

2008 Level 1 Sample Exam Volume 3

SS15/16-Fixed Income Investments

1. Is an option-free bond's price sensitivity positively correlated with the:

	<u>Bond's coupon rate?</u>	<u>Level of market interest rates?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

3. A zero coupon bond with a par value of \$1,000 is priced at \$651.38. The bond matures six years from today. Using semiannual compounding, the bond's yield to maturity is closest to:

- A. 6.90%.
- B. 7.02%.
- C. 7.27%.
- D. 7.41%.

5. For collateralized mortgage obligations (CMOs), are prepayment risk and interest rate risk, respectively, different for the various classes (tranches) of bonds?

	<u>Prepayment risk?</u>	<u>Interest rate risk?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

6. At yield levels that are high relative to the bond's coupon rate, is the price of an option-free bond higher than the price of an otherwise identical:

	<u>Callable bond?</u>	<u>Puttable bond?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

SS12-Portfolio Management

8. As an investor continues to move upward on the efficient frontier, which of the following best describes the changes in the:

	<u>Slope of the efficient frontier?</u>	<u>Incremental return per unit of incremental risk?</u>
A.	Increase	Increase
B.	Increase	Decrease
C.	Decrease	Increase
D.	Decrease	Decrease

SS1-Ethics and Professional Standards

13. Regarding the definition of the firm, do the GIPS standards require that total firm assets include the market value of the firm's:

	<u>Nondiscretionary assets under management?</u>	<u>non-fee-paying assets?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

15. David Donnigan enrolled to take the Level II CFA examination in the current year; however, he did not take the exam. Donnigan advised his employer that he was confident that he passed Level II. Did Donnigan violate the CFA Institute Standard of Professional Conduct relating to:

	<u>Professional misconduct?</u>	<u>Duty to employer?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

17. Winnie Wong and William Leung are enrolled to take the Level I CFA examination. Wong and Leung jointly purchased study materials from a well-known CFA review program. Wong made a photocopy of the copyrighted materials and gave the copied materials to Leung. Wong studied from the original materials. Did Wong and Leung, respectively, violate the CFA Institute Code of Ethics or any Standards of Professional Conduct?

	<u>Wong</u>	<u>Leung</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

SS2/3-Quantitative Methods

19. If the observations in a dataset have different values, is the geometric mean for that dataset greater than that dataset's:

	<u>Harmonic mean?</u>	<u>Arithmetic mean?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

20. An analyst gathered the following information (\$ millions) about the performance of a portfolio:

Quarter	Value at Beginning of Quarter (prior to inflow or outflow)	Cash Inflow (Outflow) At Beginning of Quarter	Value at End of Quarter
1	2.0	0.2	2.4
2	2.4	0.4	2.6
3	2.6	(0.2)	3.2
4	3.2	1.0	4.1

The portfolio's annual time-weighted rate of return is closest to:

- A. 8%.
B. 27%.
C. 32%.
D. 60%.

22. A mutual fund manager wants to create a fund based on a high-grade corporate bond index. She first distinguishes between utility bonds and industrial bonds; she then, for each segment, defines maturity intervals of less than 5 year, 5 to 10 years, and greater than 10 years. For each segment and maturity level, she classifies the bonds as callable or non-callable. For the manager's sample, which of the following best describes the:

	<u>Sampling approach?</u>	<u>Number of sampling cells?</u>
A.	Simple random sample	3
B.	Simple random sample	12
C.	Stratified random sample	3
D.	Stratified random sample	12

SS4/5/6-Economics

27. Costs included in the determination of a company's economic profit that are *most likely* to be included in that company's accounting costs are:

- A. Explicit costs.
 B. Implicit costs.
 C. Opportunity costs associated with labor provided by the company's owners.
 D. Opportunity costs associated with equity capital provided by the company's owners.
28. Which of the following fiscal policy models is most likely to support the conclusion that government budget deficits will stimulate aggregate demand?
- A. Keynesian.
 B. Supply-side.
 C. New classical.
 D. Crowding-out.
29. In order to implement a more expansionary monetary policy, would an effective strategy for a government's central bank include:
- | | <u>Selling the government's securities?</u> | <u>Raising reserve requirements?</u> |
|----|---|--------------------------------------|
| A. | No | No |
| B. | No | Yes |
| C. | Yes | No |
| D. | Yes | Yes |
31. In perfectly competitive constant-cost industries and perfectly competitive increasing-cost industries, respectively, what is the most likely long-run effect of a permanent increase in demand?

	<u>Constant-cost industry</u>	<u>Increasing-cost industry</u>
A.	Price decreases	Price decreases
B.	Price decreases	Price remains unchanged
C.	Price remains unchanged	Price increases
D.	Price remains unchanged	Price remains unchanged

SS7/8/9/10-Financial Statement Analysis

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

An analyst gathered the following information about Waynesboro, Inc.'s common stock:

- 1 January 2007 180,000 shares outstanding
- 1 June 2007 60,000 shares issued
- 1 August 2007 2-for-1 stock split
- 31 December 2007 480,000 shares outstanding

To calculate earnings per share for 2007, Waynesboro's weighted average number of shares outstanding is closest to:

- A. 210,000.
- B. 215,000.
- C. 420,000.
- D. 430,000.

33. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Carlton Company uses the LIFO inventory method, but most of the other companies in Carlton's industry use FIFO. Which of the following best describes one of the adjustments that would be made to Carlton's financial statements to compare Carlton with other companies in the industry? An increase in Carlton's LIFO reserve for the year would be:

- A. Added to ending inventory.
- B. Added to cost of goods sold.
- C. Subtracted from ending inventory.
- D. Subtracted from cost of goods sold.

34. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. A company entered into a three-year construction project with a total contract price of \$5.3 million and expected cost of \$4.4 million. The following table provides cash flow information relating to the contract:

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
Costs incurred and paid	\$600,000	\$3,000,000	\$800,000
Amounts billed and payments received	\$1,200,000	\$2,800,000	\$1,300,000

What is the cumulative effect of the contract on the cash balance that would have been recorded on the company's balance sheet at the end of Year 2 using the:

	<u>percentage-of-completion method?</u>	<u>completed contract method?</u>
A.	\$400,000	\$0
B.	\$400,000	\$400,000
C.	\$2,800,000	\$0
D.	\$2,800,000	\$400,000

35. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst gathered the following information (U.S. \$ millions) for two companies operating in the same industry during the same period:

	<u>Butler Enterprises</u>	<u>Annandale Corporation</u>
Net sales	\$120	\$300

Total assets	\$70	\$140
Total liabilities	\$25	\$40

If both companies achieved a return on equity of 15 percent for the period, the company most likely to have the higher net profit margin and higher financial leverage multiplier, respectively, is:

	<u>Higher net profit margin</u>	<u>Higher financial leverage multiplier</u>
A.	Butler	Butler
B.	Butler	Annandale
C.	Annandale	Butler
D.	Annandale	Annandale

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

On January 2, 2005, Lyon Limited bought a piece of manufacturing equipment for \$250,000. At that time they estimated its useful life to be 10 years and its salvage value to be \$10,000. During 2007, it became apparent that the equipment was wearing out more quickly than they had originally estimated. It now appeared that its useful life would only be 6 years in total. If Lyon Limited uses the straight-line method for depreciation and has a policy of only taking one-half year's depreciation in the year of acquisition, the depreciation expense on this piece of equipment for 2007 will be closest to:

- A. \$48,000.
- B. \$51,000.
- C. \$53,125.
- D. \$60,000.

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

GreenTech Incorporated recently paid more than the net book value to acquire Cleanway Corporation. Cleanway operates an active research and development program into environmentally friendly clearing products. GreenTech is very interested in this research program as well as the good management team in place at Cleanway. The excess price paid over the net book value of the assets should be accounted for on GreenTech's financial statements as:

- A. Goodwill
- B. A trademark.
- C. An expense in the period of acquisition.
- D. An intangible asset, research and development.

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

An adjustment to operating income for the effects of a change in LIFO reserves will most likely be required if the change in the LIFO reserve is the result of:

- A. Price declines.
- B. Price increases.

- C. A decrease in the number of units held in inventory.
- D. An increase in the number of units held in inventory.

39. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. All else equal, will a company's implementation of the accounting standard (SFAS 143) related to asset retirement obligations incurred because of environmental damage *most likely* increase or decrease that company's:

	<u>Return on assets?</u>	<u>Net income?</u>
A.	Increase	Increase
B.	Increase	Decrease
C.	Decrease	Increase
D.	Decrease	Decrease

40. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Crockett, Inc. had 100,000 shares of common stock outstanding on 1 January 2007. The company has no plans to issue additional shares or purchase treasury shares during the year, but does plan either a 2-for-1 stock split or a 100% stock dividend on 1 July. The number of shares that will be used to determine earnings per share at 31 December 2007, if the company uses the 2-for-1 stock split or 100% stock dividend, respectively, is closest to:

	<u>2-for-1 stock split</u>	<u>100% stock dividend</u>
A.	150,000	150,000
B.	150,000	200,000
C.	200,000	150,000
D.	200,000	200,000

42. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. During inflationary periods, a company's reported net income is *least likely* to be overstated relative to economic income if the company depreciates fixed assets using:

- A. Accelerated depreciation and long average lives.
- B. Accelerated depreciation and short average lives.
- C. Straight-line depreciation and long average lives.
- D. Straight-line depreciation and short average lives.

43. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Two companies are identical except for their accounting treatment of research and development costs. One company expenses all such costs immediately, while the other company capitalizes a portion of the costs. Compared to the company that capitalizes costs, the company that expenses immediately will most likely:

- A. Earn a lower return on assets.
- B. Have lower financial leverage.

- C. Exhibit a smoother pattern of net income over time.
- D. Report lower cash flow from operations in the statement of cash flows.

