. Prices do not change much from one transaction to the next in the absence of new information.

43. A price-weighted series is composed of the following three stocks:

Stock	Number of Shares Outstanding Before Stock Split	Market Price Before Split Day 1	Market Price After Split Day 3
X	1,000,000	$10	$12
Y	5,000,000	$20	$19
Z	4,000,000	$60	$22

If stock Z completes a three-for-one stock split at the end of Day 1, the value of the index after the split (at the end of Day 3) is closest to:

A. 29.9
B. 31.7
C. 32.3

44. An analyst gathers the following information about a company:

Current earnings per share reported	$5.00
Current dividend per share paid on the company's common stock	$3.00
Required rate of return on the company's common stock	15.0%
Return on equity	17.5%

Using the dividend discount model, the value of a share of the company's stock is closest to:

A. $37.50
B. $40.13
C. $73.67

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

Earnings per share-most recent year	$2.00
Expected growth rate of dividends	5.10%

Dividend payout ratio	60%
Stock's beta	1.50
Market risk premium	5.60%
Risk-free rate	4.2%
Company's weighted average cost of capital	12%

Using the dividend discount model, the company's price per share is closest to:

A. $16.00
B. $16.82
C. $18.28

SS17-Derivative Investments

46. A company borrows €15 million from a bank for 1 year at a rate of LIBOR, currently 4.75 percent, plus 50 basis points. At the same time, the company enters a 1-year, plain vanilla interest rate swap to pay the fixed rate of 5.25 percent and receive LIBOR. Payments are made on the basis of 180 days in the settlement period. Floating payments are made on the basis of 360 days in a year while fixed payments are made on the basis of 365 days in a year. LIBOR is 5.00 percent on the first settlement date. The company's total interest expenses for the loan and swap for the first settlement period is closest to:

A. €388,400.
B. €425,900.
C. €444,600.

47. An investor purchases a 3-month put option on a stock with an exercise price of $35. The risk-free rate is 4.5 percent. At expiration, the stock price is $33.50. The option's payoff is closest to:

A. $0.
B. $1.48.
C. $1.50.

48. The following information relates to a futures market contract:

Initial futures price on Day 0	$100
Initial margin requirement	$5
Maintenance margin requirement	$3
Settlement price on Day 1	$103
Settlement price on Day 2	$96
Settlement price on Day 3	$98

If no funds are withdrawn and margin calls are met at the beginning of the next day, the ending balance on Day 3 for an investor with a short position of 10 contracts is closest to:

A. $70.
B. $80.
C. $100.

SS18-Alternative Investments

49. Venture capital investments used to provide capital for companies initiating commercial manufacturing and sales are most likely to be considered a form of:

A. First-stage financing
B. Mezzanine financing
C. Second-stage financing

50. An analyst compared the performance of a hedge fund index with the performance of a major stock index over the past eight years. She noted that the hedge fund index (created from a database) had a higher average return, higher standard deviation, and higher Sharpe ratio than the stock index. All the successful funds that have been in the hedge fund database continued to accept new money over the eight-year period. Are the average return and the standard deviation, respectively, for the hedge fund index most likely overstated?

A. Yes.
B. No, average return is overstated and standard deviation is understated.
C. No, average return is understated and standard deviation is overstated.

51. An analyst estimates that an initial investment of £500,000 in a venture capital project will pay £6 million at the end of five years if the project succeeds and that the probability the project survives to the end of the fifth year is 25 percent. The required rate of return for the project is 19 percent. The expected net present value of the venture capital investment is closest to:

A. £128,000.
B. £1,125,000.
C. £2,014,000.

SS15/16-Fixed Income Investments

52. For amortizing bonds that have the same maturity date and same yield to maturity,

the reinvestment risk for an investor holding the bonds to maturity is greatest for the bonds that are selling at:

A. A premium to par value.
B. A discount to par value as a result of the bonds being issued as zero-coupon bonds.
C. A discount to par value as a result of market yields increasing after the bond was issued.

53. If investors expect stable rates of inflation in the future, the pure expectations theory suggests that the yield curve now will be:

A. Flat
B. Inverted
C. Upward-sloping

54. A portfolio of option-free bonds is least likely to be exposed to:

A. volatility risk
B. yield curve risk
C. reinvestment risk

55. Which of the following provides the most protection to a bondholder?

A. Call protection.
B. Refunding protection.
C. Sinking fund protection.

56. Which embedded option is most beneficial to a bond issuer?

A. A conversion privilege
B. A floor on a floating rate bond.
C. An accelerated sinking fund provision.

57. The most relevant definition for duration is:

A. The first derivative of the security's price.
B. A security's price sensitivity to changes in yield.
C. The weighted-average time until receipt of the present value of cash flows.

SS12-Portfolio Management

58. Which of the following statements about the market portfolio and the capital market

line (CML) is least accurate? The market portfolio:

A. Assumes an equal amount is invested in each risky asset.
B. Is perfectly positively correlated with other portfolios on the CML.
C. Allows the elimination of all unsystematic risk at every point along the CML.

59 An investment strategy that seeks to grow portfolio value over time through capital gains and reinvestment of current income is most likely appropriate if the investment objective is:

A. Total return
B. Current income
C. Capital appreciation.

60. For a retired 65-year-old investor, with moderate risk tolerance and adequate insurance and cash reserves, the appropriate portfolio will most likely have the following mix of bonds and stocks.

	Bonds	Stocks
A	55%-65%	35%-45%
B	30%-40%	60%-70%
C	15%-50%	50%-85%

A. A
B. B
C. C