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| **20** | Which of the following actions on the part of a central bank is *most consistent* with increasing the quantity of money? | | | | | |
|  |  | | **A.** Selling securities on the open market |  |  |  |
|  |  | | **B.** Increasing the required reserve ratios |  |  |  |
|  |  | | **C.** Purchasing securities on the open market |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Money, the Price Level, and Inflation," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 371–372, 376 Study Session 6–24–d Explain the goals of the U.S. Federal Reserve (Fed) in conducting monetary policy and how the Fed uses its policy tools to control the quantity of money, and describe the assets and liabilities on the Fed's balance sheet.  When a central bank such as the Fed purchases securities, bank reserves increase. The banks therefore have excess reserves and are able to increase their lending, increasing the money supply. See the sequence of events given on p. 376 of the reading. | | | | | |
| 21 | **Perfect price discrimination is best described as pricing that allows producers to increase their economic profit while consumer surplus:** | | | | | |
|  |  | **A.** increases. | | | | | |  |  |  |
|  |  | **B.** decreases. | | | | | |  |  |  |
|  |  | **C.** remains steady. | | | | | |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Monopoly," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 193, 206–208 Study Session 4–19–c Explain price discrimination and why perfect price discrimination is efficient.  In perfect price discrimination, all surplus is captured by the producer. Consumer surplus falls to zero. | | | | | | | | | |

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| **22** | Which of the following multipliers is *least likely* to be part of fiscal policy? | | | | |
|  |  | **A.** Money multiplier |  |  |  |
|  |  | **B.** Balanced budget multiplier |  |  |  |
|  |  | **C.** Government expenditure multiplier |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Money, the Price Level, and Inflation," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 377–380 "Fiscal Policy," Michael Parkin 2011 Modular Level I, Vol. 2, pp. 445–446 Study Sessions 6–24–f, 6–26–d Describe the monetary base and explain the relation among the monetary base, the money multiplier, and the quantity of money. Discuss the use of fiscal policy to stabilize the economy, including the effects of the government expenditure multiplier, the tax multiplier, and the balanced budget multiplier.  The balanced budget multiplier and the government expenditure multiplier are part of fiscal policy. The money multiplier is best thought of as part of monetary policy. | | | | |

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| **23** | Which of the following statements is *most accurate* about the responsibilities of an auditor for a publicly traded firm in the United States? The auditor: | | | | |
|  |  | **A.** assures the reader that the financial statements are free from error, fraud, or illegal acts. |  |  |  |
|  |  | **B.** must express an opinion about the effectiveness of the company’s internal control systems. |  |  |  |
|  |  | **C.** must state that it has prepared the financial statements according to generally accepted accounting principles. |  |  |  |
|  | **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. 18–22 Study Session 7–29–d Discuss the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls.  For a publicly traded firm in the United States, the auditor must express an opinion as to whether the company's internal control system is in accordance with the Public Accounting Oversight Board, under the Sarbanes-Oxley Act. This is done either as a final paragraph in the Auditor's Report, or as a separate opinion. | | | | |

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| **24** | In accrual accounting, if an adjusting entry results in the reduction of an asset and the recording of an expense, the originating entry recorded was *most likely* a(n): | | | | |
|  |  | **A.** prepaid expense. |  |  |  |
|  |  | **B.** accrued expense. |  |  |  |
|  |  | **C.** unearned revenue. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "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. 63–65 Study Session 7–30–d Explain the need for accruals and other adjustments in preparing financial statements.  The adjusting entry to record the expiry of a prepaid expense is the reduction of an asset (the prepaid) and the recognition of the expense. | | | | |

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| **25** | At the beginning of the year, a company had total shareholders’ equity consisting of ¥200,000 in common share capital, and ¥50,000 in retained earnings.  During the year, the following events occurred:   |  |  | | --- | --- | |  | **¥** | | 1. Net income reported | 42,000 | | 2. Dividend paid | 7,000 | | 3. Realized loss on available-for-sale investments | 3,000 | | 4. Foreign currency translation gain on foreign subsidiaries | 8,000 | | 5. Repurchase of company stock, to be held as Treasury stock | 6,000 |   The total shareholders’ equity at the end of the year is *closest* to: | | | | |
|  |  | **A.** ¥268,000. |  |  |  |
|  |  | **B.** ¥284,000. |  |  |  |
|  |  | **C.** ¥287,000. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "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. 223–230 Study Session 8–33–f, g Demonstrate the appropriate classifications and related accounting treatments for marketable and nonmarketable financial instruments held as assets or owed by the company as liabilities. List and explain the components of owners' equity.   |  |  |  | | --- | --- | --- | | **Shareholders' Equity (¥)** | | | | Start-of-year share capital |  | 200,000 | | Less Treasury stock |  | (6,000) | | Beginning retained earnings | 50,000 |  | | Plus net income | 42,000 |  | | Less dividends paid | (7,000) |  | | Ending retained earnings | 85,000 | 85,000 | | Accumulated other comprehensive income    Foreign currency translation adjustment gain |  | $8,000 | | End-of-year shareholders' equity |  | **287,000** | | The realized loss on the available-for-sale investments is already accounted for in net income. | | | | | | | |

