

2019 Level I Mock Exam (B) AM

The morning session of the 2019 Level I Chartered Financial Analyst® Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of one and a half minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

Questions	Topic	Minutes
1–18, 31	Ethical and Professional Standards	28.5
19–30	Quantitative Methods	18
32–43	Economics	18
44–61	Financial Reporting and Analysis	27
62–73	Corporate Finance	18
74–80	Portfolio Management	10.5
81–93	Equity	19.5
94–106	Fixed Income	19.5
107–113	Derivatives	10.5
114–120	Alternative Investments	10.5
Total:		180

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- 1 Sato Kashingaki, CFA, is a financial advisor who practices in multiple jurisdictions. In his resident country, Country A, he is not required by law to hold a financial advisor's license but he is required to uphold a fiduciary duty to his clients. In Country B, authorities require him to hold a financial advisor's license, but he is not expected to uphold a fiduciary duty to his clients. In Country C, authorities require both a financial advisor's license and an asset management license in addition to upholding a fiduciary responsibility toward clients. In which of the three countries does Kashingaki have the duty to adhere to the CFA Code and Standards over local laws?
 - A Country A.
 - B Country B.
 - C Country C.
- 2 When Jefferson Piedmont, CFA, joined Branch Investing, Branch began using a quantitative stock selection model Piedmont had developed on his own personal time prior to his employment with Branch. One year later when Piedmont left the firm, he found the original copy of the model he had developed in a file at his home and presented it to his new employer, who immediately began using the model. According to the *Standards of Practice Handbook*, did Piedmont *most likely* violate any CFA Institute Standards of Professional Conduct?
 - A No.
 - B Yes, because he misappropriated property now belonging to Branch.
 - C Yes, because he failed to inform his new employer the model was the same one used by his previous employer.
- 3 Jeffrey Jones passed the Level I CFA examination in 1997 and the Level II examination in 2009. He is not currently enrolled for the Level III examination. According to the CFA Institute Standards of Professional Conduct, which of the following is the *most* appropriate way for Jones to refer to his participation in the CFA Program?
 - A Jeffrey Jones, CFA (expected 2014)
 - B Candidate in the CFA Institute CFA Program
 - C Passed Level II of the CFA examination in 2009
- 4 Nicholas Bennett, CFA, is a trader at a stock exchange. Another trader approached Bennett on the floor of the exchange and verbally harassed him about a poorly executed trade. In response, Bennett pushed the trader and knocked him to the ground. After investigating the incident, the exchange cleared Bennett from any wrongdoing. Which of the following *best* describes Bennett's conduct in relation to the CFA Institute Code of Ethics or Standards of Professional Conduct? Bennett:
 - A did not violate any Code or Standard.
 - B violated the Professional Misconduct Standard.
 - C violated both Misconduct and Integrity of Capital Markets Standards.
- 5 Alexandra Smirnov, CFA, is a pension consultant to the Springwell Pension Fund. After reviewing Springwell's three-year performance presentation showing the fund's underperformance relative to its investment objectives and agreed benchmarks, Smirnov recommends that the fund hire new asset managers. Smirnov proposes that the fund hire Newday Managers on the basis of

recent meetings she has had with the firm. Lengthy discussions at these meetings included Newday's investment strategy, its suitability to manage pension funds, its ability to adhere to its stated strategy, the firm's historical investment performance, and its adoption of the CFA Institute Code and Standards. Smirnov turned down Newday's offer of an introduction fee when recommending its services, but did not inform Springwell trustees of this offer. Which of the following CFA Institute Standards does Smirnov *most likely* violate?

- A Referral Fees
 - B Loyalty, Prudence, and Care
 - C Diligence and Reasonable Basis
- 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 golf game, tells his assistant to raise cash by selling 15% 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 of the CFA Institute Standards of Professional Conduct?
- A Suitability
 - B Priority of transactions
 - C Diligence and reasonable basis
- 7 Molly Burnett, CFA, is a portfolio manager for a fund that only invests in environmentally friendly companies. A multinational utility company recently acquired one of the fund'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 then sells the shares. Burnett *most likely* violated the CFA Institute Standard of Professional Conduct concerning:
- A suitability.
 - B disclosure of conflicts.
 - C independence and objectivity.
- 8 Pia Nilsson is a sole proprietor investment advisor. An economic recession has reduced the number of clients she advises and caused revenues to decline. As a result, Nilsson has not paid her CFA Institute membership dues for the past two years. When a national financial publication recently interviewed Nilsson, she indicated that up until two years ago she had been a CFA charterholder and a CFA Institute member in good standing. In addition, she stated the completion of the CFA Program enhanced her portfolio management skills and enabled her to achieve superior returns on behalf of her clients. Which of Nilsson's following actions *most likely* violated the CFA Institute Standards of Professional Conduct?
- A Nonpayment of CFA Institute membership dues
 - B Attributing her superior returns to participation in the CFA Program
 - C Indicating that being a CFA charterholder has enhanced her portfolio management skills

