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| **1** | Which of the following *least likely* reflects the two primary principles of the CFA Institute Rules of Procedure for Professional Conduct? | | | | |
|  |  | **A.** Confidentiality of proceedings |  |  |  |
|  |  | **B.** Fair process to the member and candidate |  |  |  |
|  |  | **C.** Public disclosure of disciplinary sanctions |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Code of Ethics and Standards of Professional Conduct," CFA Institute 2011 Modular Level I, Vol. 1, p. 8 Study Session 1–1–a Describe the structure of the CFA Institute Professional Conduct Program and the process for the enforcement of the Code and Standards.  The two principles of the Rules of Procedure for Professional Conduct are confidentiality of proceedings and fair process to the member and candidate. | | | | |

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| **2** | Fundamental Asset Managers (FAM) claims compliance with the CFA Institute Global Investment Performance Standards (GIPS®) and manages both discretionary and nondiscretionary accounts. Juma Dzuya, CFA, includes all discretionary, fee-paying value and growth accounts when constructing a composite for FAM. Does the composite Dzuya constructed *most likely* meet GIPS criteria? | | | | |
|  |  | **A.** Yes. |  |  |  |
|  |  | **B.** No, because value and growth accounts are included. |  |  |  |
|  |  | **C.** No, because nondiscretionary accounts are not included. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  Introduction to the Global Investment Performance Standards (GIPS®), CFA Institute 2011 Modular Level I, Vol. 1, p. 173 Study Session 1–3–b Explain the construction and purpose of composites in performance reporting.  A composite must include all actual, fee-paying, discretionary portfolios managed in accordance with the same investment mandate, objective, or strategy. By including both value and growth accounts, the composite is made up of portfolios with different investment mandates or strategies. | | | | |

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| **3** | Adira Badawi, CFA, who owns a research and consulting company, is an independent board member of a leading cement manufacturer in a small local market. Based on Badawi’s expertise in the cement industry, a foreign cement manufacturer looking to enter the local market has hired him to undertake a feasibility study. Under what circumstances can Badawi *most likely* undertake the assignment without violating the CFA Code of Ethics and Standards of Professional Conduct? | | | | |
|  |  | **A.** If he makes full disclosure to both companies. |  |  |  |
|  |  | **B.** If he receives written permission from the local company. |  |  |  |
|  |  | **C.** If he signs confidentiality agreements with both companies. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Guidance for Standards I–VII," CFA Institute 2011 Modular Level I, Vol. 1, pp. 123–125 Study Session 1–2–c Recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct.  Making full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients is required by Standard VI, Conflicts of Interest, of the CFA Code of Ethics and Standards of Professional Conduct. | | | | |

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| **4** | Noor Mawar, CFA, manages a trust fund for an orphaned 18-year-old student. The trust assets are expected to provide the beneficiary with a stable, low-risk source of income until she reaches 30. The student asks Mawar to invest in a new business venture expected to provide a handsome income return over the next 10 to 25 years as was discussed on an Internet blog. Mawar ignores the request, instead securing conservative investments to provide sufficient income. Did Mawar *most likely* violate the CFA Code of Ethics and Standards of Professional Conduct? | | | | |
|  |  | **A.** Yes. |  |  |  |
|  |  | **B.** No, because the client’s objectives were met. |  |  |  |
|  |  | **C.** No, because the student’s age allows for a high-risk profile. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Guidance for Standards I–VII," CFA Institute 2011 Modular Level I, Vol. 1, pp. 78–80 Study Session 1–2–b Distinguish between conduct that conforms to the Code and Standards and conduct that violates the Code and Standards.  The client is the trust/trustees, not the beneficiary. Mawar followed Standard III(C), Duties to Clients (Suitability), by managing the assets in a way that would likely result in a stable source of income while keeping the risk profile low. | | | | |

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| **5** | Vishal Chandarana, an unemployed research analyst, recently registered for the CFA Level I exam. After two months of intense interviewing, he accepts a job with a stock brokerage company in a different region of the country. While posting on his social networking webpage he brags about how being a CFA Candidate really helped him get a job. He adds he was so relieved his new employer didn’t ask about his being fired from his former employer. Which CFA Code of Ethics or Standards of Professional Conduct did Chandarana *least likely* violate? | | | | |
|  |  | **A.** Integrity |  |  |  |
|  |  | **B.** Duties to Employers |  |  |  |
|  |  | **C.** Reference to the CFA Program |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Guidance for Standards I–VII," CFA Institute 2011 Modular Level I, Vol. 1, pp. 46–47, 90–91, 145–147 Study Session 1–2–a, b Demonstrate a thorough knowledge of the Code of Ethics and Standards of Professional Conduct by applying the Code and Standards to situations involving issues of professional integrity. Distinguish between conduct that conforms to the Code and Standards and conduct that violates the Code and Standards.  There is no evidence that Chandarana violated Standard VII(B) with regard to his being a CFA Candidate. It does appear that Chandarana did not act with integrity when he hid information that could potentially harm his new employer's reputation, thus violating Standard I(C), Professionalism (Misrepresentation), and Standard IV(A), Duty to Employers (Loyalty). | | | | |

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| **6** | Kam Bergeron, CFA, is an equity portfolio manager who often takes time off in the afternoon to play golf with important clients. Today, Bergeron is on the golf course when his game is interrupted by a phone call from his office. The call is from Bergeron’s assistant, who notifies him of a steep and accelerating market decline. Bergeron, eager to get back to his clients, tells his assistant to raise cash by selling 15 percent of all clients’ holdings. Bergeron instructs his assistant to first sell the most liquid stocks in each client’s portfolio and then do the same for his personal account. Bergeron is *least likely* to be in violation of which CFA Institute Standards of Professional Conduct? | | | | |
|  |  | **A.** Suitability |  |  |  |
|  |  | **B.** Priority of transactions |  |  |  |
|  |  | **C.** Diligence and reasonable basis |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  CFA Institute Standards 2011 Modular Level I, Vol. 1, pp. 76, 105, 114, 131 Study Session 1–2–b Distinguish between conduct that conforms to the Code and Standards and conduct that violates the Code and Standards.  There is no indication that a violation of this standard (VI(B), Conflicts of Interest (Priority of Transactions)) occurred. The standard concerns transactions for clients having priority over employees' transactions and is not applicable in this case since the manager sells his personal holdings after clients' holdings. | | | | |

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| **7** | Ileana Inkster, CFA, was recently offered a senior management position with the trust department of a regional bank. The department is new but the bank has plans to expand it significantly over the next few months. Inkster has been told she needs to aid that growth and has been asked to have her department conduct educational seminars and then pursue new business by follow-up contacts with the attendees. Inkster notices that advertisements for upcoming seminars, prepared by the marketing department, do not mention any investment products. The ads indicate attendees can “learn how to immediately add $100,000 to their net worth.” What is the first action Inkster *most likely* should take to avoid violating any CFA Institute Standards of Professional Conduct? | | | | |
|  |  | **A.** Decline to accept the new position. |  |  |  |
|  |  | **B.** Accept the position and revise the marketing material. |  |  |  |
|  |  | **C.** Accept the position but bring the lack of procedures to the attention of senior management. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Code of Ethics and Standards of Professional Conduct," CFA Institute 2011 Modular Level I, Vol. 1, p. 99 Study Session 1–2–c Recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct.  The prospective supervisor's first step should be to bring the inadequate compliance system to the attention of the firm's senior managers and recommend corrective action before taking the position. This may be accomplished by the supervisor taking on an interim consulting role with the bank in order to implement adequate procedures before taking on the supervisory role. | | | | |