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| **26** | A company’s comparative income statements and balance sheets are presented below.   |  |  |  | | --- | --- | --- | | **Income Statement for the year ended 31 August (U.S. $ thousands)** | | | |  | **2009** | **2008** | | Sales | $100,000 | $ 95,000 | | Cost of goods sold | 47,000 | 47,500 | | Gross profit | 53,000 | 47,500 | | Operating expenses | 34,000 | 38,000 | | Interest expense | 2,400 | 2,700 | | Earnings before taxes | 16,600 | 6,800 | | Income taxes 33% | 5,478 | 2,244 | | **Net Income** | $  11,122 | $   4,556 | |  | | | | **Balance Sheet as at 31 August (U.S. $ thousands)** | | | |  | **2009** | **2008** | | **Assets** |  |  | | Cash & investments | $  21,122 | $  25,000 | | Accounts receivable | 25,000 | 13,500 | | Inventories | 13,000 | 8,500 | | Total current assets | $  59,122 | $  47,000 | | Total long-term assets | 72,000 | 80,000 | | **Total Assets** | $131,122 | $127,000 | |  | | | | **Liabilities** |  |  | | Accounts payable | $  15,000 | $  15,000 | | Other current liabilities | 7,000 | 9,000 | | Total current liabilities | $  22,000 | $  24,000 | | Long-term debt | 35,000 | 40,000 | | Total liabilities | $57,000 | $64,000 | | **Shareholders' equity** |  |  | | Common stock | $  58,000 | $  58,000 | | Retained earnings | 16,122 | 5,000 | |  | $  74,122 | $  63,000 | | **Total Liabilities & Equity** | $131,122 | $127,000 |   The cash collected from customers in 2009 is *closest* to: | | | | |
|  |  | **A.** $88,500. |  |  |  |
|  |  | **B.** $96,100. |  |  |  |
|  |  | **C.** $111,500. |  |  |  |
|  | **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. 267–268 Study Session 8–34–e Demonstrate the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data.  Cash collected from customers = Revenues – increase in AR = $100 – (25 – 13.5) = 88.5. | | | | |

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| **27** | Selected information for a company and the common size data for its industry are provided below.   |  |  |  | | --- | --- | --- | |  | **Company (£)** | **Common Size Industry Data (% of sales)** | | EBIT | 76,000 | 28.0 | | Pretax profit | 66,400 | 19.6 | | Net income | 44,488 | 13.1 | | Sales | 400,000 | 100.0 | | Total assets | 524,488 | 131.0 | | Total equity | 296,488 | 74.0 | |  | | | | ROE | 14.5% | 17.7% |   The main driver of the company’s inferior ROE compared to that of the industry is *most likely* the result of its lower: | | | | |
|  |  | **A.** EBIT margin. |  |  |  |
|  |  | **B.** tax burden ratio. |  |  |  |
|  |  | **C.** interest burden 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. 342–346 "Financial Statement Analysis," Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 213–215 Study Sessions 8–35–f, 11–49 Demonstrate the application of and interpret changes in the component parts of the DuPont analysis (the decomposition of return on equity).   |  |  |  |  | | --- | --- | --- | --- | |  | **Calculation** | **Company** | **Industry** | | EBIT Margin | EBIT / Sales | 76,000 / 400,000 = **0.19** | 28.0 / 100 = **0.28** | | Tax Burden ratio | Net Inc / EBT | 44,488 / 66,400 = **0.67** | 13.1 / 19.6 = **0.67** | | Interest Burden ratio | EBT / EBIT | 66,400 / 76,000 = **0.87** | 19.6 / 28.0 = **0.70** | | The company has a higher interest burden ratio but a lower EBIT margin than the industry, and the same tax burden ratio; the lower EBIT margin relative to the industry is the cause of the company's poor relative performance. | | | | | **EBT:** Pretax profit (earnings before tax)     **Net Inc:** Net Income | | | | | | | | |

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| **28** | Which of the following is *least likely* to be a fundamental principle in the preparation of financial statements within the IFRS Framework? | | | | |
|  |  | **A.** Matching |  |  |  |
|  |  | **B.** Materiality |  |  |  |
|  |  | **C.** Accrual basis |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Financial Reporting Standards," 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, p. 113 "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, p. 156 Study Sessions 8–31–e, 8–32–c Explain the general requirements for financial statements. Discuss the general principles of expense recognition, such as the matching principle, specific expense recognition applications (including depreciation of long-term assets and inventory methods), and the implications of expense recognition principles for financial analysis.  The five fundamental principles underlying the preparation of financial statements under the IFRS Framework are fair presentation, going concern, accrual basis, consistency, and materiality. Matching is a general principle of expense recognition. | | | | |