- 9 Lisa Hajak, CFA, specialized in research on real estate companies at Cornerstone Country Bank for the past twenty years. Hajak recently started her own investment research firm, Hajak Investment Advisory. One of her former clients at Cornerstone asks Hajak to update a research report she wrote on a real estate company when she was at Cornerstone. Hajak updates the report, which she had copied to her personal computer without the bank's knowledge, and replaces references to the bank with her new firm, Hajak Investment Advisory. Hajak also incorporates the conclusions of a real estate study conducted by the Realtors Association that appeared in the *Wall Street Journal*. She references the Journal as her source in her report. She provides the revised report free of charge along with a cover letter for the bank's client to become a client of her firm. Concerning the reissued research report, Hajak *least likely* violated the CFA Institute Standards of Professional Conduct because she:
- A solicited the bank's client.
 - B did not obtain consent to use the bank report.
 - C did not cite the actual source of the real estate study.
- 10 Lin Liang, CFA, is an investment manager and an auto industry expert. Last month, Liang sent securities regulators an anonymous letter outlining various accounting irregularities at Road Rubber Company. Shortly before he sent the letter to the regulators, Liang shorted Road stock for his clients. Once the regulators opened an investigation, which Liang learned about from his sources inside the company, Liang leaked this information to multiple sources in the media. When news of the investigation became public, the share price of Road immediately dropped 30%. Liang then covered the short positions and made \$5 per share for his clients. Liang *least likely* violated which of the CFA Institute Standards of Professional Conduct?
- A Misconduct.
 - B Market Manipulation.
 - C Priority of Transactions.
- 11 Chan Liu, CFA, is the new research manager at the Pacific MicroCap Fund. Liu observed the following activities after she published a research report on a thinly traded micro cap stock that included a "buy" recommendation:
- Pacific traders purchased the stock for Pacific's proprietary account and then purchased the same stock for all client accounts; and
 - Pacific marketing department employees disseminated positive, but false, information about this stock in widely read Internet forums.
- Liu notes the stock's price increased more than 50% within a period of two days and was then sold for Pacific's account. Which of the following steps is most appropriate for Liu to take to avoid violating the CFA Institute Code of Ethics and Standards of Professional Conduct?
- A Report the observed activities to her employer.
 - B Remove her name from the micro cap stock research report.
 - C Publicly refute the false information posted on Internet forums.
- 12 Teresa Staal, CFA, is an investment officer in a bank trust department. She manages money for celebrities and public figures, including an influential local politician. She receives a request from the politician's political party headquarters to disclose his stock holdings. The request indicates that local law requires the disclosure. What steps should Staal *most likely* take to ensure she does **not** violate any CFA Institute Standards of Professional Conduct?
- A Provide the information and inform her client.

- B Send the requested documents and inform her supervisor.
 - C Check with her firm's compliance department to determine her legal responsibilities.
- 13 Yao Tsang, CFA, has a large percentage of his net worth invested in the Australian mining company Outback Mines, which he has held for many years. Tsang is in the process of moving to a new employer where he is responsible for initiating research on mining companies. Shortly after his move, Tsang is asked to complete a research report on Outback. In order to meet the CFA Institute Standards of Professional Conduct concerning his stock holding, which of the following actions is *most* appropriate for Tsang to take?
- A Disclose his stock holding to his employer and to clients.
 - B Sell his stock holdings to eliminate any potential conflict of interest.
 - C Refuse to write the report and ask his employer to assign another analyst to complete the analysis.
- 14 Joan Tasha, CFA, a supervisor at Olympia Advisors (OA), wrote and implemented compliance policies at her firm. A long-time OA employee, Derek Longtree, recently changed the asset allocation of a client, which is inconsistent with her financial needs and objectives and with OA's policies. Until now, Longtree has never violated OA's policies. Tasha discusses the issue with Longtree but takes no further action. Do Tasha's actions concerning Longtree most likely violate any CFA Institute Standards of Professional Conduct?
- A No.
 - B Yes, because she failed to detect Longtree's actions.
 - C Yes, because she did not take steps to ensure that the violation will not be repeated.
- 15 Which of the following situations *most likely* helps to explain why the GIPS standards were created?
- A Firms only including top performing funds to represent their performance history.
 - B Asset managers including the performance of all portfolios including those no longer managed in their performance history.
 - C Consistency amongst fund managers when making investment performance presentations.
- 16 Which of the following statements does *not* accurately represent the objectives of Global Investment Performance Standards (GIPS)? The GIPS standards:
- A ensure consistent, accurate investment performance data in areas of reporting, records, marketing, and presentations.
 - B obtain global acceptance of calculation and presentation standards in a fair, comparable format with full disclosure.
 - C promote fair competition amongst investment management firms in all markets requiring common fee structures.
- 17 Firms claiming compliance with GIPS standards are *most likely* required to:
- A comply with all updates, interpretations, and clarifications.
 - B make negative assurance disclosures when presenting the firm's performance.
 - C meet at least 85% of the requirements before claiming compliance.
- 18 The *most* important factor in promoting ethical decision making among an investment firm's employees is:

- A a strong culture of integrity by the firm's senior management.
 - B adoption of a code of ethics that clearly defines the firm's ethical principles.
 - C the investment professional's natural desire to do the right thing.
- 19 Monte Carlo simulation is *best* described as:
- A providing a distribution of possible solutions to complex functions.
 - B a restrictive form of scenario analysis.
 - C an approach to back-test data.
- 20 A project offers the following incremental after-tax cash flows (CF):

Year	0	1	2	3	4	5	6
Cash flow (€)	-12,500	2,000	4,000	5,000	2,000	1,000	500

- The internal rate of return (IRR) of the project is *closest* to:
- A 5.5%.
 - B 2.5%.
 - C 4.4%.
- 21 If a paired comparison test of mean differences supports rejecting the null hypothesis, then the:
- A independence of the samples is statistically significant.
 - B standard error of the mean differences is low relative to the sample mean difference.
 - C difference in means is not statistically significant.
- 22 A tree diagram is *most likely* used when dealing with investment problems that involve outcomes that are:
- A independent at each node.
 - B mutually exclusive.
 - C unconditional at each node.
- 23 By definition, the probability of any Event E is a number between:
- A zero and positive infinity.
 - B minus one and positive one.
 - C zero and positive one.
- 24 Two events A and B are independent if the probability of occurrence of A :
- A equals the product of the individual probabilities of occurrence of A and B .
 - B is related to the occurrence of B .
 - C does not affect the probability of occurrence of B .
- 25 Which of the following, holding all else constant, will *most likely* increase the width of the confidence interval for a parameter estimate?
- A Reduction in the degree of confidence
 - B Increase in the sample size
 - C Use of the t -distribution rather than the normal distribution to establish the confidence interval
- 26 An analyst collects the following set of 10 returns from the past:

Year	1	2	3	4	5	6	7	8	9	10
Return (%)	2.2	6.2	8.9	9.3	10.5	11.7	12.3	14.1	15.3	18.4

The geometric mean return is *closest* to:

- A 10.89%.
 B 10.80%.
 C 9.62%.
- 27 Common stock prices are approximately lognormally distributed. Therefore, it is *most likely* that conventional (discrete) common stock prices are:
 A leptokurtic.
 B skewed to the right.
 C skewed to the left.
- 28 In Elliott Wave Theory, Wave 2 commonly exhibits a pattern *best* described as a(n):
 A basing pattern consisting of five smaller waves.
 B Fibonacci ratio percentage retracement composed of three smaller waves.
 C uptrend moving above the high of Wave 1 and consisting of five smaller waves.
- 29 Once an investor chooses a particular course of action, the value forgone from alternative actions is *best* described as a(n):
 A sunk cost.
 B required return.
 C opportunity cost.
- 30 An investor deposits £2,000 into an account that pays 6% per annum compounded continuously. The value of the account at the end of four years is *closest* to:
 A £2,854.
 B £2,525.
 C £2,542.
- 31 The CFA Institute Code of Ethics and Standards of Professional Conduct are *most likely* designed to foster and reinforce a culture of:
 A responsibility and professionalism.
 B regulatory compliance.
 C service to the firm.
- 32 A research report produced by a dealer includes the following exchange rates:

	Spot Rate	Expected Spot Rate in One Year
USD/EUR	1.3960	1.3860
USD/CAD	1.0110	1.0300
EUR/GBP	1.2850	1.2790

The expected appreciation (%) of the Canadian dollar (CAD) relative to the British pound (GBP) is *closest* to:

- A -3.00
 B 3.09.
 C 0.70.
- 33 The following information is available:
 New Zealand dollar (NZD) to British pound (GBP) spot exchange rate:
 2.0979
 Libor interest rates for the British pound: 1.6025%

Libor interest rates for the New Zealand dollar: 3.2875%

All Libor interest rates are quoted on a 360-day year basis

The 180-day forward points (scaled up by four decimal places) in NZD/GBP is *closest* to:

- A 39.
- B 348.
- C 176.