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| **8** | Molly Burnett, CFA, is a portfolio manager that specializes in investing in environmentally friendly companies. A multinational utility company recently acquired one of Burnett’s best performing investments, a wind power company. The wind power company’s shareholders received utility company shares as part of the merger agreement. The utility has one of the worst environmental records in the industry, but its shares have been one of the top performers over the past 12 months. Because the utility pays a high dividend every three months, Burnett holds the utility shares until the remaining two dividends are paid for the year, and then sells the shares. Burnett *most likely* violated the CFA Institute Standards of Professional Conduct concerning: | | | | |
|  |  | **A.** suitability. |  |  |  |
|  |  | **B.** disclosure of conflicts. |  |  |  |
|  |  | **C.** independence and objectivity. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Code of Ethics and Standards of Professional Conduct," CFA Institute 2011 Modular Level I, Vol. 1, pp. 25, 76, 121 Study Session 1–2–b Distinguish between conduct that conforms to the Code and Standards and conduct that violates the Code and Standards.  The utility is not a suitable investment for clients who desire investments in companies with good environmental records. | | | | |

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| **9** | Pia Nilsson is a sole proprietor investment advisor. The economic recession has reduced the number of clients that she advises and her revenues. As a result, Nilsson has not paid her CFA Institute membership dues for the past two years. When a national financial publication interviewed Nilsson recently, she indicated that she had been a CFA charterholder for many years. In addition, she stated that the completion of the CFA program contributed to her successful career, enhanced her portfolio management skills, and enabled her to achieve superior returns and performance results. Nilsson’s actions concerning which of the following *most likely* violated the CFA Institute Standards of Professional Conduct? | | | | |
|  |  | **A.** Discussion of the CFA Program |  |  |  |
|  |  | **B.** Nonpayment of CFA Institute Membership dues |  |  |  |
|  |  | **C.** Statement about being a CFA charterholder |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Code of Ethics and Standards of Professional Conduct," CFA Institute 2011 Modular Level I, Vol. 1, p. 137 Study Session 1–2–b Distinguish between conduct that conforms to the Code and Standards and conduct that violates the Code and Standards.  The reference to the superior management abilities ascribed to the CFA Program is improper. An appropriate reference would be to indicate "completion of the CFA Program has enhanced my portfolio management skills." | | | | |
|  | **说明：** 完成检查您对此考题的结果并准备好继续下一考题时，单击Continue（继续）按键。 | | | | |

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| **10** | An analyst has established the following prior probabilities regarding a company’s next quarter’s earnings per share (EPS) exceeding, equaling, or being below the consensus estimate.   |  |  | | --- | --- | |  | **Prior probabilities** | | EPS exceed consensus | 25% | | EPS equal consensus | 55% | | EPS are less than consensus | 20% |   Several days before releasing its earnings statement, the company announces a cut in its dividend. Given this information, the analyst revises his opinion regarding the likelihood that the company will have EPS below the consensus estimate. He estimates the likelihoods the company will cut the dividend given that EPS exceed/meet/fall below consensus as reported below.   |  |  | | --- | --- | |  | **Probabilities the company cuts dividends conditional on EPS exceeding/equaling/falling below consensus** | | P(Cut div | EPS exceed) | 5% | | P(Cut div | EPS equal) | 10% | | P(Cut div | EPS below) | 85% |   Based on this analysis, the updated (posterior) probability that the company’s EPS are below the consensus is *closest* to: | | | | |
|  |  | **A.** 72%. |  |  |  |
|  |  | **B.** 85%. |  |  |  |
|  |  | **C.** 100%. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Probability Concepts," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, pp. 467–471 Study Session 2–8–n Calculate and interpret an updated probability using Bayes' formula.  First, calculate the unconditional probability for a cut in dividends:   |  |  | | --- | --- | | P(Cut div) = | P(Cut div | EPS exceed) × P(EPS exceed) + | |  | P(Cut div | EPS equal) × P(EPS equal) + | |  | P(Cut div | EPS below) × P(EPS below) | | = | (0.05 × 0.25) + (0.10 × 0.55) + (0.85 × 0.20) = 0.2375 | | Then update the probability of EPS falling below the consensus as: | | | P(EPS below | Cut div) = | [P(Cut div | EPS below) / P(Cut div)] × P(EPS below) | | = | (0.85 / 0.2375) × 0.20 = 0.71579 = 72% | | | | | |

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| **11** | If the distribution of the population from which the samples are drawn is positively skewed, the sampling distribution of the sample means for samples drawn from that population is *most likely*: | | | | |
|  |  | **A.** approximately normally distributed. |  |  |  |
|  |  | **B.** to have a variance equal to the entire population. |  |  |  |
|  |  | **C.** to have a mean smaller than the mean of the entire population. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Sampling and Estimation," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, pp. 556–559 Study Session 3–10–d Interpret the central limit theorem and describe its importance.  The central limit theorem establishes that the sampling distribution of sample means will be approximately normal, will have a mean equal to the population mean, and will have a variance equal to the population variance divided by the sample size. | | | | |

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| **12** | A project offers the following incremental after-tax cash flows:   |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | | **Year** | **0** | **1** | **2** | **3** | **4** | | **Cash flow (€)** | –12,500 | 2,000 | 4,000 | 5,000 | 2,000 |   The appropriate discount rate to use in evaluating the project is 8 percent. The NPV (in €) of the project is *closest* to: | | | | |
|  |  | **A.** –1,780. |  |  |  |
|  |  | **B.** –1,736. |  |  |  |
|  |  | **C.** 474. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Discounted Cash Flow Applications," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, pp. 312–314 "Capital Budgeting," John D. Stowe, CFA, and Jacques R. Gagne, CFA 2011 Modular Level I, Vol. 4, pp. 10–11 Study Sessions 2–6–a, 11–44–d Calculate and interpret the net present value (NPV) and the internal rate of return (IRR) of an investment. Calculate and interpret the results using each of the following methods to evaluate a single capital project: net present value (NPV), internal rate of return (IRR), payback period, discounted payback period, and profitability index (PI).  Enter the given cash flows and the given discount rate into a financial calculator and solve for NPV. The NPV is –1,780 (negative 1,780). | | | | |

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| **13** | Over a four-year period, a portfolio has returns of 10 percent, –2 percent, 18 percent, and –12 percent. The geometric mean return across the period is *closest* to: | | | | |
|  |  | **A.** 2.9%. |  |  |  |
|  |  | **B.** 3.5%. |  |  |  |
|  |  | **C.** 8.1%. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Statistical Concepts and Market Returns," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, pp. 370–373 Study Session 2–7–e Define, calculate, and interpret measures of central tendency, including the population mean, sample mean, arithmetic mean, weighted average or mean (including a portfolio return viewed as a weighted mean), geometric mean, harmonic mean, median, and mode.  The geometric mean return is calculated as [(1 + 0.10) × (1 – 0.02) × (1 + 0.18) × (1 – 0.12)]0.25 – 1 = 0.0286 => 2.9% | | | | |

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| **14** | Monte Carlo simulation is *best* described as: | | | | |
|  |  | **A.** an approach to back testing data. |  |  |  |
|  |  | **B.** providing exact analytic solutions to complex functions. |  |  |  |
|  |  | **C.** providing a distribution of possible solutions to complex functions. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Common Probability Distributions," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, pp. 528–535 Study Session 3–9–p Explain Monte Carlo simulation and historical simulation and describe their major applications and limitations.  Monte Carlo simulation provides a distribution of possible solutions to complex functions. The central tendency and the variance of the distribution of solutions give important clues to decision-makers regarding expected results and risk. | | | | |