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| **29** | The following information is available about a company:   |  |  |  | | --- | --- | --- | | (all figures in $ thousands) | **2010** | **2009** | | Deferred tax assets | 200 | 160 | | Deferred tax liabilities | (450) | (360) | | Net deferred tax liabilities | (250) | (200) | |  | | | | Earnings before taxes | 4,000 | 3,800 | | Income taxes at the statutory rate | 1,200 | 1,140 | | Income tax payable (Current income tax expense) | 1,000 | 900 |   The company’s 2010 income tax expense (in thousands) is *closest* to: | | | | |
|  |  | **A.** $1,000. |  |  |  |
|  |  | **B.** $1,050. |  |  |  |
|  |  | **C.** $1,250. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Income Taxes," Elbie Antonites, CFA, and Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, pp. 459–461, 480–485 Study Session 9–38–d, i Calculate income tax expense, income taxes payable, deferred tax assets, and deferred tax liabilities, and calculate and interpret the adjustment to the financial statements related to a change in the income tax rate. Analyze disclosures relating to deferred tax items and the effective tax rate reconciliation, and discuss how information included in these disclosures affects a company's financial statements and financial ratios.  Income tax expense reported on the income statement = Income tax payable + net changes in the deferred tax assets and deferred tax liabilities. The change in the net deferred tax liability is a $50 increase (indicating that the income tax expense is $50 in excess of the income tax payable (or current income tax expense)) and representing an increase in the expense. Therefore, the income tax expense = $1,000 + 50 = $1,050. | | | | |

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| **30** | Which of the following inventory valuation methods *best* matches the actual historical cost of the inventory items to their physical flow? | | | | |
|  |  | **A.** FIFO |  |  |  |
|  |  | **B.** LIFO |  |  |  |
|  |  | **C.** Specific identification |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Inventories," Michael A. Broihahn, CFA 2011 Modular Level I, Vol. 3, p. 381 Study Session 9–36–b Describe different inventory valuation methods (cost formulas).  Specific identification best matches the physical flow of the inventory items because it tracks the actual units that are sold. | | | | |

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| **31** | A company has announced that it is going to distribute a group of long-lived assets to its owners in a spin-off. The *most appropriate* way to account for the assets until the distribution occurs is to classify them as: | | | | |
|  |  | **A.** held for sale with no depreciation taken. |  |  |  |
|  |  | **B.** held for use until disposal with no depreciation taken. |  |  |  |
|  |  | **C.** held for use until disposal with depreciation continuing to be taken. |  |  |  |
|  | **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. 437, 449 Study Session 9–37–i Discuss the derecognition of property, plant and equipment, and intangible assets.  Long-lived assets that will be disposed of other than by sale (such as a spin-off, an exchange for other assets, or abandonment) are classified as held for use until disposal and continue to be depreciated until that time. | | | | |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **32** | The following information is available from a company’s 2010 financial statements:   **Note 6: Employee costs**   |  |  |  | | --- | --- | --- | | (all figures in $ thousands) | **2010** | **2009** | | Wages and salaries | $21,000 | $18,500 | | Share-based payment costs (Note 15) | 600 | 425 | | Defined contribution pension plan | 1,525 | 1,462 | | Retirement benefit obligations (Note 17) | 728 | 620 | | Other employee costs | 3,233 | 3,080 | | Total employee costs | $27,086 | $24,087 |   **Note 17: Retirement benefit obligations** Amounts recognized in the income statement for the year   |  |  |  | | --- | --- | --- | | (all figures in $ thousands) | **2010** | **2009** | | Current service cost | $ 692 | $ 588 | | Interest cost on pension obligation | 80 | 65 | | Expected return on plan assets | (50) | (45) | | Past service costs recognized in the year | 6 | 12 | | Total income statement charge | $ 720 | $ 620 |   The pension expense (thousands) reported in 2010 is *closest* to: | | | | |
|  |  | **A.** $1,525. |  |  |  |
|  |  | **B.** $2,217. |  |  |  |
|  |  | **C.** $2,253. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Non-Current (Long-Term) Liabilities," Elizabeth A. Gordon and Elaine Henry, CFA 2011 Modular Level I, Vol. 3, pp. 538–541 Study Session 9–39–j, k Describe defined contribution and defined benefit pension plans. Compare and contrast the presentation and disclosure of defined contribution and defined benefit pension plans.  The pension expense would be the sum of the expense for the defined contribution plan and the defined benefit plan (retirement benefit obligation): 1,525 + 728 = 2,253 | | | | |

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| **33** | Given the following information about a company:   |  |  |  | | --- | --- | --- | | (all figures in $ millions) | **2010** | **2009** | | Short-term borrowings | $ 2,240 | $5,400 | | Current portion of long-term interest-bearing debt | 2,000 | 1,200 | | Long-term interest-bearing debt | 12,000 | 9,000 | | Total shareholders' equity | 23,250 | 21,175 | | EBIT | 3,850 | 3,800 | | Interest payments | 855 | 837 | | Operating lease payments | 800 | 800 |   What is the *most appropriate* conclusion an analyst can make about the solvency of the company? Solvency has: | | | | |
|  |  | **A.** improved because the debt-to-equity ratio decreased. |  |  |  |
|  |  | **B.** deteriorated because the debt-to-equity ratio increased. |  |  |  |
|  |  | **C.** improved because the fixed charge coverage ratio increased. |  |  |  |
|  | **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. 333–335 "Non-Current (Long-Term) Liabilities," Elizabeth A. Gordon and Elaine Henry, CFA 2011 Modular Level I, Vol. 3, pp. 542–545 Study Sessions 8–35–d, 9–39–l Calculate, classify, and interpret activity, liquidity, solvency, profitability, and valuation ratios. Calculate and interpret leverage and coverage ratios.  The debt-to-equity ratio decreased thereby improving solvency; the fixed charge coverage ratio remained the same.   https://nlb4.testrac.com/cfa/graphics/FSL1V1201111.jpg | | | | |