- 34 The following international trade information is available for a hypothetical economy:

	Exports	Imports
Initial Value (DCU)	4,800	6,500
Demand elasticity	0.70	0.55

DCU: domestic currency units

Following a 12% depreciation in the DCU, the trade balance will be *closest* to:

- A -1,726.
- B -1,648.
- C -1,674.

- 35 Which of the following *best* describes a function of the International Bank for Reconstruction and Development?
- A Lending foreign currencies on a temporary basis to address balance of payment issues
 - B Regulating cross-border trade relationships on a global scale
 - C Providing low interest rate loans to developing countries
- 36 Which of the following is *least likely* to be a valid function/characteristic of money? Money:
- A provides a store of wealth.
 - B requires a double coincidence of wants.
 - C acts as a unit of account.
- 37 An advantage of indirect taxes as a fiscal policy tool is that such taxes:
- A have a greater impact on aggregate spending and output than direct government spending.
 - B can be adjusted almost immediately.
 - C minimize interference with consumer choices.
- 38 The following data apply to a firm operating in perfect competition.

Quantity	Total Revenue	Total Cost
21	\$210	\$138
22	\$220	\$145
23	\$230	\$154
24	\$240	\$165

The firm's profit maximizing output (in units) is *most likely*:

- A 23.
- B in excess of 24.

- C 21.
- 39 Which of the following statements with respect to Giffen and Veblen goods is *least* accurate?
- A Giffen goods are “inferior,” whereas Veblen goods are “high-status” goods.
 - B The highly negative income effect overpowers the substitution effect for both types of goods.
 - C Both types of goods demonstrate the possibility of a positively sloping demand curve.
- 40 The most recent economic data release indicates the following:
- capital spending is expanding rapidly, but the growth rate of spending has begun to slow down; and
 - the rate of hiring has slowed, but the unemployment rate continues to fall.
- The economy is *most likely* in which of the following phases?
- A Peak
 - B Late expansion
 - C Contraction
- 41 The consumer price index (CPI) this year is 252. The CPI last year was 246. The inflation rate this year is *closest* to:
- A 6.00%.
 - B 2.38%.
 - C 2.44%.
- 42 The price index that *best* resolves the substitution bias is the:
- A Fisher index.
 - B Laspeyres index.
 - C Paasche index.
- 43 A positive movement in a lagging indicator would *least likely* be used to:
- A confirm that an expansion is currently underway.
 - B identify a past condition of the economy.
 - C identify an expected future economic upturn.
- 44 By themselves, financial ratios are *least likely* to be sufficient in determining a company's:
- A past performance.
 - B creditworthiness.
 - C current financial condition.
- 45 The following information is available about a conglomerate and one of its reportable operating segments:

	Segment A (\$ millions)	Total (\$ millions)
Assets	300	6,000
Liabilities	100	4,000
Capital expenditures	140	550
Revenue	1,250	12,000
Expenses	1,160	11,000
Operating profit	90	1,000

The element of Segment A's financial statement excerpts that *most likely* causes it to qualify as a reportable segment is its:

- A capital expenditures.
- B assets.
- C revenue.

- 46 Which of the following conditions conducive to issuing low-quality financial reports is *most likely* a result of poor internal controls?
- A Rationalization
 - B Opportunity
 - C Motivation
- 47 Which of the following approaches will *most likely* reveal manipulation of financial reporting?
- A Using EBITDA to adjust for non-recurring items
 - B Evaluating potential warning signals in isolation
 - C Comparing a company's methods and policies to those of its peers
- 48 Which of the following is *least* consistent with the goals of accounting standards developed under the joint conceptual framework project of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB)? Accounting standards should be:
- A principles based.
 - B developed independently.
 - C internally consistent.
- 49 To evaluate the potential effect of an innovative and unique type of business transaction on financial statements, an analyst's *best* approach is to:
- A monitor the actions of standard setters and regulators.
 - B gain an understanding of the transaction's economic purpose.
 - C consider the approach taken for "new" transactions that arose in the past.
- 50 An analyst uses a stock screener and selects the following metrics from his equity universe:
- price-to-equity ratio lower than the median P/E
 - price-to-book value ratio lower than the median P/BV
- The stocks selected would be *most* appropriate for portfolios for which type of investors?
- A Value investors
 - B Growth investors
 - C Market-oriented investors
- 51 Which of the following events will *most likely* result in a decrease in a valuation allowance for a deferred tax asset under US GAAP? A(n):
- A decrease in interest rates
 - B reduction in tax rates
 - C extension in the tax loss carry-forward period
- 52 Selected information from a company that uses the FIFO inventory method is provided:

Event	Units	\$/Unit	Total (\$)
Opening inventory	1,000	7.50	7,500
First purchase	250	7.60	1,900
Sales	550	12.00	6,600
Second purchase	300	7.70	2,310
Sales	600	12.00	7,200
Ending inventory	400		

If the company used a perpetual system versus a periodic inventory system, the gross margin would *most likely* be:

- A higher.
- B lower.
- C the same.

