Sample Exam 3
Morning Session

Calculating Your Score

Topic	*Maximum Score*	*Your Score*
Ethics	18	
Quantitative Methods	14	
Economics	12	
Accounting and Corporate Finance	34	
Asset Valuation	36	
Portfolio Management	6	
Total	120	

The morning and afternoon exams are identically weighted over the topics and readings. You can therefore treat the morning and afternoon exams as independent events.

If you took more than three hours (180 minutes) to complete this portion of the exam, you should adjust your score downward by one point for each minute you ran over.

Remember: the real exam *will be more difficult* than these sample exams. The main reason for this is the general anxiety and stress that you will be feeling on exam day, coupled with the time pressure you will be under. Many of the questions on this practice exam and the real exam are not individually difficult, so if you take extra time to answer the questions on this practice exam, your score will go up significantly. However, if you want an accurate measure of your potential performance on the exam, adhere to the 3-hour time limit.

After you have finished grading your sample exam, you may find it useful to use the exam questions and recommended solutions for review purposes (as flash review points). Many of these questions were specifically written for your use as study tools. Once again, I feel I should remind you not to memorize these questions; you will not see them on the actual exam. What you will see on the exam, though, are the concepts, terms, and procedures presented in these questions.

Your actual exam will most likely "look different" than what you see in this book. Please remember, no study provider knows the content of the actual exam. These sample exams are our "best guess" as to the structure and content of your actual exam.

Test Answers

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SAMPLE EXAM 3
MORNING SESSION

The following 18 questions relate to Ethics.

1. York Investment Advisors, which has publicly adopted the CFA Institute® Standards of Professional Conduct, has recently published a new marketing brochure highlighting the accomplishments of its investment professionals. Which of the following statements made in York's marketing brochure is a violation of Standard VII(B) Reference to CFA Institute, the CFA Designation, and the CFA Program?
   A. Roger Langley, Chartered Financial Analyst, has been a portfolio manager with York for ten years and managed to pass all three levels of the CFA examinations on his first attempts.
   B. Langley is one of three CFAs on staff with York. We expect that two more of our staff members will earn the right to use the designation in the future.
   C. Level III candidates, Tara Smith and Fred Hurley, both passed the Level II CFA exam and are scheduled to sit for the next exam in June.
   D. Paul Yeng has retired from the firm after 25 years of service. Yeng was awarded the CFA charter in 1988. Much of the firm's past successes can be attributed to Yeng's efforts as an analyst and portfolio manager.

2. Tamara Higgins is the compliance officer for Hedge Funds Unlimited, a global hedge fund with offices in New York, London, and Singapore. The firm has publicly acknowledged in writing that it has adopted the CFA Institute Code and Standards as its policies. Although Higgins is not currently participating in the CFA program, she will begin the program next year. For purposes of compliance, which of the following is *least likely* a violation of the firm's policies?
   A. A portfolio manager at the firm accepts an undisclosed trip to Bermuda as a gift from a client for good performance.
   B. An analyst at the firm working overseas uses material nonpublic information as allowed by local law to make investment decisions for discretionary client accounts.
   C. A junior analyst at the firm uses a subscription to his local newspaper and the opinions of his friends and colleagues to make investment recommendations for discretionary client accounts.
   D. A CFA candidate at the firm, who is registered for the Level III exam, includes reference to participation in the CFA program and her status as a Level III candidate in her biographical background.

3. Ralph Malone, CFA, is an investment advisor at a multinational finance corporation. He has many wealthy individuals among his client base, including a trust account that benefits three of his immediate family members as well as himself. The research department of Malone's firm issues a "buy" recommendation on a stock that would be a suitable investment for several client accounts, including the

family trust account. Which of the following would be considered a violation of Standard VI(B) Priority of Transactions?

A. Malone trades for his clients' accounts before the release of material nonpublic information.
B. Malone trades on the family account immediately after his firm's clients have been informed of the buy recommendation.
C. Malone waits to trade on the family account until four days after his firm's clients have been informed of the buy recommendation.
D. Malone buys stock for a client's account after the stock is put on the firm's recommended buy list but before this information is made public.