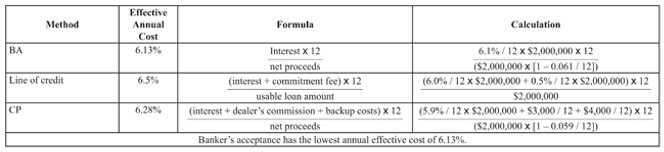
|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **34** | Which of the following will *most likely* increase a company’s operating cash flow? An increase in: | | | | |
|  |  | **A.** days sales payable (DSP). |  |  |  |
|  |  | **B.** gains on the sale of long-term assets. |  |  |  |
|  |  | **C.** use of operating leases versus financing leases. |  |  |  |
|  | **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. 537 "Accounting Shenanigans on the Cash Flow Statement," Marc A. Siegel 2011 Modular Level I, Vol. 3, pp. 578–579 Study Sessions 9–39–i, 10–41 Compare and contrast the disclosures relating to finance and operating leases. The candidate should be able to analyze and discuss the following ways to manipulate the cash flow statement:   * stretching out payables, * financing of payables, * securitization of receivables, and * using stock buybacks to offset dilution of earnings.   An increase in the days sales payable would indicate the company is stretching out its payables, which would increase the cash from operations. | | | | |

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| **35** | When computing the cash flows for a capital project, which of the following is *least likely* to be included? | | | | |
|  |  | **A.** Tax effects |  |  |  |
|  |  | **B.** Financing costs |  |  |  |
|  |  | **C.** Opportunity costs |  |  |  |
|  | **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. 8 Study Session 11–44–b Discuss the basic principles of capital budgeting, including the choice of the proper cash flows.  Financing costs are not included in a cash flow calculation, but are considered in the calculation of the discount rate. | | | | |

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| **36** | A firm’s estimated costs of debt, preferred stock, and common stock are 12 percent, 17 percent, and 20 percent, respectively. Assuming equal funding from each source and a 40 percent tax rate, the weighted average cost of capital is *closest* to: | | | | |
|  |  | **A.** 9.8%. |  |  |  |
|  |  | **B.** 13.9%. |  |  |  |
|  |  | **C.** 14.7%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Cost of Capital," Yves Courtois, CFA, Gene C. Lai, and Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 41–42 Study Session 11–45–a, b Calculate and interpret the weighted average cost of capital (WACC) of a company. Describe how taxes affect the cost of capital from different capital sources.  WACC = wdrd (1 – t) + wprp + were = [0.12 × (1 – 0.40) + 0.17 + 0.20] / 3 = 14.73% | | | | |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **37** | A project has the following annual cash flows:   |  |  |  |  | | --- | --- | --- | --- | | **Year 0** | **Year 1** | **Year 2** | **Year 3** | | –$606,061 | $2,151,515 | –$2,542,424 | $1,000,000 |   Which discount rate *most likely* provides a positive net present value? | | | | |
|  |  | **A.** 15% |  |  |  |
|  |  | **B.** 18% |  |  |  |
|  |  | **C.** 21% |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Capital Budgeting," John D. Stowe, CFA, and Jacques R. Gagne, CFA 2011 Modular Level I, Vol. 4, pp. 10–13, 17–19 Study Session 11–44–d, e 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). Explain the NPV profile, compare and contrast the NPV and IRR methods when evaluating independent and mutually exclusive projects, and describe the problems associated with each of the evaluation methods.   |  |  |  | | --- | --- | --- | | **Discount Rate** | **NPV** | **Calculation** | | 15% | –100 | = –$606,061 + $2,151,515 / (1.15) – $2,542,424 / (1.15)2 + $1,000,000 / (1.15)3 | | 18% | –42 | –$606,061 + $2,151,515 / (1.18) – $2,542,424 / (1.18)2 + $1,000,000 / (1.18)3 | | 21% | +15 | –$606,061 + $2,151,515 / (1.21) – $2,542,424 / (1.21)2 + $1,000,000 / (1.21)3 | | The NPV at 21% is $15 while the other two NPVs are negative. | | | | | | | |