53 The following information is available for a manufacturing company:

	\$ millions
Cost of ending inventory computed using FIFO	4.3
Net realizable value	4.1
Current replacement cost	3.8

If the company is using International Financial Reporting Standards (IFRS) instead of US GAAP, its cost of goods sold (in millions) is *most likely*:

- A \$0.3 higher.
- B \$0.3 lower.
- C the same.

54 If an analyst is concerned about the liquidity of a company's inventory, he would *most likely* look in the notes to the financial statements to determine the:

- A amount of inventories recognized as expense during the period.
- B cost formula or inventory valuation method used.
- C breakdown of inventory between work in progress and finished goods.

55 The following information is available concerning a new showroom a company built. Construction started on 1 January 2012, and the grand opening was on 1 January 2014:

Loan: Funds borrowed on 1 January 2012 and put to use immediately	€30 million
Interest rate on loan	8%, payable annually
Repayment terms for loan	Balloon payment, due on 1 January 2017
Total construction costs incurred during 2012 and 2013	€38.5 million
Expected useful life of the showroom	40 years
Expected residual value of the showroom	€5 million
Depreciation method	Straight line

The depreciation expense (in millions) for the showroom in 2014 is *closest* to:

- A €1.0175.
- B €0.9575.
- C €0.8375.

- 56 At the end of the year, a company revalued its manufacturing facilities, increasing their carrying amount by 12%. There had been no prior downward revaluation of these facilities. The revaluation will *most likely* cause the company's:
- A return on assets to increase.
 - B return on equity to decline.
 - C net profit margin to increase.
- 57 A technology company, reporting under US GAAP, has three classes of intangible assets. The table below shows information on each of the three classes.:

Accumulated Impairment Losses and Amortization (Currency in USD)

(in thousands)	Goodwill	Licenses	Computer Software
31 December 2019	65,321	8,243	5,257
Exchange movements	7,324	821	334
Amortization charge for year	—	1,244	2,102
Net additions (disposals)	—	(25)	—
Impairment charge for the year	?	?	?
31 December 2020	73,194	10,856	8,214

Based on the data provided, the intangible asset that has the largest absolute impairment charge for the period ended 31 December 31 2020, is:

- A computer software.
 - B licenses.
 - C goodwill.
- 58 A company issued a \$50,000 seven-year bond for \$47,565. The bonds pay 9% per annum, and the yield to maturity at issue was 10%. The company uses the effective interest rate method to amortize any discounts or premiums on bonds. After the first year, the yield to maturity on bonds equivalent in risk and maturity to these bonds is 9%. The amount of the bond discount amortization recorded in the first year is *closest* to:
- A \$257.
 - B \$0.
 - C \$348.
- 59 Which of the following statements about balance sheets is *most* accurate? For balance sheets prepared under:
- A IFRS, a classified balance sheet must present current assets before non-current assets.
 - B US GAAP, intangibles must be valued at historical cost.
 - C IFRS, a commercial real estate company should use a liquidity based presentation.
- 60 Which of the following statements about cash flow ratios is *most* valid?
- A Reinvestment ratio measures a firm's ability to acquire assets with investing cash flows.
 - B Debt payment ratio measures a firm's ability to pay debts with operating cash flows.

- C Interest coverage ratio is calculated as operating cash flow divided by interest payments.

61 The following data are available on a company for the current year:

Metric	£ thousands
Comprehensive income	246,000
Dividends paid	60,000
Ending retained earnings	821,000
Opening retained earnings	580,000

The company will *most likely* report other comprehensive income (OCI) (in £ thousands) as a:

- A loss of 55,000.
 B gain of 186,000.
 C gain of 301,000.
- 62 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%, the discounted payback period (in years) is *closest* to:
- A 3.0.
 B 3.2.
 C 2.8.
- 63 In an acquisition, the interests of minority shareholders are *best* protected through the use of:
- A sell-out rights.
 B clawback provisions.
 C covenants within indentures.
- 64 Which of the following is the *best* example of a good corporate governance practice?
- A Independent board members are prior, but not current employees of the firm.
 B Supervisory and management boards have overlapping membership.
 C The chief executive position is separate from the chair position on the company's board.
- 65 Which of the following features is *most likely* to be found in a well-structured executive compensation plan?
- A Links to factors that drive overall corporate performance
 B Reasonably consistent total compensation from year to year
 C Higher total remuneration relative to peer companies with comparable performance
- 66 The cost of which source of capital *most likely* requires adjustment for taxes in the calculation of a firm's weighted average cost of capital?
- A Common stock
 B Preferred stock
 C Bonds

- 67 The optimal capital budget for a firm is *best* described as occurring when the company's marginal cost of capital is:
- A equal to the investment opportunity schedule.
 - B less than the investment opportunity schedule.
 - C greater than the investment opportunity schedule.