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| **15** | A subset of a population is *best* described as a: | | | | |
|  |  | **A.** sample. |  |  |  |
|  |  | **B.** statistic. |  |  |  |
|  |  | **C.** parameter. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Statistical Concepts and Market Returns," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, p. 343 Study Session 2–7–a, b Differentiate between descriptive statistics and inferential statistics, between a population and a sample, and among the types of measurement scales. Define a parameter, a sample statistic, and a frequency distribution.  A sample is a subset of a population. | | | | |

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| **16** | Assume that the real risk-free rate of return is 3 percent and that the expected inflation premium is 5 percent. If the risk premium incorporates default risk, liquidity risk, and any maturity premium, an observed (nominal) interest rate of 12 percent implies that the risk premium is *closest* to: | | | | |
|  |  | **A.** 2%. |  |  |  |
|  |  | **B.** 4%. |  |  |  |
|  |  | **C.** 8%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "The Time Value of Money," Richard A. DeFusco, CFA, Dennis W. McLeavey, CFA, Jerald E. Pinto, CFA, and David E. Runkle, CFA 2011 Modular Level I, Vol. 1, pp. 256–258 Study Session 2–5–b Explain an interest rate as the sum of a real risk-free rate, expected inflation, and premiums that compensate investors for distinct types of risk.  The nominal rate is equal to the real risk-free rate of return plus an inflation premium plus risk premiums (default, liquidity, maturity preference). In this case, 12 = 3 + 5 + X. Solve for X. X = 4. | | | | |

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| **17** | Which of the following government interventions in market forces is *most likely* to cause underproduction? | | | | |
|  |  | **A.** Subsidies |  |  |  |
|  |  | **B.** Price floors |  |  |  |
|  |  | **C.** Production quotas |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Markets in Action," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 87–89 Study Session 4–15–d Discuss the impact of subsidies, quotas, and markets for illegal goods on demand, supply, and market equilibrium.  Production quotas are most likely to result in underproduction. | | | | |

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| **18** | Demand for a good is *most likely* to be more elastic when: | | | | |
|  |  | **A.** the good is a necessity. |  |  |  |
|  |  | **B.** a lesser proportion of income is spent on the good. |  |  |  |
|  |  | **C.** there has been a longer time since the price change. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Elasticity," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 16–18 Study Session 4–13–a Calculate and interpret the elasticities of demand (price elasticity, cross elasticity, and income elasticity) and the elasticity of supply, and discuss the factors that influence each measure.  The longer the time that has elapsed since a price change, the more elastic is demand. | | | | |

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| **19** | If the currency drain ratio is 1.05 and the desired reserve ratio is 0.20, the money multiplier is *closest* to: | | | | |
|  |  | **A.** 1.26. |  |  |  |
|  |  | **B.** 1.64 |  |  |  |
|  |  | **C.** 5.25. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Money, the Price Level, and Inflation," Michael Parkin 2011 Modular Level I, Vol. 2, p. 379 Study Session 6–24–f Describe the monetary base and explain the relation among the monetary base, the money multiplier, and the quantity of money.   The money multiplier is calculated as 1 plus the currency drain ratio divided by the sum of the currency drain ratio and the desired reserve ratio. In this problem, the money multiplier is (1 + 1.05) / (1.05 + 0.20) = 1.64. | | | | |

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| **20** | An economy in which all firms and individuals, whether suppliers or consumers, accept the market price as their transaction price is *best* described as: | | | | |
|  |  | **A.** an oligopoly. |  |  |  |
|  |  | **B.** perfectly competitive. |  |  |  |
|  |  | **C.** monopolistic competition. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Perfect Competition," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 160–161 Study Session 5–18–a Describe the characteristics of perfect competition, explain why companies in a perfectly competitive market are price takers, and differentiate between market and company demand curves.   Firms in perfect competition are price takers. A price taker is a firm that cannot influence the market price and that sets its own price at the market price. | | | | |

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| **21** | Suppose that at a tax rate of 85 percent, a nation’s growth rate in GDP is 2 percent and its tax revenue is the equivalent of $100 billion. If the nation reduces its tax rate to 50 percent, growth rate of GDP becomes 6 percent, and tax revenue increases to $120 billion. Such a possibility is *best* described as an example that is consistent with the: | | | | |
|  |  | **A.** tax wedge. |  |  |  |
|  |  | **B.** Laffer curve. |  |  |  |
|  |  | **C.** Phillips curve. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Fiscal Policy," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 435–436 Study Session 6–26–a Explain supply-side effects on employment, potential GDP, and aggregate supply, including the income tax and taxes on expenditure, and describe the Laffer curve and its relation to supply-side economics.  The Laffer curve argues that when a nation reduces its tax rate from a "too high" tax rate, economic growth will be stimulated to such a degree that tax revenue to the government will actually increase. It is difficult to define exactly how high "too high" is. | | | | |

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| **22** | In the United States, monetary policy is *primarily* a function of the: | | | | |
|  |  | **A.** Congress. |  |  |  |
|  |  | **B.** President. |  |  |  |
|  |  | **C.** Federal Reserve System. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Monetary Policy," Michael Parkin 2011 Modular Level I, Vol. 2, p. 463 Study Session 6–27–a, b Discuss the goals of U.S. monetary policy and the Federal Reserve System's means for achieving the goals, including how the Fed operationalizes those goals. Describe how the Fed conducts monetary policy, and explain the Fed's decision-making strategy, including an instrument rule, a targeting rule, open-market operations, and the market for reserves.  In the United States, the Federal Reserve System is primarily responsible for monetary policy. | | | | |

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| **23** | Which of the following is *least likely* to appear in a company’s proxy statement? | | | | |
|  |  | **A.** Compensation arrangements for management and directors |  |  |  |
|  |  | **B.** Significant events and contingencies that may affect future operations |  |  |  |
|  |  | **C.** Potential conflicts of interest between management, directors, and shareholders |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Financial Statement Analysis: An Introduction," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 18, 23 Study Session 7–29–c, e Discuss the importance of financial statement notes and supplementary information, including disclosures of accounting methods, estimates, and assumptions, and management's discussion and analysis. Identify and explain information sources other than annual financial statements and supplementary information that analysts use in financial statement analysis.  Significant events, conditions, trends, and contingencies that may affect future operations are contained in Management's Discussion and Analysis. Compensation agreements for directors and management and their potential conflicts of interest are required in the proxy statement. | | | | |

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| **24** | At the start of the year, a company’s capital contributed by owners and retained earnings accounts had balances of $10,000 and $6,000, respectively. During the year, the following events took place:   |  |  | | --- | --- | | Net income earned | $4,000 | | Interest paid on debt | $   500 | | Repayment of long-term debt | $1,000 | | Proceeds from shares issued | $1,000 | | Dividends paid | $   600 |   The end-of-year owners’ equity is *closest* to: | | | | |
|  |  | **A.** $19,400. |  |  |  |
|  |  | **B.** $19,900. |  |  |  |
|  |  | **C.** $20,400. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Financial Reporting Mechanics," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Karen O'Connor Rubsam, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 38–43 Study Session 7–30–b, e Explain the accounting equation in its basic and expanded forms. Explain the relationships among the income statement, balance sheet, statement of cash flows, and statement of owners' equity.   |  |  |  | | --- | --- | --- | | Start-of-year capital contributed by owners | | $10,000 | | Additional shares issued | | 1,000 | | Initial retained earnings | | 6,000 | | Net income | 4,000 |  | | Dividends paid | (600) |  | | Increase in retained earnings | 3,400 | 3,400 | | Ending owners' equity | | **$20,400** | | | | | |