4. Linda Bryant, CFA, is an employee of Roomkin Investment House. She has been approached by SimthCo to consult on a private debt placement. According to CFA Institute Standards of Professional Conduct, before Bryant agrees to accept this job she is required to:

A. obtain consent from Roomkin after submitting details of the arrangement.
B. talk to her immediate supervisor and get her written approval to take this consulting job.
C. turn the job down because it is in conflict with Standard III(E) Preservation of Confidentiality.
D. inform SimthCo in writing that she will accept the job and provide details of the arrangement to Roomkin in writing.

5. Mary Houston is a compliance officer for Green Investments, an environmentally conscious investment group. Green Investments utilizes the CFA Institute Standards of Professional Conduct as their standards for ethical practice. Houston passed Level I of the CFA exam two years ago and then took some time off for her family. Having taken care of this commitment, Houston recently registered for the next CFA examination. For purposes of compliance, which of the following is *least likely* a violation of Green Investment's policies?

A. Houston updates her bio on the company website to include "CFA, Level II, expected 2007."
B. One of Green Investment's marketing brochures states that several of the firm's portfolio managers passed all three levels of the CFA exam on their first attempts.
C. At a meeting with potential clients, chief investment officer Bill Ray, CFA, states that he is among an "elite group of the most qualified investment professionals who passed all three CFA exams in three consecutive years."
D. In interviewing a prospective employee, a portfolio manager at the firm says that the position could be financially rewarding because "CFA charterholders are known to achieve superior performance results."

6. Marilyn Walters, CFA, supervises a large group of research analysts. Walters has delegated some of her supervisory responsibilities to her assistant, Amy Brooks, who is a CFA candidate. In carrying out her responsibilities, Brooks has discovered that the firm's compliance system is inadequate and that Walters is not very supportive of Brooks' efforts to correct the situation. According to CFA Institute Standards of Professional Conduct, Brooks should:

A. take no action because the policing of compliance matters is the responsibility of her supervisor.
B. resign because her firm is not in compliance with the CFA Institute Standards, leaving her open to legal action.
C. decline in writing to accept supervisory responsibilities until a reasonable compliance system is adopted.
D. take no action because her efforts to correct the situation have satisfied her obligation under CFA Institute standards.

7. Jarrett Rogers, CFA, is a registered investment advisor and a principal for Macrovest Broker-Dealer. Rogers is the head of the firm's investment program and recommends certain investment advisors in the program to high net worth individuals looking for separately managed discretionary accounts. Investment advisors in the program pay Macrovest a portion of their investment management fees to participate in the program, some of which is paid to Rogers as compensation for client referrals. When a

client inquires with Rogers about criteria for including managers in the Macrovest program, Rogers indicates that managers are selected based only on historical investment performance versus a universe of comparable peer investment managers but he does not mention fees paid by investment advisors to be included in the program. Which of the following CFA Institute Standards of Professional Conduct has Rogers violated?

A. Standard VI(C) Referral Fees.
B. Standard I(C) Misrepresentation.
C. Standard III(B) Fair Dealing.
D. Standard V(A) Diligence and Reasonable Basis.

8. Ken Toma, a CFA charterholder and securities analyst for the leisure services industry, has just completed an extensive review of the demand for beach vacations in Hawaii and concluded that the demand will far exceed the supply for the foreseeable future. Toma writes a research report stating, "Based on the fact that the demand for Hawaiian beach vacations will exceed the supply of rooms for the foreseeable future, I recommend the purchase of shares of the Hawaiian Fund, a diversified portfolio of Hawaiian beachfront resorts." If Toma presents this report to his clients, he will have violated the CFA Institute Standards:

A. because he did not distinguish between fact and opinion.
B. by failing to complete a thorough and diligent review of the facts.
C. because he made conclusions based only upon his own research.
D. because he did not consider the suitability of the investment for his clients.