- 68 A company that wants to determine its cost of equity gathers the following information:

Rate of return on 3-month Treasury bills	3.0%
Rate of return on 10-year Treasury bonds	3.5%
Market risk premium	6.0%
The company's equity beta	1.6
Dividend growth rate	8.0%
Corporate tax rate	35%

Using the capital asset pricing model (CAPM) approach, the cost of equity (%) for the company is closest to:

- A 12.6%.
 - B 7.5%.
 - C 13.1%.
- 69 A company intends to issue new common stock with floatation costs of 5.0% per share. The expected dividend next year is \$0.32, and the dividend growth rate is expected to be 10% in perpetuity. Assuming the shares are issued at a price of \$14.69, the cost (%) of external equity for the firm is *closest* to:
- A 12.2.
 - B 12.5.
 - C 12.3.

- 70 The following information is available for a company and the industry in which it competes:

	Company	Industry
Accounts receivable turnover	5.6 times	6.5 times
Inventory turnover	4.2 times	4.0 times
Number of days of payables	28 days	36 days
Operating cycle	?	147 days
Cash conversion cycle	124 days	?

Relative to the industry, the company's operating cycle:

- A is shorter, but its cash conversion cycle is longer.
 - B and cash conversion cycle are both longer.
 - C is longer, but its cash conversion cycle is shorter.
- 71 The following information is available for a firm:

Revenue	£800,000
Variable cost	400,000
Fixed cost	200,000
Operating income	200,000
Interest	60,000
Net income	140,000

The firm's degree of total leverage (DTL) is *closest* to:

- A 1.43.
- B 2.00.
- C 2.86.

72 Which is *most likely* considered a “pull” on liquidity?

- A Increased difficulty in collecting receivables
- B Obsolete inventory
- C Reduction in a line of credit

73 Which of the following sources of short-term financing is *most likely* used by smaller companies?

- A Commercial paper
- B Collateralized loans
- C Uncommitted lines

74 A financial adviser gathers the following information about a new client:

- The client is a successful economics professor at a major university.
- The client plans to work full time for seven years and then will work part time for three years before retiring.
- The client owns two homes and does not have any outstanding debt.
- The client has accumulated retirement savings of approximately \$2 million through his employer's retirement plan and will have anticipated retirement spending needs of \$60,000 per year.
- The client reads numerous financial publications and follows markets closely.
- Although concerned about the current health of the global economy, the client maintains that he is a long-term investor.

Based on the above information, which of the following *best* describes this client?

- A High ability to take risk but a low willingness to take risk
- B High ability to take risk and a high willingness to take risk
- C Low ability to take risk but a high willingness to take risk

75 An analyst observes that the historic geometric nominal return for equities is 9%. Given a real return of 1% for riskless Treasury bills and annual inflation of 2%, the real rate of return and risk premium for equities are *closest* to:

- A 7.9% and 5.8%.
- B 6.9% and 7.9%.
- C 6.9% and 5.8%.

76 The following table presents historical information for two stocks, RTF and KIU:

Variance of returns for RTF	0.0625
Variance of returns for KIU	0.0900
Correlation coefficient between RTF and KIU	0.4500

The covariance between RTF and KIU is *closest* to:

- A 0.0025.
- B 0.0675.
- C 0.0338.

- 77 A stock has a correlation of 0.45 with the market and a standard deviation of returns of 12.35%. If the market has a standard deviation of returns of 8.25%, then the beta of the stock is *closest* to:
- A 0.30.
 - B 0.67.
 - C 1.50.
- 78 A portfolio manager generated a rate of return of 15.5% on a portfolio with beta of 1.2. If the risk-free rate of return is 2.5% and the market return is 11.8%, Jensen's alpha for the portfolio is *closest* to:
- A 1.84%.
 - B 4.34%.
 - C 3.70%.
- 79 A portfolio engages in an investment strategy that relies on a particular element of the tax code to produce superior after-tax returns for high-net-worth individuals. Because of this strategy, the portfolio *most likely* faces a high level of:
- A compliance risk.
 - B model risk.
 - C legal risk.
- 80 A risk metric that measures how different an actual investment outcome could be from what the investor expects is *most likely* a:
- A vega.
 - B duration.
 - C standard deviation.
- 81 Which date in the chronology of a dividend payment is *most likely* determined by a security exchange?
- A Holder-of-record date
 - B Declaration date
 - C Ex-dividend date
- 82 A company's non-callable, non-convertible preferred stock that pays an annual dividend of \$3.75 is currently selling at its par value of \$50 per share. If the required rate of return increases by 75 bps, the preferred stock's new price is *closest* to:
- A \$45.45.
 - B \$49.50.
 - C \$55.56.