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| **25** | A retailer provides credit cards only to its most valued customers who pass a rigorous credit check. A credit card customer ordered an item from the retailer in May. The item was shipped and delivered in July. The item appeared on the customer’s July credit card statement and was paid in full by the due date in August. The *most appropriate* month in which the retailer should recognize the revenue is: | | | | |
|  |  | **A.** May. |  |  |  |
|  |  | **B.** July. |  |  |  |
|  |  | **C.** August. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Understanding the Income Statement," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 144–145 Study Session 8–32–b Explain the general principles of revenue recognition and accrual accounting, demonstrate specific revenue recognition applications (including accounting for long-term contracts, installment sales, barter transactions, and gross and net reporting of revenue), and discuss the implications of revenue recognition principles for financial analysis.  The appropriate time to recognize revenue would be in the month of July, the risk and rewards have been transferred to the buyer (shipped and delivered), the revenue can be reliably measured, and it is probable that the economic benefits will flow to the seller (the rigorous credit check was completed). Neither the actual payment date nor the credit card statement date is relevant here. | | | | |

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| **26** | Which of the following will *most likely* result in an increase in a company’s sustainable growth rate? | | | | |
|  |  | **A.** Higher tax burden ratio |  |  |  |
|  |  | **B.** Lower interest burden ratio |  |  |  |
|  |  | **C.** Higher dividend payout ratio |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Financial Analysis Techniques," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA  2011 Modular Level I, Vol. 3, pp. 342–347, 349, 351 "Cost of Capital," Yves Courtois, CFA, Gene C. Lai, and Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 57, 75 Study Sessions 8–35–e, f, g; 11–45–h Demonstrate how ratios are related and how to evaluate a company using a combination of different ratios. Demonstrate the application of and interpret changes in the component parts of the DuPont analysis (the decomposition of return on equity). Calculate and interpret the ratios used in equity analysis, credit analysis, and segment analysis. Calculate and interpret the cost of equity capital using the capital asset pricing model approach, the dividend discount model approach, and the bond-yield-plus-risk-premium approach.  **Sustainable growth rate = retention ratio × ROE** The higher a company's ROE and its ability to finance itself from internally generated funds (a higher retention ratio), the greater will be its sustainable growth rate.  In the 5 factor ROE, any factor that increases ROE will increase sustainable growth:  **ROE = tax burden × interest burden × EBIT margin × asset turnover × leverage** A higher tax burden ratio (Net Income/Earnings before tax) implies that the company can keep a higher percentage of pretax profits: this implies a lower tax rate, and a higher ROE. The interest burden ratio is Earnings before tax/EBIT, and a lower ratio means that the company has higher borrowing costs (it gets to keep a lower pre-tax income from a given EBIT), implying a lower ROE and sustainable growth. | | | | |

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| **27** | During 2009, the following events occurred at a company. The company:   |  |  | | --- | --- | | 1. | purchased a customer list for $100,000, which is expected to provide equal annual benefits for the next 4 years. | | 2. | recorded $200,000 of goodwill in the acquisition of a competitor. It is estimated that the acquisition would provide substantial benefits for the company for at least the next 10 years. | | 3. | repeatedly received favorable mention in the media for its response to a local natural disaster, in which it donated $300,000 in products and services to the community. The CEO of the company was heard to say that the publicity enhanced the firm's reputation substantially and would likely be worth at least $100,000 annually over the next 5 years. |   Based on those events, the amortization expense that the company should report in 2010 is *closest* to: | | | | |
|  |  | **A.** $25,000. |  |  |  |
|  |  | **B.** $45,000. |  |  |  |
|  |  | **C.** $125,000. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Understanding the Balance Sheet," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 218–222 Study Session 8–33–e Explain the measurement bases (e.g., historical cost and fair value) of assets and liabilities, including current assets, current liabilities, tangible assets, and intangible assets.  The customer list is the only identifiable intangible asset and it should be amortized on a straight-line basis over its expected future life: $100,000 / 4 = $25,000 per year. Goodwill is an unidentifiable intangible and should be tested for impairment but not amortized. If the reputation of the company has been enhanced as the CEO suggests, this is an internally generated intangible that is not recorded on the balance sheet and is therefore not amortized. | | | | |

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| **28** | The following items are from a company’s Cash Flow Statement.   |  |  |  | | --- | --- | --- | | **Classification of cash flow** | **Item** | **Amount (£-000s)** | | Operating activities | Cash received from customers | 55,000 | | Investing activities | Interest and dividends received | 10,000 | | Financing activities | Net repayment of revolving credit loan | 12,000 |   Which of the following standards and formats did the company *most likely* use in the preparation of its financial statements? | | | | |
|  |  | **A.** IFRS, direct format |  |  |  |
|  |  | **B.** IFRS, indirect format |  |  |  |
|  |  | **C.** Either IFRS or U.S. GAAP, direct format |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Understanding the Cash Flow Statement," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA  2011 Modular Level I, Vol. 3, pp. 254–263 "International Standards Convergence," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 650–651 Study Sessions 8–34–c, d; 8–43–c Compare and contrast the key differences in cash flow statements prepared under international financial reporting standards and U.S. generally accepted accounting principles. Demonstrate the difference between the direct and indirect methods of presenting cash from operating activities and explain the arguments in favor of each. Identify and explain the major differences between international and U.S. GAAP accounting standards concerning the treatment of interest and dividends on the statement of cash flows.  The direct method of cash flow statement presentation shows the specific cash inflows and outflows that result in reported cash flow from operating activities; e.g., cash from customers, cash to suppliers, etc. Companies using IFRS reporting standards can decide to report interest and dividend receipts as either an investing or an operating activity, whereas under U.S. GAAP, they must report such income as an operating activity. The listed operating and investment activities indicate that the company reports under IFRS, using the direct method. | | | | |

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| **29** | The following information is available about a manufacturing company:   |  |  | | --- | --- | |  | **$ million** | | Cost of ending inventory computed using FIFO | 4.3 | | Net realizable value | 4.1 | | Current replacement cost | 3.8 |   Compared to U.S. GAAP, the company’s gross profit ($ millions) computed under International Financial Reporting Standards (IFRS) is *most likely*: | | | | |
|  |  | **A.** the same. |  |  |  |
|  |  | **B.** 0.3 lower. |  |  |  |
|  |  | **C.** 0.3 higher. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Inventories," Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 386–388 "International Standards Convergence," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 639–640, 648 Study Sessions 9–36–f, 10–43–a Discuss the measurement of inventory at the lower of cost and net realizable value. Identify and explain the major international accounting standards for each asset and liability category on the balance sheet and the key differences from U.S. generally accepted accounting principles (GAAP).  Under IFRS, the inventory would be written down to its net realizable value ($4.1 million) whereas, under U.S. GAAP, market is defined as current replacement cost and hence would be written down to its current replacement cost ($3.8). The smaller write-down under IFRS will reduce the amount charged to the cost of goods sold, as compared to U.S. GAAP, and result in a higher gross profit of $0.3 million. | | | | |