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| **38** | Based on a need to borrow $2 million for one month, which of the following alternatives has the *least expensive* effective annual cost? | | | | |
|  |  | **A.** A banker’s acceptance with an all-inclusive annual rate of 6.1% |  |  |  |
|  |  | **B.** A credit line at 6.0% annually with a 0.5% annual commitment fee |  |  |  |
|  |  | **C.** Commercial paper at 5.9% annually with a dealer’s commission of $3,000 (or 0.15%) and a backup line cost of $4,000 (or 0.20%) |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Working Capital Management," Edgar A. Norton, Jr., CFA, Kenneth L. Parkinson, and Pamela Peterson Drake, CFA 2011 Modular Level I, Vol. 4, pp. 198–200 Study Session 11–48–g Evaluate the choices of short-term funding available to a company and recommend a financing method. | | | | |



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| **39** | Given the following income statement:   |  |  | | --- | --- | |  | **$ millions** | | Revenues | 9.8 | | Variable Operating Costs | 7.2 | | Fixed Operating Costs | 1.5 | | Operating Income | 1.1 | | Interest | 0.6 | | Taxable Income | 0.5 | | Tax | 0.2 | | Net Income | 0.3 |   The company’s degree of operating leverage is *closest* to: | | | | |
|  |  | **A.** 1.1. |  |  |  |
|  |  | **B.** 1.7. |  |  |  |
|  |  | **C.** 2.4. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Measures of Leverage," Pamela Peterson Drake, CFA, Raj Aggarwal, CFA, Cynthia Harrington, CFA, and Adam Kobor, CFA 2011 Modular Level I, Vol. 4, pp. 97–98  Study Session 11–46–b Calculate and interpret the degree of operating leverage, the degree of financial leverage, and the degree of total leverage.   https://nlb4.testrac.com/cfa/graphics/CFL1V1201105.jpg | | | | |

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| **40** | A stop-buy order is *most likely* placed when a trader: | | | | |
|  |  | **A.** thinks that the stock is overvalued. |  |  |  |
|  |  | **B.** wants to limit the loss on a long position. |  |  |  |
|  |  | **C.** wants to limit the loss on a short position. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Market Organization and Structure," Larry E. Harris 2011 Modular Level I, Vol. 5, pp. 51–53 Study Session 13–55–g, h Compare and contrast execution, validity, and clearing instructions. Compare and contrast market orders with limit orders.  Investors who have entered into a short sale will incur losses if the stock begins to increase in value. A stop-buy order helps limit the loss on a short position, as it becomes valid when the stock price rises above the specified stop price. | | | | |

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| **41** | The type of voting in board elections that is most beneficial to shareholders with a small number of shares is *best* described as: | | | | |
|  |  | **A.** statutory voting. |  |  |  |
|  |  | **B.** voting by proxy. |  |  |  |
|  |  | **C.** cumulative voting. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "The Corporate Governance of Listed Companies: A Manual for Investors," CFA Institute 2011 Modular Level I, Vol. 4, pp. 260–261 "Overview of Equity Securities," Ryan C. Fuhrmann, CFA, and Asjeet S. Lamba, CFA 2011 Modular Level I, Vol. 5, p. 171 Study Session 11–50–g, 14–58–d Evaluate, from a shareowner's perspective, company policies related to voting rules, shareowner sponsored proposals, common stock classes, and takeover defenses. Discuss the differences in voting rights and other ownership characteristics among various equity classes.  Cumulative voting allows shareholders to direct their total voting rights to specific candidates, as opposed to having to allocate their voting rights evenly among all candidates. Thus, applying all of the votes to one candidate provides the opportunity for a higher level of representation on the board than would be allowed under statutory voting. | | | | |

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| **42** | An investor gathered the following data in order to estimate the value of the company’s preferred stock:   |  |  | | --- | --- | | Par value of preferred stock offered at a 6% dividend rate | $100 | | Company's sustainable growth rate | 5% | | Yield on comparable preferred stock issues | 11.5% | | Investor's marginal tax rate | 30% |   The value of the company’s preferred stock is *closest* to: | | | | |
|  |  | **A.** $52.17. |  |  |  |
|  |  | **B.** $74.53. |  |  |  |
|  |  | **C.** $96.92. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Equity Valuation: Concepts and Basic Tools," John J. Nagorniak, CFA, and Stephen E. Wilcox, CFA 2011 Modular Level I, Vol. 5, pp. 276–277 Study Session 14–60–d Calculate the intrinsic value of a non-callable, non-convertible preferred stock.  V0 = D0 / r = ($100 × 0.06) / 0.115 = $52.17 | | | | |