- 83 The following information is available about a company:

Next year's sales revenue	\$180 million
Next year's net profit margin	15%
Dividend payout ratio	60%
Dividend growth rate expected during Years 2 and 3	25%
Dividend growth rate expected after Year 3	5%
Investors' required rate of return	12%
Number of outstanding shares	8.1 million

The current value per share of the company's common stock according to the two-stage dividend discount model is *closest* to:

- A \$39.36.

- B \$49.20.
C \$52.86.
- 84 After a two-for-one stock split, which of the following will *most likely* change relative to its pre-split value?
A Earnings per share (EPS)
B Price-to-earnings ratio (P/E)
C Dividend payout ratio
- 85 Which of the following statements is *most* accurate about recessions?
A If severe, the demand for products of defensive companies will eventually be adversely affected.
B Consumers are more likely to defer purchases of products of defensive companies than of cyclical companies.
C Non-cyclical companies tend to underperform cyclical companies.
- 86 A change in which of the following *best* describes a macroeconomic influence on industry growth?
A The cost of debt
B Personal spending habits
C Population size
- 87 A corporate manager pursuing a low-cost strategy will *most likely*:
A engage in offering products of unique quality or type.
B have strong market research teams for product development and marketing.
C invest in productivity-improving capital equipment.
- 88 In a highly efficient market, unexpected positive news on a stock is announced to the public. After this announcement, the difference between the market value and the intrinsic value of the stock will *most likely*:
A remain zero.
B decrease.
C increase.
- 89 An internal evaluation of the trading behavior of three fund managers of a mutual fund company during the past year has revealed the following:
- | | |
|-----------|---|
| Manager X | Was slower than peers when reacting to changes in information |
| Manager Y | Rarely realized investment losses but realized most of the investment gains |
| Manager Z | Tended to overreact by disliking losses more than liking comparable gains |
- Which of the three managers *most likely* displayed the disposition effect bias?
A Manager Y
B Manager X
C Manager Z
- 90 A company that pursues differentiation as its competitive strategy is *most likely* to emphasize:
A strong market research.
B efficient operating and reporting systems.
C defensive market positions.

- 91 A trader buys 500 shares of a stock on margin at \$36 a share using an initial leverage ratio of 1.66. The maintenance margin requirement for the position is 30%. The stock price at which the margin call will occur is *closest* to:
- A \$25.20.
 - B \$30.86.
 - C \$20.57.
- 92 The MSCI All Country World Index is *best* described as a:
- A broad market equity index.
 - B multi-market equity index.
 - C global sector equity index.
- 93 Which of the following statements regarding rebalancing and reconstitution of an index is *most* accurate?
- A Market-capitalization-weighted indexes require frequent rebalancing.
 - B Reconstitution can dramatically affect prices of both current and prospective constituents.
 - C Reconstitution is part of index management that reduces the need for rebalancing.
- 94 Which of the following is *most likely* an indicator of liquidity in the secondary market for bonds?
- A Bid-to-cover ratio
 - B Bid-offer spread
 - C Settlement period
- 95 ANZ Corporation has issued a three-year bond that makes semiannual interest payments in March and September at the coupon rate of six-month Libor + 250 bps. This bond is *most likely* referred to as a:
- A floating-rate note.
 - B plain vanilla bond.
 - C pure discount bond.
- 96 For two equally rated speculative grade bonds, what factor is *least likely* to account for differences in their valuation?
- A Severity of loss
 - B Probability of default
 - C Perceived creditworthiness of the companies
- 97 A credit analyst observes the following information for Alpha Co. at fiscal years ending 20X1 and 20X2.

Excerpt from the Consolidated Income Statement of Alpha Co. for the Fiscal Years Ending 31 December 20X1 and 20X2 (in millions)

	20X1	20X2
Gross profit	\$550.0	\$505.0
Operating expenses	450.0	370.0
Operating profit	100.0	135.0
Interest expense	30.0	35.0
Income before taxes	70.0	100.0
Income taxes (at 30%)	21.0	30.0

(Continued)

	20X1	20X2
Net income	49.0	70.0
<i>Additional information</i>		
Depreciation and amortization	25.0	35.0

Based on this information, over this period Alpha's interest coverage ratio has:

- A improved.
- B remained unchanged.
- C deteriorated.

98 Credit spreads are *most likely* to narrow during:

- A economic contractions.
- B a period of flight to quality.
- C economic expansions.

99 Which of the following is *least likely* a form of internal credit enhancement used in a securitization?

- A Subordination
- B Overcollateralization
- C Letter of credit

100 Residential mortgage-backed securities issued in the US by government-sponsored enterprises are guaranteed by:

- A the full faith and credit of the government.
- B the government-sponsored enterprise.
- C external credit enhancements.