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| **30** | For which type of long-lived asset is it *most appropriate* to test for impairment at least annually? | | | | |
|  |  | **A.** Property, plant, and equipment |  |  |  |
|  |  | **B.** Intangible assets with a finite life |  |  |  |
|  |  | **C.** Intangible assets with indefinite lives |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Long-Lived Assets," Elaine Henry, CFA, and Elizabeth A. Gordon  2011 Modular Level I, Vol. 3, pp. 435–436 Study Session 9–37–h Discuss the impairment of property, plant and equipment, and intangible assets.  Intangible assets with indefinite lives need to be tested for impairment at least annually. PP&E and intangibles with finite lives are tested only if there has been a significant change or other indication of impairment. | | | | |

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| **31** | On 1 January 2010 the market rate of interest on a company’s bonds is 5 percent and it issues a bond with the following characteristics:   |  |  | | --- | --- | | Face value | €50 million | | Coupon rate, paid annually | 4% | | Maturity date | December 31, 2019 (10 years) | | Issue price | 92.28 |   If the company uses IFRS, its interest expense (in millions) in 2010 is *closest* to: | | | | |
|  |  | **A.** €1.846. |  |  |  |
|  |  | **B.** €2.307. |  |  |  |
|  |  | **C.** €2.500. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Non-Current (Long-Term) Liabilities," Elizabeth A. Gordon and Elaine Henry, CFA 2011 Modular Level I, Vol. 3, pp. 505–508 Study Session 9–39–b Discuss the effective interest method and calculate interest expense, amortization of bond discounts/premiums, and interest payments.  IFRS recommends the effective interest method for the amortization of bond discounts/premiums. The bond is issued for 0.9228 × 50 million = 46.140.  Interest expense = liability value × market rate at issuance: 0.05 × 46.140 = 2.307 | | | | |

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| **32** | An analyst is assessing a company’s quality of earnings by looking at the cash flow earnings index (operating cash flow divided by net income). Potential problems would *most likely* be indicated if the ratio were consistently: | | | | |
|  |  | **A.** equal to 1.0. |  |  |  |
|  |  | **B.** less than 1.0. |  |  |  |
|  |  | **C.** greater than 1.0. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Financial Reporting Quality: Red Flags and Accounting Warning Signs," Thomas R. Robinson, CFA, and Paul Munter 2011 Modular Level I, Vol. 3, p. 562 Study Session 10–40–e Describe common accounting warning signs and methods for detecting each.  A cash flow earnings index consistently below 1.0 could indicate potential problems in a company's quality of earnings. | | | | |

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| **33** | As a result of a change in strategy to selling differentiated products at premium prices, a company’s gross margin ratio increased by 5 percentage points (i.e., from 35 percent to 40 percent). The *most likely* effect on the company’s operating margin ratio as a result of the change in strategy would be an increase: | | | | |
|  |  | **A.** equal to 5%. |  |  |  |
|  |  | **B.** less than 5%. |  |  |  |
|  |  | **C.** greater than 5%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Financial Statement Analysis: Applications," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA  2011 Modular Level I, Vol. 3, pp. 591–594 Study Session 10–42–a Evaluate a company's past financial performance and explain how a company's strategy is reflected in past financial performance.  A strategy of selling differentiated products at premium prices usually requires additional advertising or research and development to support the differentiating features; therefore, the effect on operating profit is normally less than the effect on gross profit margin. | | | | |

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| **34** | A retail company that leases the majority of its space has total assets of $4,500 million and total long-term debt of $2,125 million bearing an average interest rate of 10 percent. Note 8 to the 2010 financial statements contains the following information about the company’s leases:   |  |  | | --- | --- | | **Note 8: Operating leases.** | | | **Year** | **Millions** | | 2011 | $ 140 | | 2012 | 140 | | 2013 | 140 | | 2014 | 140 | | 2015 | 140 | | 2016 and thereafter | 1,260 | | Total | $1,960 |   After adjustment for the off-balance sheet financing, the debt-to-total-assets ratio for the company is *closest* to: | | | | |
|  |  | **A.** 58%. |  |  |  |
|  |  | **B.** 62%. |  |  |  |
|  |  | **C.** 72%. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Non-Current (Long-Term) Liabilities," Elizabeth A. Gordon and Elaine Henry, CFA 2011 Modular Level I, Vol. 3, p. 542 "Financial Statement Analysis: Applications," Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, Elaine Henry, CFA, and Michael A. Broihahn, CFA  2011 Modular Level I, Vol. 3, pp. 620–625 Study Sessions 9–39–l, 10–42–e Calculate and interpret leverage and coverage ratios. Determine and justify appropriate analyst adjustments to a company's financial statements to facilitate comparison with another company.  The present value of the operating leases should be added to both the total debt and the total assets. To estimate the present value it is appropriate to estimate the number of years of lease payments reflected in the 2016 and thereafter figure. Based on the constant expense shown in the first 5 years, there are 9 (1,260 / 140) more payments for a total of 14 payments. The present value of an annuity due of $140 for 14 years at 10% = $1,134. [N = 14; I = 10; PMT = 140; Mode = Begin]  Adjusted debt to total assets = (2,125 + 1,134) / (4,500 + 1,134) = 57.8% | | | | |

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| **35** | Matrix pricing is a process in which a bond’s yield-to-maturity is determined from bonds currently available in the market that have similar attributes as the bond being considered. Matrix pricing is *most similar* to the: | | | | |
|  |  | **A.** debt-rating approach only. |  |  |  |
|  |  | **B.** yield-to-maturity approach only. |  |  |  |
|  |  | **C.** yield-to-maturity approach and the debt-rating approach. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Cost of Capital," Yves Courtois, CFA, Gene C. Lai, and Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 47–49 Study Session 11–45–f Calculate and interpret the cost of fixed-rate debt capital using the yield-to-maturity approach and the debt-rating approach.  Matrix pricing (as described) is an example of the debt-rating approach only. | | | | |

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| **36** | A company has an equity beta of 1.4 and is 60 percent funded with debt. Assuming a tax rate of 35 percent, the company’s asset beta is *closest* to: | | | | |
|  |  | **A.** 0.71. |  |  |  |
|  |  | **B.** 0.98. |  |  |  |
|  |  | **C.** 1.01. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Cost of Capital," Yves Courtois, CFA, Gene C. Lai, and Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 60–61 Study Session 11–45–i Calculate and interpret the beta and cost of capital for a project.  Note: (60% debt financing is equivalent to a D/E ratio of 1.50 = 0.60 / (1 – 0.60). βAssets = βEQ × [1 / (1 + (1 – *t*) D / E)] = 1.4 / (1 + (1 – 0.35) × 1.5) = 0.7089 => 0.71 | | | | |

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| **37** | A company’s taxable income is 17.1 percent of sales. Assuming taxes of 42 percent and a dividend payout of 50 percent, the net profit margin is *closest* to: | | | | |
|  |  | **A.** 5.0%. |  |  |  |
|  |  | **B.** 7.2%. |  |  |  |
|  |  | **C.** 9.9%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Financial Statement Analysis," Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 217–225 Study Session 11–49 The candidate should be able to demonstrate the use of pro forma income and balance sheet statements.   |  |  | | --- | --- | | Net Profit Margin = Net Income / Sales = | Earnings Before Tax × (1 – Tax Rate) / Sales | | = | 0.171 × Sales × (1 – 0.42) / Sales = 9.92% | | | | | |