SS11-Corporate Finance

44. An analyst is developing net present value (NPV) profiles for two investment projects being considered by a company. The only difference between the two projects is that Project 1 is expected to receive larger cash flows early in the life of the project, while Project 2 is expected to receive larger cash flows late in the life of the project. Compared to Project 1, which of the following best describes the:

	<u>Slope of the NPV profile for Project 2?</u>	<u>Sensitivity of the NPV for Project 2 to changes in the company's cost of capital?</u>
A.	Flatter	Less sensitive
B.	Flatter	More sensitive
C.	Steeper	Less sensitive
D.	Steeper	More sensitive

45. Two techniques for forecasting cash flows are to use projection models and averages, or statistical techniques. Which of these two methods would be most appropriate for:

	<u>Medium-term forecasting?</u>	<u>Long-term forecasting?</u>
A.	Statistical techniques	Statistical techniques
B.	Statistical techniques	Projection models and average
C.	Projection models and averages	Statistical techniques
D.	Projection models and averages	Projection models and averages

46. In comparing the use of the IRR and NPV methods to make decisions on mutually exclusive capital projects for a specific firm, which of the following statements is least accurate?

- A. The IRR method can result in multiple values.
- B. The NPV rankings depend on the cost of capital.
- C. The IRR method has the more appropriate reinvestment rate assumption.
- D. The IRR method contains valuable information about a project's "safety margin" by comparing the IRR to the cost of capital.

39. Sorbonne Systems Incorporated wants to determine the cost of equity that can be used in the calculation of the weighted average cost of capital. The CFO has gathered the following information:

Rate of return on 3-month Treasury bills	3.0%
Rate of return on 10-year Treasury bonds	3.5%

Market equity risk premium	6.0%
Sorbonne's estimated beta	1.6
Sorbonne's before-tax cost of debt	8.0%
Risk premium of equity over debt	4.0%

Using the capital asset pricing model (CAPM) approach and the bond yield plus risk premium approach, respectively, the cost of equity for Sorbonne is closest to:

	<u>CAPM</u>	<u>Bond yield plus risk premium</u>
A.	12.6%	12%
B.	12.6%	14%
C.	13.1%	12%
D.	13.1%	14%

48. As part of working capital management, the short-term investment strategy that has the highest degree of risk for an entity and requires highly accurate and reliable forecasts of cash flows is:

- A. A matching strategy.
- B. A laddering strategy.
- C. A mismatching strategy.
- D. A money market strategy.

SS13/14-Equity Investments

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

Stock	Number of Shares Outstanding	Price
A	1,000,000	\$10
B	5,000,000	\$20
C	6,000,000	\$60

If stock C completes a two-for-one stock split, the value of the index after the split will be closest to:

- A. 20.
- B. 30.
- C. 97.
- D. 157.

50. With respect to the three forms of the efficient market hypothesis (EMH), is the information set associated with the weak-form of the EMH best described as including all information associated with the:

	Semistrong-form of the EMH?	Strong-form of the EMH?
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

51. An analyst gathered the following information about a company:

Return on equity	20.0%
Earnings retention rate	50.0%
Current dividend per share (D_0) paid on the company's common stock	€2.00
Required rate of return on the company's common stock	15.0%
Beta for the company's stock	0.8

The stock is currently selling for €50 per share. Which of the following best characterizes the:

	<u>Intrinsic value of the stock?</u>	<u>Type of stock?</u>
A.	€40	Cyclical
B.	€40	Speculative
C.	€44	Cyclical
D.	€44	Speculative

52. Which of the following describes the *most* direct function of:

	<u>Primary capital markets?</u>	<u>Secondary capital markets?</u>
A.	Source of liquidity	Security underwriting
B.	Source of liquidity	Source of new capital
C.	Source of new capital	Source of liquidity
D.	Source of new capital	Security underwriting

53. For an analyst evaluating the common stock of a financial institution that reported a small loss for the year just ended, the price multiple that is least likely to be meaningful is:

- A. price to cash flow.
- B. price to book value.
- C. leading price to earnings.
- D. trailing price to earnings.

54. Attractive investment opportunities as a country's economy slows or goes into recession would include:

- A. commodities.
- B. interest-rate-sensitive stocks.
- C. cyclical stocks and commodities.

D. commercial and residential properties.

SS17-Derivative Investments

56. Which of the following uncovered positions is *most likely* to have a graph that looks like the graph for a:

	<u>Protective put?</u>	<u>Covered call?</u>
A.	Long call	Long put
B.	Long call	Short put
C.	Short call	Long put
D.	Short call	Short put

57. Dwayne, Inc., goes long (buys) a 90-day forward rate agreement (FRA) with a dealer in London. The notional principal is \$20 million and the underlying rate is 180-day LIBOR that the dealer quotes at 6.0 percent. At expiration of the contract, 180-day LIBOR is 6.5 percent. The payment that must be made to settle the contract is closest to:

- A. \$24,213 from Dwayne to the dealer.
- B. \$24,213 from the dealer to Dwayne.
- C. \$48,426 from Dwayne to the dealer.
- D. \$48,426 from the dealer to Dwayne.

SS18-Alternative Investments

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

	<u>Correlation with traditional stock or bond investments</u>	<u>Correlation with inflation</u>
A.	Positive	Positive
B.	Positive	Negative
C.	Negative	Positive
D.	Negative	Negative