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| **43** | An investor uses the data below and the constant growth model to evaluate a company’s common stock. To estimate growth, she uses the average value of the:   1. dividend growth rate over the period 2004–2009 and 2. sustainable growth rate for the year 2009.  |  |  |  |  | | --- | --- | --- | --- | | **Year** | **EPS** | **DPS** | **ROE** | | 2009 | $3.20 | $1.92 | 12% | | 2008 | $3.60 | $1.85 | 17% | | 2007 | $2.44 | $1.74 | 13% | | 2006 | $2.08 | $1.62 | 15% | | 2005 | $2.76 | $1.35 | 11% | | 2004 | $2.25 | $1.25 | 9% |   If her required return is 15 percent, the stock’s estimated value is *closest* to: | | | | |
|  |  | **A.** $23.71. |  |  |  |
|  |  | **B.** $25.31. |  |  |  |
|  |  | **C.** $30.14. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Equity Valuation: Concepts and Basic Tools," John J. Nagorniak, CFA, and Stephen E. Wilcox, CFA 2011 Modular Level I, Vol. 5, pp. 279–281 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.  Dividend growth rate over the period 2004–2009 = 1.25 × (1 + *g*)5 = 1.92; *g* = 8.96% ≅ 9% Sustainable growth rate for the year 2009: b = earnings retention rate = (1 – Dividend payout ratio) = [1 – (1.92 / 3.20)] = 0.40 *g* = b × ROE; *g* = 0.40 × 12% = 4.8% Average of the two approaches = (9 + 4.8) / 2 = 6.90% V0 = D1 / (r – *g*) = ($1.92 × 1.069) / (0.15 – 0.069) = $2.05 / 0.081 = $25.31 | | | | |

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| **44** | Which of the following is *least likely* to be directly reflected in the returns on a commodity index? | | | | |
|  |  | **A.** Roll yield |  |  |  |
|  |  | **B.** Risk-free interest rate |  |  |  |
|  |  | **C.** Changes in the underlying commodity’s price |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Security-Market Indices," Paul D. Kaplan, CFA, and Dorothy C. Kelly, CFA 2011 Modular Level I, Vol. 5, pp. 109–110 Study Session 13–56–j Discuss indices representing alternative investments.  Commodity index returns reflect the risk-free interest rate, the changes in futures prices, and the roll yield. Changes in the underlying commodity price are not directly reflected in a commodity index. | | | | |

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| **45** | The following data pertains to a margin purchase of a stock by an investor.   |  |  | | --- | --- | | Stock's purchase price | $50 / share | | Sale price | $55 / share | | Shares purchased | 500 | | Margin | 45% | | Call money rate | 6% | | Dividend | $1.80 / share | | Transaction commission on purchase | $0.05 / share | | Transaction commission on sale | $0.05 / share |   If the stock is sold exactly one year after the purchase, the total return on the investor’s investment is *closest* to: | | | | |
|  |  | **A.** 14%. |  |  |  |
|  |  | **B.** 19%. |  |  |  |
|  |  | **C.** 22%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Market Organization and Structure," Larry E. Harris 2011 Modular Level I, Vol. 5, pp. 44–45 Study Session 13–55–f Calculate and interpret the leverage ratio, the rate of return on a margin transaction, and the security price at which the investor would receive a margin call.   |  |  | | --- | --- | | Proceeds on sale: $55 × 500 | $27,500 | | Payoff loan: $50 × 500 × 0.55 | – $13,750 | | Margin interest paid: $13,750 × 0.06 | – $825 | | Dividend received: $1.80 × 500 | + $900 | | Sales commission paid: $0.05 × 500 | – $25 | | Remaining equity | $13,800 | | Initial investment (including commission): ($50 × 500 × 0.45) + ($0.05 × 500) | $11,275 | | Return on the initial investment:  ($13,800 – $11,275) / $11,275 | 22.4% |   See Example 19 on pp. 44-45. | | | | |

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| **46** | Derivative markets serve a number of purposes in global economic systems. Which of the following is *least likely* one of these purposes? | | | | |
|  |  | **A.** Reveal prices and volatility of the underlying assets |  |  |  |
|  |  | **B.** Improve market efficiency by lowering transaction costs |  |  |  |
|  |  | **C.** Enable companies to more easily practice risk management |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Derivative Markets and Instruments," Don M. Chance 2011 Modular Level I, Vol. 6, pp. 18–20 Study Session 17–68–d Discuss the purposes and criticisms of derivative markets.  Derivative markets improve market efficiency for the underlying assets by increasing market fairness and competitiveness, not by lowering transaction costs. Lower transaction costs is a characteristic of derivative markets that is required for them to exist, not a purpose for derivative markets. | | | | |

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| **47** | A futures trader takes a long position of 10 contracts. The initial margin requirement is $10 per contract and the maintenance margin requirement is $7 per contract. She deposits the required initial margin on the trade date. On Day 3, her margin account balance is $40. What is the variation margin on Day 4? | | | | |
|  |  | **A.** $30 |  |  |  |
|  |  | **B.** $60 |  |  |  |
|  |  | **C.** $100 |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Futures Markets and Contracts," Don M. Chance 2011 Modular Level I, Vol. 6, pp. 55–59 Study Session 17–70–c Differentiate between margin in the securities markets and margin in the futures markets, and explain the role of initial margin, maintenance margin, variation margin, and settlement in futures trading.  On any day when the balance in the margin account falls below the maintenance margin, the trader must deposit sufficient funds to bring the balance back up to the initial margin requirement. This additional amount is called the variation margin. Therefore, $100 – $40 = $60 variation margin. | | | | |