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| **38** | A project has the following annual cash flows:   |  |  |  |  |  | | --- | --- | --- | --- | --- | | **Year 0** | **Year 1** | **Year 2** | **Year 3** | **Year 4** | | –$75,000 | $21,600 | $23,328 | $37,791 | $40,815 |   With a discount rate of 8 percent, the discounted payback period (in years) is *closest* to: | | | | |
|  |  | **A.** 2.8. |  |  |  |
|  |  | **B.** 3.2. |  |  |  |
|  |  | **C.** 4.0. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Capital Budgeting," John D. Stowe, CFA, and Jacques R. Gagne, CFA 2011 Modular Level I, Vol. 4, p. 15 Study Session 11–44–d Calculate and interpret the results using each of the following methods to evaluate a single capital project: net present value (NPV), internal rate of return (IRR), payback period, discounted payback period, and profitability index (PI).   |  |  |  |  | | --- | --- | --- | --- | | **Year** | **Cash Flow** | **PV (Cash Flow) @ 8%** | **Amount to Pay Back** | | 0 | –75,000 | –75,000 | 75,000 | | 1 | 21,600 | 20,000 | 55,000 | | 2 | 23,328\* | 20,000 | 35,000 | | 3 | 37,791 | 30,000 | 5,000 | | 4 | 40,814 | 30,000 |  | | The first three cash flows recover $70,000 (in present value terms) of the cost, making only $5,000 of the $30,000 in Year 4 necessary to completely recover the cost. Therefore, the discounted payback is 3.2 years. | | | | | \* For example: PV of Year 2's cash flow is $23,328 / [1.08]2 | | | | | | | | |

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| **39** | Review the following income statement:   |  |  | | --- | --- | |  | **$ million** | | Revenues | 10.2 | | Variable Operating Costs | 4.6 | | Fixed Operating Costs | 2.0 | | Operating Income | 3.6 | | Interest | 1.2 | | Taxable Income | 2.4 | | Tax | 1.0 | | Net Income | 1.4 |   The firm’s degree of financial leverage is *closest* to: | | | | |
|  |  | **A.** 1.5. |  |  |  |
|  |  | **B.** 1.7. |  |  |  |
|  |  | **C.** 2.6. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Measures of Leverage," Pamela Peterson Drake, CFA, Raj Aggarwal, CFA, Cynthia Harrington, CFA, and Adam Kobor, CFA 2011 Modular Level I, Vol. 4, pp. 103–105 Study Session 11–46–b Calculate and interpret the degree of operating leverage, the degree of financial leverage, and the degree of total leverage.   |  |  | | --- | --- | | DFL = | (Operating Income) / (Operating Income – Interest Expense) | |  | or operating income divided by pretax earnings | | = | ($2.4 + $1.2) | |  | $2.4 | | = | 1.50 | | | | | |

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| **40** | The index weighting that results in portfolio weights shifting away from securities that have increased in relative value toward securities that have fallen in relative value whenever the portfolio is rebalanced is *most accurately* described as: | | | | |
|  |  | **A.** equal weighting. |  |  |  |
|  |  | **B.** fundamental weighting. |  |  |  |
|  |  | **C.** float-adjusted market-capitalization weighting. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Security-Market Indices," Paul D. Kaplan, CFA, and Dorothy C. Kelly, CFA  2011 Modular Level I, Vol. 5, p. 98 Study Session 13–56–d, f Compare and contrast the different weighting methods used in index construction. Discuss rebalancing and reconstitution.  Fundamentally weighted indices generally will have a contrarian "effect" in that the portfolio weights will shift away from securities that have increased in relative value and toward securities that have fallen in relative value whenever the portfolio is rebalanced. | | | | |

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| **41** | According to the industry life-cycle model, an industry in the shakeout stage is *best* characterized as experiencing: | | | | |
|  |  | **A.** increasing demand but falling prices. |  |  |  |
|  |  | **B.** slowing growth and intense competition. |  |  |  |
|  |  | **C.** little or no growth and industry consolidation. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Introduction to Industry and Company Analysis," Patrick W. Dorsey, CFA, Anthony M. Fiore, CFA, and Ian Rossa O'Reilly, CFA  2011 Modular Level I, Vol. 5, p. 235 Study Session 14–59–g Describe product and industry life-cycle models, classify an industry as to life-cycle phase (i.e., embryonic, growth, shakeout, maturity, or decline) based on a description of it, and discuss the limitations of the life-cycle concept in forecasting industry performance.  The shakeout stage is usually characterized by slowing growth, intense competition, and declining profitability. During the shakeout stage, demand approaches market saturation levels because few new customers are left to enter the market. Competition is intense as growth becomes increasingly dependent on market share gains. | | | | |

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| **42** | An investor gathers the following data. To estimate the stock’s justified forward P/E, the investor prefers to use:   * the earnings growth rate rather than the dividends growth rate and * the average of the payout ratios over the relevant period, in this case 2006–2009, rather than the most recent payout ratio.  |  |  |  |  | | --- | --- | --- | --- | | **Year** | **EPS** | **DPS** | **ROE** | | 2009 | $3.20 | $1.92 | 12% | | 2008 | $3.60 | $1.80 | 17% | | 2007 | $2.44 | $1.71 | 13% | | 2006 | $2.50 | $1.60 | 15% |   The yield on 10-year T-notes is 3 percent and the current equity risk premium is 6.5 percent. If the stock’s beta is 1.3, the stock’s justified forward P/E is *closest* to: | | | | |
|  |  | **A.** 12. |  |  |  |
|  |  | **B.** 16. |  |  |  |
|  |  | **C.** 21. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Equity Valuation: Concepts and Basic Tools," John J. Nagorniak, CFA, and Stephen E. Wilcox, CFA  2011 Modular Level I, Vol. 5, pp. 276, 281, 289–291 Study Session 14–60–h Calculate and interpret the following multiples: price to earnings, price to an estimate of operating cash flow, price to sales, and price to book value.  Earnings growth rate over the period 2006–2009 = 2.50 × (1 + *g*)3 = 3.20; *g* = 8.6% Average payout ratio = (0.60 + 0.50 + 0.70 + 0.64) / 4 = 0.61 Required rate of return on share *i* = Current expected risk-free rate of return + Beta*i* [Market (equity) risk premium]  = 3% + 1.3 (6.5%) = 11.5% P/E1 = *p* / (r – *g* = 0.61 / (0.115 – 0.086) = 0.61 / 0.029 = 21.0 | | | | |

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| **43** | An investor evaluating a company’s common stock for investment has gathered the following data.   |  |  | | --- | --- | | Current year's earnings per share | $2.50 | | Dividend payout ratio | 60% | | Dividend growth rate expected during Years 1 and 2 | 25% | | Dividend growth rate expected after Year 2 | 5% | | Investors' required rate of return | 12% |   The value per share of this common stock is *closest* to: | | | | |
|  |  | **A.** $28.57. |  |  |  |
|  |  | **B.** $31.57. |  |  |  |
|  |  | **C.** $38.70. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Equity Valuation: Concepts and Basic Tools," John J. Nagorniak, CFA, and Stephen E. Wilcox, CFA  2011 Modular Level I, Vol. 5, pp. 284–286 Study Session 14–60–e Calculate and interpret the intrinsic value of an equity security based on the Gordon (constant) growth dividend discount model or a two-stage dividend discount model, as appropriate.   |  |  | | --- | --- | | Current year's dividend per share = $2.50 × 0.6 = $1.50 | | | V = | 1.50(1.25) / 1.12 + 1.50(1.25)2 / 1.122 + [1.50(1.25)2(1.05) / (0.12 – 0.05)] / 1.122 | | = | $1.67 + $1.87 + $28.03 = $31.57 | | | | | |