9. Derek Stevens, CFA, manages the pension plan assets of Colors Inc. When voting proxies on plan equities, Stevens owes a fiduciary duty to:

A. the plan trustees who hired him.
B. the managers, stockholders, and bondholders of Color Inc. equally.
C. the plan participants only.
D. the plan participants and beneficiaries.

10. Dawn Shields, CFA, decides to change her recommendation on TelSky from "Buy" to "Sell." In the morning, she mails the revision to all her clients with a known interest in TelSky. That afternoon, one of these clients calls in an order to buy 15,000 shares of TelSky. According to CFA Institute Standards of Professional Conduct, Shields:

A. must not accept the order because it runs against her recommendation.
B. must accept the order without mentioning the change because Standard III(B) Fair Dealing requires her to inform all clients of the change in recommendation simultaneously.
C. should advise her customer of the change in her recommendation before accepting the order.
D. must not accept the order until the customer has had time to receive and read the new report.

11. Which of the following is one of the eight major sections of the GIPS standards?

A. Venture capital.
B. Private equity.
C. Asset weighting.
D. Sub-advisors.

12. Patrick Wilcox was recently hired by SafeTrust Investments as a fixed-income portfolio manager. Wilcox is informed by the head of the fixed income desk that all security analysis done by SafeTrust employees must be generated through the SafeTrust model that was developed in-house. Wilcox has reviewed reports that are based upon the model and appear to be thoroughly and accurately researched, but since he does not know first-hand the assumptions that the SafeTrust model is based on, he would prefer to use

the services of an outside vendor that he has used for years. If Wilcox uses the in-house model as instructed, he will:

A. violate Standard III(C) Suitability because he will be making recommendations of unknown quality.
B. not violate Standard V(A) Diligence and Reasonable Basis because the firm has deemed the model reliable.
C. violate Standard IV(A) Loyalty because he may cause harm to his employer by using a potentially unreliable model.
D. violate Standard V(A) Diligence and Reasonable Basis because he does not have personal knowledge of the model's reliability.

13. Greg Hoffman, a Level I CFA candidate, works as an independent securities research consultant and is known for unbiased, objective research and recommendations. Hoffman has been hired by managers of Hill Manufacturing Inc. (HMI) to write a research report on their company. Hoffman performs a thorough analysis of the firm's financials, the industry in which it operates, and the overall market and economy. After conducting his due diligence, Hoffman writes a report on HMI with a strong "Buy" recommendation. Hoffman posts the report for purchase on a website he created to support his consulting business but does not state either on the website or in the report that HMI paid for the research. Several of Hoffman's regular clients purchase the report and subsequently purchase shares in HMI which rapidly increase in price by over 20%. According to CFA Institute Standards of Professional Conduct, which of the following statements is **CORRECT**? Hoffman has:

A. violated Standard I(B) Independence and Objectivity, but not Standard VI(A) Disclosure of Conflicts.
B. violated Standard VI(A) Disclosure of Conflicts, but not Standard I(B) Independence and Objectivity.
C. not violated either Standard I(B) Independence and Objectivity or Standard VI(A) Disclosure of Conflicts.
D. violated both Standard I(B) Independence and Objectivity and Standard VI(A) Disclosure of Conflicts.

14. Rhonda Morrow, CFA, is an analyst for Waller & Madison, a brokerage and investment banking firm. Waller & Madison is a market maker for CorpEast, and Tim Waller, a principal in the firm, sits on CorpEast's board. Morrow has been asked to write a research report on CorpEast. According Standard VI(A) Disclosure of Conflicts, Morrow:

A. may write the report without disclosure of Waller's seat on CorpEast's board since he is not writing the report, but she must disclose that Waller & Madison is a market maker in CorpEast shares.
B. must not write the report and must request that Waller & Madison put CorpEast on their restricted list.
C. may write the report only if she discloses that Waller & Madison is a market maker in CorpEast shares and that Waller sits on the CorpEast board.
D. may write the report without disclosing that the firm is a market maker in CorpEast shares since that role conveys no special information, but she must disclose that Waller sits on the CorpEast board.