101 Consider a five-year option-free bond that is priced at a discount to par value. Assuming the discount rate does not change, one year from now the value of the bond will *most likely*:

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

102 Which of the following 90-day money market instruments *most likely* offers the investor the highest rate of return?

Money Market Instrument	Quoted Rate	Quotation Basis	Day Convention
Instrument A	5.78%	360	Discount rate
Instrument B	5.80%	365	Discount rate
Instrument C	5.96%	365	Add-on rate

- A Instrument A
- B Instrument C
- C Instrument B

103 Assume the following annual forward rates were calculated from the yield curve.

Time Period	Forward Rate
0y1y	0.50%
1y1y	0.70%
2y1y	1.00%
3y1y	1.50%
4y1y	2.20%

The four-year spot rate is *closest* to:

- A 0.924%.
- B 1.348%.
- C 1.178%.

104 A bond is selling for 98.2. It is estimated that the price will fall to 96.6 if yields rise 30 bps and that the price will rise to 100.1 if yields fall 30 bps. Based on these estimates, the effective duration of the bond is *closest* to:

- A 1.78.
- B 5.94.
- C 11.88.

105 A portfolio consists of four bonds with the following characteristics:

Bond	Market Value	Duration
A	\$1.2 million	3.2
B	\$3.4 million	7.6
C	\$2.9 million	12.4
D	\$1.6 million	1.5

The duration of the portfolio is *closest* to:

- A 7.48.
- B 5.40.
- C 6.18.

106 The factor *least likely* to influence the yield spread on an option-free, fixed-rate bond is a change in the:

- A credit risk of the issuer.
- B expected inflation rate.
- C liquidity of the bond.

107 The price of a forward contract *most likely*:

- A decreases as the price of the underlying goes up.
- B is constant and set as part of the contract specifications.
- C increases as market risk increases.

108 Which of the following statements *best* describes changes in the value of a long forward position during its life?

- A As the time to maturity goes down, the value of the position goes up.
- B As the price of the underlying goes up, the value of the position goes up.
- C As interest rates go down, the value of the position goes up.

109 Conceptually, a forward rate agreement *most likely* allows a company that wants to invest money in the future to lock in a rate by making a:

- A variable payment and receiving a fixed payment.

- B fixed payment and receiving a different fixed payment.
 - C fixed payment and receiving a variable payment.
- 110 In the binomial model, the difference between the up and down factors *best* represents the:
- A volatility of the underlying.
 - B moneyness of an option.
 - C pseudo probability.
- 111 A derivative can *best* be described as a financial instrument that:
- A duplicates the underlying asset's performance.
 - B transforms the underlying asset's performance.
 - C passes through the underlying asset's returns.
- 112 Which of the following is *most likely* to be a feature common to both forward and futures contracts?
- A Daily marking to market of contracts
 - B Standardization of the contract's terms and conditions
 - C Their use for hedging or speculation
- 113 If the implied volatility for options on a broad-based equity market index goes up, then it is *most likely* that:
- A the broad-based equity market index has gone up in value.
 - B the general level of market uncertainty has gone up.
 - C market interest rates have gone up.
- 114 Compared to traditional investments, alternative investments *least likely* demonstrate which of the following characteristics?
- A Narrow manager specialization
 - B Underlying investments that are illiquid
 - C A high degree of regulation
- 115 Capital provided for companies moving toward operation but before commercial manufacturing and sales have occurred *best* describes which stage in venture capital investing?
- A Later stage
 - B Seed stage
 - C Early stage
- 116 The *most likely* impact of adding commodities to a portfolio of equities and bonds is to:
- A increase risk.
 - B provide higher current income.
 - C reduce exposure to inflation.
- 117 With regard to venture capital, which of the following statements is *most likely* true regarding venture capital?
- A Investments typically are in later stage and more established companies.
 - B Investors tend to have short time horizons.
 - C Investors require a higher return than investors in publicly traded equity.
- 118 Commodity futures prices are *most likely* in backwardation when:
- A interest rates are high.
 - B storage costs are high.

C the convenience yield is high.

Initial investment capital	\$100 million
Return at the end of one year	12%
Management fee based on assets under management	1%
Incentive fee based on the return net of the management fee	10%

119 Assume management fees are calculated using end-of-period valuation. The investor's net return given this fee structure is *closest* to:

- A** 10.88%.
- B** 9.79%.
- C** 9.68%.

120 Alternative investments that rely on estimates rather than observable market prices for valuation purposes are *most likely* to report:

- A** returns that are understated.
- B** volatility of returns that is understated.
- C** correlations of returns with the returns of traditional assets that are overstated.