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| **44** | According to behavioral finance, observed overreaction in securities markets *most likely* occurs due to: | | | | |
|  |  | **A.** loss aversion. |  |  |  |
|  |  | **B.** gambler’s fallacy. |  |  |  |
|  |  | **C.** disposition effect. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Market Efficiency," W. Sean Cleary, CFA, Howard J. Atkinson, CFA, and Pamela Peterson Drake, CFA  2011 Modular Level I, Vol. 5, pp. 148–149 Study Session 13–57–g Compare and contrast the behavioral finance view of investor behavior with that of traditional finance in regards to market efficiency.  According to loss aversion related arguments in behavioral theories, investors dislike losses more than they like comparable gains. Thus, such a behavioral bias can explain observed overreaction in markets. | | | | |

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| **45** | Companies pursuing cost leadership will *most likely*: | | | | |
|  |  | **A.** invest in productivity-improving capital equipment. |  |  |  |
|  |  | **B.** engage in defensive pricing when the competitive environment is one of high rivalry. |  |  |  |
|  |  | **C.** establish strong market research teams to match customer needs with product development. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Introduction to Industry and Company Analysis," Patrick W. Dorsey, CFA, Anthony M. Fiore, CFA, and Ian Rossa O'Reilly, CFA  2011 Modular Level I, Vol. 5, pp. 250–251 Study Session 14–59–k Describe the elements that should be covered in a thorough company analysis.  Companies pursuing cost leadership must be able to invest in productivity-improving capital equipment in order to be low-cost producers and maintain efficient operating systems. | | | | |

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| **46** | Epsilon Inc., a U.S.-based company, is obligated to deliver 1,000,000,000 yen to its Japanese component supplier in 3 months. Epsilon approaches a dealer and enters into a USD/JPY currency forward contract with physical delivery to manage the foreign exchange risk associated with the cash flow. Which of these *best* describes the currency forward contract? | | | | |
|  |  | **A.** The dealer will deliver yen on expiration. |  |  |  |
|  |  | **B.** Epsilon has the right but not the obligation to deliver USD. |  |  |  |
|  |  | **C.** The amount of USD exchanged for yen is determined on expiration. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Forward Markets and Contracts," Don M. Chance 2011 Modular Level I, Vol. 6, pp. 43–44 Study Session 17–69–h Describe the characteristics of currency forward contracts.  A currency forward contract can settle in cash or with actual delivery of the foreign currencies specified in the contract. This question refers to physical delivery; therefore, Epsilon receives 1,000,000,000 JPY from the dealer in exchange for paying USD. | | | | |

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| **47** | Which of the following options makes the following statement *most accurate*? The greater of either zero or the present value of the exercise price minus the underlying price is the lower bound on the price of a(n): | | | | |
|  |  | **A.** European put. |  |  |  |
|  |  | **B.** American put. |  |  |  |
|  |  | **C.** American call. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Option Markets and Contracts," Don M. Chance 2011 Modular Level I, Vol. 6, pp. 103–107 Study Session 17–71–k Calculate and interpret the lowest prices of European and American calls and puts based on the rules for minimum values and lower bounds.  For a European put, the exercise price must be adjusted to the present value since the option can be exercised only on expiration. | | | | |

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| **48** | An investor executes a protective put strategy on ABC stock. At the time of execution, the price of ABC is $71. A $66 strike put option on ABC with a 2-month expiration is trading at $1.45. The protective put strategy breaks even when the price of ABC is *closest* to: | | | | |
|  |  | **A.** $67.45. |  |  |  |
|  |  | **B.** $69.55. |  |  |  |
|  |  | **C.** $72.45. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Risk Management Applications of Option Strategies," Don M. Chance 2011 Modular Level I, Vol. 6, pp. 172–175 Study Session 17–73–b Determine the value at expiration, profit, maximum profit, maximum loss, breakeven underlying price at expiration, and general shape of the graph of a covered call strategy and a protective put strategy, and explain the risk management application of each strategy.  To break even, the underlying stock must be at least as high as the amount expended up front to establish the position. To establish the protective put, the investor would have spent $71 + $1.45 = $72.45. | | | | |

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| **49** | An analyst is evaluating an investment in an apartment complex based on the following annual data:   |  |  | | --- | --- | | Gross rental income | $2,100,00 | | Estimated vacancy and collection expenses | 3% | | Operating expenses | $1,600,00 | | Depreciation | 300,00 | | Current mortgage rate | 5% | | Financing percentage | 80% | | Capitalization rate | 12% | | Cost of equity | 15% |   Based on the income approach, the value of the investment is *closest* to: | | | | |
|  |  | **A.** $1,141,667. |  |  |  |
|  |  | **B.** $3,641,667. |  |  |  |
|  |  | **C.** $6,242,857. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Alternative Investments," Bruno Solnik and Dennis McLeavey 2011 Modular Level I, Vol. 6, pp. 205–207 Study Session 18–74–f Calculate the net operating income (NOI) from a real estate investment, the value of a property using the sales comparison and income approaches, and the after-tax cash flows, net present value, and yield of a real estate investment.  Using the income approach: ($2,100,000 – 0.03 × 2,100,000 – $1,600,000) / 0.12 = $437,000 / 0.12 = $3,641,666.70. The property is appraised based on cash flows and is independent of the financing decision. | | | | |

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| **50** | A project that requires an initial investment of €5 million is expected to pay €22 million at the end of 5 years if it is successful. The probabilities of failure for the project are provided below:   |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | | **Year** | **1** | **2** | **3** | **4** | 5 | | Failure | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | | Probability | 5 | 0 | 5 | 5 | 5 |   Assuming the cost of capital for the project is 16 percent, the project’s expected net present value is *closest* to: | | | | |
|  |  | **A.** –€3,157,000. |  |  |  |
|  |  | **B.** –€1,140,000. |  |  |  |
|  |  | **C.** €2,017,000. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Alternative Investments," Bruno Solnik and Dennis McLeavey 2011 Modular Level I, Vol. 6, pp. 216–218 Study Session 18–74–h Calculate the net present value (NPV) of a venture capital project, given the project's possible payoff and conditional failure probabilities.  You calculate the probability of success as (1 – 0.25) × (1 – 0.20) × (1 – 0.15) × (1 – 0.15) × (1 – 0.15) = 0.3685.  Then calculate the NPV from success: (22,000 / 1.165) – 5,000 = 5,474 × 0.3685 = 2,017.  Subtracting the NPV of failure, –5,000 × (1 – 0.3685, or 0.632) = –3,157. The difference between the NPVs is the expected NPV of the project: 2,017 – 3,157 = –1,140. | | | | |

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| **51** | Which of the following statements is *most likely* correct with respect to valuing a privately held company? | | | | |
|  |  | **A.** The cost approach values company assets using historical book value. |  |  |  |
|  |  | **B.** To estimate a control premium, the base is an estimate of that company’s value of equity not reflecting control. |  |  |  |
|  |  | **C.** Share prices should reflect a liquidity premium compensating investors for illiquidity in the market for the shares. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Alternative Investments," Bruno Solnik and Dennis McLeavey 2011 Modular Level I, Vol. 6, pp. 232–233 Study Session 18–74–n Describe alternative valuation methods for closely held companies and distinguish among the bases for the discounts and premiums for these companies. | | | | |