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| **48** | A portfolio manager enters into an equity swap with a swap dealer. The portfolio manager pays the return on the Value index and, in return, receives the return on the Growth index. The swap’s notional principal is $50 million and the payments will be made semiannually. The levels of the equity indices are as follows:   |  |  |  | | --- | --- | --- | | Index | **Level at Start of Swap** | **Level 6 Months Later** | | Value Index | 5,460 | 5,350 | | Growth Index | 1,190 | 1,200 |   The net payment due after 6 months is *closest* to: | | | | |
|  |  | **A.** $587,158. |  |  |  |
|  |  | **B.** $1,007,326. |  |  |  |
|  |  | **C.** $1,427,494. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Swap Markets and Contracts," Don M. Chance 2011 Modular Level I, Vol. 6, pp. 144–147 Study Session 17–72–b Define, calculate, and interpret the payment of currency swaps, plain vanilla interest rate swaps, and equity swaps.  The portfolio manager pays the Value Index return, which had a loss, and receives the Growth Index, which had a gain during the period. Therefore, the portfolio manager will receive a cash flow from the swap dealer. Value Index payment: [(5,350 / 5,460) – 1] × $50,000,000 = $(1,007,326) Growth Index payment: [(1,200 / 1,190) –1] × $50,000,000 = $420,168 Net payment to portfolio manager = $420,168 – $(1,007,326) = $1,427,494 | | | | |

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| **49** | A mutual fund with a 2.0 percent sales charge and 0.75 percent annual expense, earns 6.0 percent annually for 4 years. At the end of year 4, the NAV calculation *most likely* reflects: | | | | |
|  |  | **A.** a deduction of the sales charge and annual expenses at *t* = 0. |  |  |  |
|  |  | **B.** the compounded return, net of expenses, after deducting the sales charge at *t* = 0. |  |  |  |
|  |  | **C.** the compounded return after deducting the compounded sales charge and annual expenses. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Alternative Investments," Bruno Solnik and Dennis McLeavey 2011 Modular Level I, Vol. 6, pp. 189–192 Study Session 18–74–a Differentiate between an open-end and a closed-end fund, and explain how net asset value of a fund is calculated and the nature of fees charged by investment companies.  NAV calculation first deducts the sales charge at *t* = 0 and then compounds the annual return. The NAV also reflects the compounded deduction of the annual expenses. | | | | |

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| **50** | Which of the following statements regarding biases in hedge fund performance in hedge fund databases is *least likely* correct? | | | | |
|  |  | **A.** Only hedge fund managers with good track records enter the database, creating a positive bias. |  |  |  |
|  |  | **B.** The correlations between asset class returns are artificially low when underlying assets trade infrequently. |  |  |  |
|  |  | **C.** Hedge fund database administrators decide which funds to include in the database to overcome self-selection bias. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Alternative Investments," Bruno Solnik and Dennis McLeavey 2011 Modular Level I, Vol. 6, pp. 227–229 Study Session 18–74–l Discuss the performance of hedge funds, and the biases present in hedge fund performance measurement, and explain the effect of survivorship bias on the reported return and risk measures for a hedge fund database.  The hedge fund managers themselves decide whether they want to be included in a database. Managers who have funds with an unimpressive track record will not wish to have that information exposed. | | | | |

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| **51** | When market participants expect the spot price of a commodity to be higher in the future, the commodity market is said to be in: | | | | |
|  |  | **A.** contango. |  |  |  |
|  |  | **B.** full carry. |  |  |  |
|  |  | **C.** backwardation. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Investing in Commodities," Ronald G. Layard-Liesching 2011 Modular Level I, Vol. 6, pp. 262–263 Study Session 18–75–a Explain the relationship between spot prices and expected futures prices in terms of contango and backwardation.  When a commodity market is in contango, futures prices are higher than the spot price as market participants believe the spot price will be higher in the future. When spot prices are above the futures prices, the market is said to be in backwardation. | | | | |

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| **52** | Which of these embedded options *most likely* benefits a bondholder? | | | | |
|  |  | **A.** The floor in a floating-rate security |  |  |  |
|  |  | **B.** An accelerated sinking fund provision |  |  |  |
|  |  | **C.** The call option in a fixed-rate security |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Features of Debt Securities," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, p. 337 Study Session 15–61–e Identify the common options embedded in a bond issue, explain the importance of embedded options, and state whether such options benefit the issuer or the bondholder.  The floor guarantees a minimum rate that the investor will earn. | | | | |

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| **53** | Consider two bonds that are identical except for their coupon rates. The bond that will have the highest interest rate risk *most likely* has the: | | | | |
|  |  | **A.** lowest coupon rate. |  |  |  |
|  |  | **B.** highest coupon rate. |  |  |  |
|  |  | **C.** coupon rate closest to its market yield. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Risks Associated with Investing in Bonds," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, p. 354 Study Session 15–62–c Explain how features of a bond (e.g., maturity, coupon, and embedded options) and the level of a bond's yield affect the bond's interest rate risk.  A lower coupon rate means that more of the bond's value comes from repayment of face value, which occurs at the end of the bond's life. | | | | |