15. John Farr, CFA, has accumulated several pieces of nonpublic information about Cattle Corp. of Omaha from his contacts with the company. Although none of this information is material by itself, when Farr combines it with his own analysis, it leads him to conclude that Cattle Corp. will have an unexpectedly low earnings report this year. Cattle Corp. has not announced this information, and although Farr has

contacted the company, they will not confirm his finding. According to CFA Institute Standards of Professional Conduct, Farr:

A. can use the information to make investment recommendations and decisions.
B. cannot legally invest, divest, or make recommendations based on this information.
C. must inform the company in writing that he possesses this information, then after a reasonable time period he can trade on this information.
D. may use the information, but only if his company's compliance officer is able to verify with Cattle Corp. that the material he used was indeed nonmaterial.

16. Melinda Craine is an investment advisor in private practice. Craine would like to increase her assets under management and is preparing a presentation of her past performance history in order to attract new clients. Craine believes that in order to be competitive with the larger investment advisory firms, she should present her performance data in accordance with the CFA Institute Global Investment Performance Standards (GIPS). According to the GIPS standards, which of the following is FALSE?

A. Firms are not required to obtain verification for a claim of GIPS compliance.
B. A composite is a set of managed portfolios that all follow the same investment style.
C. Written documentation of policies and procedures used to establish and maintain compliance with GIPS must be maintained.
D. To claim compliance with GIPS, a company must present a minimum of ten years (or since the firm's inception if less than ten years) of GIPS-compliant performance data.

17. Geno Hanson is a portfolio manager at Bigtime Investments. James Ward, an old friend of Hanson's, is an executive head hunter in the same city. Hanson's friend has approached him about referring to Hanson's firm any high-level executives that he places locally. In return, the friend would like to play a round of golf at Hanson's country club for each new client referred. Hanson is not sure if this arrangement violates CFA Institute Standards of Professional Conduct. According to Standard VI(C) Referral Fees, which of the following statements is TRUE?

A. Hanson must disclose the arrangement with Ward to his employer, all clients, and all prospective clients.
B. Hanson is required to disclose the arrangement with Ward only to his employer.
C. Hanson is required to disclose the arrangement only to prospective clients referred by Ward.
D. Hanson must disclose the arrangement with Ward to his employer and to prospective clients referred by Ward prior to entering into any formal agreement for services.

18. Yvette Michaelson, a junior analyst for Torborg Investments, covers healthcare and consumer discretionary stocks alongside a senior analyst at the firm. During a recent flight, Michaelson inadvertently overhears a conversation between two executives regarding Collective Healthcare's ("Collective") proposed tender offer for Network Healthcare ("Network") at a 12% premium, which will be announced next week. Michaelson has followed both companies extensively and feels consolidation would be very beneficial for both companies. She calls her senior analyst to recommend a 15% increase in Torborg's current position in Network. According to Standard II(A) Material Nonpublic Information, Michaelson's actions are:

A. in violation of the Standard since she is acting on material nonpublic information.
B. not in violation of the Standard since she is acting on an unofficial conversation between two executives who have not breached any duty in discussing the information.
C. not in violation of the Standard under the mosaic theory since she has followed both Collective and Network extensively, and the tender offer information substantiates her beliefs about the benefits of consolidation.
D. in violation of the Standard since she is acting on unsubstantiated information that does not provide a reasonable and adequate basis for an investment recommendation.

The following 14 questions relate to Quantitative Methods.

19. An investor is celebrating his 50th birthday today and wants to start saving for his anticipated retirement at age 65. He wants to be able to withdraw $15,000 from his savings account on each birthday for 20 years following his retirement, with the first withdrawal being made on his 66th birthday. After extensive research, the investor determines that he can deposit his money into an account that offers 5% interest per year (compounded quarterly). He wants to make equal annual payments on each birthday into the account—the first payment on his 51st birthday, and the last on his 65th birthday. In addition, the investor's employer will contribute $100 to the account at the end of every month as part of the company's profit-sharing plan (a total of 180 contributions).