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| **52** | The table below provides a history of a fixed-income security’s coupon rate and the risk-free rate over a five-year period.   |  |  |  | | --- | --- | --- | | **Year** | **Risk-Free Rate** | **Coupon Rate** | | 1 | 3.00% | 6.00% | | 2 | 3.50% | 5.00% | | 3 | 4.25% | 3.50% | | 4 | 3.70% | 4.60% | | 5 | 3.25% | 5.50% |   The security is *most likely* a(n): | | | | |
|  |  | **A.** step-up note. |  |  |  |
|  |  | **B.** inverse floater. |  |  |  |
|  |  | **C.** deferred coupon bond. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Features of Debt Securities," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 325–330 Study Session 15–61–b Describe the basic features of a bond, the various coupon rate structures, and the structure of floating-rate securities.  The security's coupon rate moves in the opposite direction (inversely) with the risk-free rate. (Specifically, the coupon rate = 12.00% – 2 × risk-free rate.) | | | | |

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| **53** | For a 10-year floating-rate security, if market interest rates change by 1 percent, the change in the value of the security will *most likely* be: | | | | |
|  |  | **A.** zero. |  |  |  |
|  |  | **B.** related to the security’s coupon reset frequency. |  |  |  |
|  |  | **C.** similar to an otherwise identical fixed-rate security. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Risks Associated with Investing in Bonds," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 356–357 Study Session 15–62–e Explain the interest rate risk of a floating-rate security and why such a security's price may differ from par value.  The interest rate sensitivity of a floating-rate security comes primarily from the time remaining until its next coupon reset. | | | | |

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| **54** | When a bank creates a collateralized loan obligation (CLO) by securitizing a portfolio of commercial loans that it holds, the process is *best* described as a(n): | | | | |
|  |  | **A.** arbitrage transaction. |  |  |  |
|  |  | **B.** balance sheet transaction. |  |  |  |
|  |  | **C.** capital infusion transaction. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Overview of Bond Sectors and Instruments," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 426–427 Study Session 15–63–j Describe collateralized debt obligations.  A balance sheet transaction is one that removes assets from the balance sheet of the institution, often motivated by the desire to reduce the institution's risk. | | | | |

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| **55** | What is *closest* to the value of a 10-year, 6 percent coupon, $100 par value bond with semiannual payments assuming an annual discount rate of 7 percent? | | | | |
|  |  | **A.** $92.89 |  |  |  |
|  |  | **B.** $99.07 |  |  |  |
|  |  | **C.** $107.44 |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Introduction to the Valuation of Debt Securities," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 496–498 Study Session 16–65–c Calculate the value of a bond and the change in value that is attributable to a change in the discount rate.  A security with 19 semiannual payments of $3 interest and a 20th payment of $103 (interest plus return of face value) with a semiannual discount rate of 3.5% is $92.89 or  https://nlb4.testrac.com/cfa/graphics/FIL1V2201104.jpg | | | | |

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| **56** | Consider a $100 par value bond with a 7 percent coupon paid annually and 5 years to maturity. At a discount rate of 6.0 percent, the value of the bond is $104.21. One year later, the appropriate discount rate has risen to 6.5 percent and the bond’s value is $101.71. What part of this change in value is *most likely* attributable to the passage of time? | | | | |
|  |  | **A.** $0.37 |  |  |  |
|  |  | **B.** $0.74 |  |  |  |
|  |  | **C.** $1.76 |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Introduction to the Valuation of Debt Securities," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 492–495 Study Session 16–65–d Explain how the price of a bond changes as the bond approaches its maturity date, and calculate the change in value that is attributable to the passage of time.  With 4 years remaining to maturity and a discount rate that is unchanged at 6.0 percent, the value of the bond would be $103.47 or   https://nlb4.testrac.com/cfa/graphics/FIL1V2201105.jpg | | | | |

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| **57** | A fixed-income security’s current price is 101.45. You estimate that the price will rise to 103.28 if interest rates decrease 0.25 percent and will fall to 100.81 if interest rates increase 0.25 percent. The security’s effective duration is *closest* to: | | | | |
|  |  | **A.** 1.22. |  |  |  |
|  |  | **B.** 4.87. |  |  |  |
|  |  | **C.** 9.74. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Introduction to the Measurement of Interest Rate Risk," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 532–533 Study Session 16–67–d Calculate and interpret the effective duration of a bond, given information about how the bond's price will increase and decrease for given changes in interest rates.  The effective duration equals:  (price if rates fall – price if rates rise) / (2 × current price × change in rates)  = (103.28 – 100.81) / (2 × 101.45 × 0.0025) = 4.87. | | | | |

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| **58** | An investor’s transactions in a mutual fund and the fund’s returns over a four-year period are provided in the table below:   |  |  |  |  |  | | --- | --- | --- | --- | --- | |  | **Year** | | | | |  | **1** | **2** | **3** | **4** | | New investment at the beginning of the year | $2,500.00 | $1,500.00 | $1,00.00 | $500.00 | | Investment return for the year | –20% | 65% | –25% | 10% | | Withdrawal by investor at the end of the year | $0.00 | –$500.00 | –$500.00 | –$500.00 |   Based on these data, the money-weighted return (or internal rate of return) for the investor is *closest* to: | | | | |
|  |  | **A.** 2.15%. |  |  |  |
|  |  | **B.** 3.96%. |  |  |  |
|  |  | **C.** 7.50%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Portfolio Risk and Return – Part I," Vijay Singal 2011 Modular Level I, Vol. 4, pp. 281–285 Study Session 12–52–a Calculate and interpret major return measures and describe their applicability.  The calculations are shown below:   |  |  |  |  |  | | --- | --- | --- | --- | --- | | **Year** | **1** | **2** | **3** | **4** | | Starting balance | $0.00 | $2,000.00 | $5,275.00 | $4,206.25 | | New investment at beginning of year | $2,500.00 | $1,500.00 | $1,000.00 | $0.00 | | Net balance at beginning of year | $2,500.00 | $3,500.00 | $6,275.00 | $4,206.25 | | Investment return for the year | –20% | 65% | –25% | 10% | | Investment gain (loss) | –$500.00 | $2,275.00 | –$1,568.75 | $420.63 | | Withdrawal by investor at end of year | $0.00 | –$500.00 | –$500.00 | $0.00 | | Balance at end of the year | $2,000.00 | $5,275.00 | $4,206.25 | $4,626.88 |   The money weighted return is calculated by solving for *i* in the equation below:  https://nlb4.testrac.com/cfa/graphics/PML1V2201101.jpg  CF1 = –1500 CF2 = –500 CF3 = 1000 – 500 = 500 CF4 = 4,626.88 | | | | |

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| **59** | Risk that can be attributed to factor(s) that impact a company or industry is *best* described as: | | | | |
|  |  | **A.** market risk. |  |  |  |
|  |  | **B.** systematic risk. |  |  |  |
|  |  | **C.** unsystematic risk. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Portfolio Risk and Return – Part II," Vijay Singal 2011 Modular Level I, Vol. 4, pp. 405–407 Study Session 12–53–c Explain systematic and nonsystematic risk, and why an investor should not expect to receive additional return for bearing nonsystematic risk.  Risk that is due to company-specific or industry-specific factors is referred to as unsystematic risk. | | | | |

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| **60** | Which of the following factors is *least likely* to impact an individual’s ability to take risk? | | | | |
|  |  | **A.** Time horizon |  |  |  |
|  |  | **B.** Personality type |  |  |  |
|  |  | **C.** Expected income |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Basics of Portfolio Management and Construction," Alistair Byrne and Frank E. Smuddle 2011 Modular Level I, Vol. 4, pp. 453–454 Study Session 12–54–d Distinguish between the willingness and the ability (capacity) to take risk in analyzing an investor's financial risk tolerance.  An individual's ability to take risk is impacted by factors such as time horizon and expected income. Personality type is most likely to impact an individual's willingness to take risk. | | | | |