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| **54** | Duration is not an accurate measure of yield-curve risk for a bond portfolio because it: | | | | |
|  |  | **A.** can be applied only to measure the risk of a single bond. |  |  |  |
|  |  | **B.** assumes that the yield for all maturities change by the same amount. |  |  |  |
|  |  | **C.** measures the impact of a change in the short-term, riskless rate of interest. |  |  |  |
|  | **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. 359–363 Study Session 15–62–g Describe yield-curve risk and explain why duration does not account for yield-curve risk for a portfolio of bonds.  Duration measures the change in the price of a portfolio of bonds assuming that the yield for all maturities changes by the same amount. | | | | |

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| **55** | An investor whose marginal tax rate is 33.5 percent is analyzing a tax-exempt bond offering a yield of 5.20 percent. The taxable equivalent yield of the bond is *closest* to: | | | | |
|  |  | **A.** 3.46%. |  |  |  |
|  |  | **B.** 6.94%. |  |  |  |
|  |  | **C.** 7.82%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Understanding Yield Spreads," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 464–465 Study Session 15–64–i Calculate the after-tax yield of a taxable security and the tax-equivalent yield of a tax-exempt security.  The tax-equivalent yield = tax-exempt yield / (1 – marginal tax rate) = 5.20% / (1 – 0.335) = 7.82%. | | | | |

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| **56** | If the yield on a 5-year U.S. corporate bond is 7.39 percent and the yield on a 5-year U.S. Treasury note is 4.26 percent, the relative yield spread of the bond is *closest* to: | | | | |
|  |  | **A.** 3.13%. |  |  |  |
|  |  | **B.** 42.4% |  |  |  |
|  |  | **C.** 73.5%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **C**  "Understanding Yield Spreads," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 456–457 Study Session 15–64–e Calculate, compare, and contrast the various yield spread measures.  The relative yield spread = (bond yield – reference yield) / reference yield = (7.39% – 4.26%) / 4.26% = 73.5%. | | | | |

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| **57** | Consider a $100 par value bond, with an 8 percent coupon paid annually, maturing in 20 years. If the bond currently sells for $96.47, the yield to maturity is *closest* to: | | | | |
|  |  | **A.** 8.29%. |  |  |  |
|  |  | **B.** 8.37%. |  |  |  |
|  |  | **C.** 8.93%. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Yield Measures, Spot Rates, and Forward Rates," Frank J. Fabozzi, CFA 2011 Modular Level I, Vol. 5, pp. 538–539 Study Session 16–66–b Calculate and interpret the traditional yield measures for fixed-rate bonds and explain their limitations and assumptions.  A security with a present value of 96.47, 19 interest payments of 8, and a 20th payment of principal plus interest (108) has a yield to maturity of 8.37%. | | | | |

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| **58** | Which of the following types of institutions is *most likely* to have a long investment time horizon and a high level of risk tolerance? | | | | |
|  |  | **A.** A bank |  |  |  |
|  |  | **B.** An endowment |  |  |  |
|  |  | **C.** An insurance company |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Portfolio Management: An Overview," Robert M. Conroy and Alistair Byrne 2011 Modular Level I, Vol. 4, pp. 287–293 Study Session 12–51–b Discuss the types of investment management clients and the distinctive characteristics and needs of each.  Endowments have a long investment time horizon and a high level of risk tolerance (Exhibit 14). | | | | |

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| **59** | Selected information about shares of two companies is provided below:   |  |  |  |  | | --- | --- | --- | --- | | **Stock** | **Standard Deviation** | **Correlation of Returns1** | **Portfolio Weights** | | Cable Incorporated | 30% | 0.65 | 68% | | GPT Company | 20% |  | 32% | | 1Correlation of returns between Cable Incorporated and GPT Company | | | |   The standard deviation of returns of a portfolio formed with these two stocks is *closest* to: | | | | |
|  |  | **A.** 25.04%. |  |  |  |
|  |  | **B.** 26.80%. |  |  |  |
|  |  | **C.** 32.85%. |  |  |  |
|  | **Feedback:** You have answered correctly.  Correct answer: **A**  "Portfolio Risk and Return – Part I," Vijay Singal 2011 Modular Level I, Vol. 4, pp. 330–332 Study Session 12–52–e Calculate and interpret portfolio standard deviation. Portfolio standard deviation   https://nlb4.testrac.com/cfa/graphics/PML1V1201102.jpg | | | | |

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| **60** | A stock has a correlation of 0.45 with the market and a standard deviation of returns of 12.35 percent. If the market has a standard deviation of returns of 8.25 percent, then the beta of the stock is *closest* to: | | | | |
|  |  | **A.** 0.30. |  |  |  |
|  |  | **B.** 0.67. |  |  |  |
|  |  | **C.** 1.50. |  |  |  |
|  | **Feedback:** You have answered incorrectly.  Correct answer: **B**  "Portfolio Risk and Return – Part II," Vijay Singal 2011 Modular Level I, Vol. 4, pp. 410–413 Study Session 12–53–e Calculate and interpret beta.   https://nlb4.testrac.com/cfa/graphics/PML1V1201103.jpg | | | | |