What amount must the investor deposit personally each year on his birthday to enable him to make the desired withdrawals at retirement?
A. $7,305.
B. $9,411.
C. $12,667.
D. $15,549.

20. A successful investor has decided to set up a scholarship fund for deserving students at her alma mater. Her plan is for the fund to be capable of awarding $25,000 annually in perpetuity. The first scholarship is to be awarded and paid out exactly four years from today. The funds will be deposited into an account immediately and will grow at a rate of 4%, compounded semiannually, for the foreseeable future. How much money must the investor donate today to fund the scholarship?
A. $528,150.
B. $549,487.
C. $574,253.
D. $618,812.

21. Which of the following statements about return distributions is *least likely correct*?
A. With positive skewness, the mean is greater than the median.
B. A distribution with positive excess kurtosis is more peaked and has fatter tails than the normal distribution.
C. If skewness is positive, the average magnitude of positive deviations from the mean is larger than the average magnitude of negative deviations from the mean.
D. If a return distribution has positive excess kurtosis and the analyst uses statistical models that do not account for the fatter tails, the analyst will overestimate the likelihood of very bad or very good outcomes.

22. An analyst collects figures for the attendance at each of his college's hockey games over the last five years. What is the minimum percentage of the distribution that lies within plus or minus 2.4 standard deviations from the mean? (Select the *closest* answer).

Excerpt from the cumulative z-table:

z	0.00
2.3	0.9893
2.4	0.9918
2.5	0.9938

A. 58.33%.
B. 82.60%.
C. 98.36%.
D. 99.18%.

23. Which of the following statements about covariance and the correlation coefficient is *incorrect*?
A. The correlation coefficient is a measure of linear association between two variables.
B. Covariance is a measure of how the returns of two assets tend to move together over time.
C. The correlation coefficient is computed by dividing the returns covariance of assets by the individual returns variances for the two assets.
D. The returns covariance between two assets is equal to the correlation between the returns of the two assets, times the product of their returns standard deviations.

Use the following data to answer Questions 24 through 27.

An analyst develops the following information for two stocks. 50% of the funds are invested in each stock.

	Scenario 1	*Scenario 2*	*Scenario 3*
Probability	0.5	0.3	0.2
	Rate of return		
Stock A	25%	10%	–25%
Stock B	1%	–5%	35%

24. The expected return and the variance of this two-stock portfolio is *closest* to:

	Expected return	Variance
A.	8.25%	23.31%
B.	8.25%	48.09%
C.	10.50%	23.31%
D.	10.50%	48.09%

25. The correlation coefficient between Stock A and Stock B is *closest* to:
A. –0.86.
B. –0.24.
C. 0.24.
D. 0.86.

26. If Stock A has a standard deviation of returns of 18.9% and Stock B has a standard deviation of returns equal to 14.73% and returns on the stocks are perfectly positively correlated, the standard deviation of an equally weighted portfolio of the two is:
A. 4.83%.
B. 10.25%.
C. 14.67%.
D. 16.82%.

27. If the covariance of returns between Stock A and Stock B is negative, which of the following statements is *incorrect*?
A. Stock B's returns move inversely with Stock A's returns.
B. The correlation coefficient between the returns on Stock A and Stock B is negative.
C. The negative covariance acts to reduce portfolio variance, because returns on negatively correlated assets tend to be offsetting.
D. The standard deviation of the portfolio will equal the weighted average of the standard deviations of the individual securities.

28. An investment manager wants to select three analysts from a group of six analysts to receive first-, second-, and third-place awards for outstanding performance. In how many ways can the investment manager make the three awards if the order of the awards among winners matters or does not matter?
Order does:

	Matter	Not matter
A.	18 ways	54 ways
B.	120 ways	54 ways
C.	18 ways	20 ways
D.	120 ways	20 ways

29. Which of the following statements about the central limit theorem is *least likely* correct? The:
A. sample mean is the best estimator of the population mean.
B. standard deviation of the sample mean is called the standard error of the sample mean.
C. standard error of the sample mean can be estimated by dividing the population standard deviation by $\sqrt{(n-1)}$.
D. sample means for large sample sizes will have an approximately normal distribution regardless of the distribution of the underlying population.

30. An investment analyst takes a random sample of 100 aggressive equity funds and calculates the average beta as 1.7. The sample betas have a standard deviation of 0.4. Using a 95% confidence interval and a z-statistic, which of the following statements about the confidence interval and its interpretation is TRUE? The analyst can be confident at the 95% level that the interval:
A. 1.580 to 1.820 includes the mean of the sample betas.
B. 1.622 to 1.803 includes the mean of the sample betas.
C. 1.622 to 1.778 includes the mean of the population beta.
D. 1.634 to 1.766 includes the mean of the population beta.

31. Which is the correct test statistic for a test of the null hypothesis?
$H_0: \sigma^2 = \sigma_0^2$ versus $H_a: \sigma^2 \neq \sigma_0^2$
A. F-statistic.
B. t-statistic.
C. z-statistic.
D. Chi-square statistic.

32. The following regression analysis was performed on annual return on equity (ROE) for a group of 100 companies and a measure of the growth in the value of their equity (EQGR):
$ROE_i = 5.491 + 1.420 \times EQGR_i$
- Sum of the squared errors = 228,690.81.
- Sum of squares regression = 102,977.66.
- Slope coefficient standard error = 0.2182.
- Degrees of freedom = 98.

Given the above data:
A. the coefficient of determination is 0.310.
B. ROE is the independent variable.
C. The standard error of estimate = 2,334.
D. the slope coefficient is 5.491.

The following 12 questions relate to Economics.

33. The term "crowding out" implies that:
A. Fed purchases of securities cause inflation in the long run.
B. a budget surplus will be a highly effective weapon against inflation.
C. sales of Treasury securities by the Fed is an effective weapon against inflation.
D. budget deficits will increase real interest rates and thereby retard business investment.

34. Automatic stabilizers are government programs that tend to:
A. automatically increase tax collections during a recession.
B. reduce interest rates, thus stimulating aggregate demand.
C. increase the ups and downs in aggregate demand without legislative action.
D. change government deficits in a manner counter-cyclical to economic growth without legislative action.

35. Joe DeRita is giving an economic briefing before the Senate Banking Committee. During his testimony, Senator Morris Howard states, "Based on the Phillips curve relationship, if we increase the inflation rate from 3% to 5%, we can achieve a reduction in the rate of unemployment in both the short run and in the long run." Senator Lawrence Fine adds, "Furthermore, if the central bank is able to credibly announce that they will maintain the money supply growth rate, so that the increased inflation rate is well anticipated, borrowers, lenders, workers, and employers will incorporate the new higher rate of inflation into long-term contracts, so there will be no adverse impact on the economy." Should DeRita agree or disagree with the two Senators?

	M. Howard	L. Fine
A.	Agree	Agree
B.	Agree	Disagree
C.	Disagree	Agree
D.	Disagree	Disagree

36. North Shore Excursions faces a downward sloping demand curve, has three identifiable customer groups with the same elasticity of demand, and can prevent resale of the product. Can North Shore profit from price discrimination and in general, does a firm that engages in price discrimination achieve more gains from customers with elastic or with inelastic demand?

	Can North Shore profit?	Higher gain from customers with
A.	Yes	Elastic demand
B.	Yes	Inelastic demand
C.	No	Elastic demand
D.	No	Inelastic demand

37. Utilitarianism, in reference to economic fairness, refers to the idea that:
    A. the greatest good occurs when wealth is equalized.
    B. the greatest utility of production and consumption results from competitive markets.
    C. equality of opportunity is an important measure of economic fairness.
    D. economic efficiency is greatest when the marginal social cost is just equal to the marginal social benefit.

38. Alice Costain operates a convenience store in the financial district of London. If Costain increases the price of a Magnim ice cream bar from £1.00 to £1.15, weekly sales decrease from 200 units to 180 units. Which of the following statements is TRUE?
    A. The price elasticity of demand is –0.66.
    B. The slope of the demand curve equals the elasticity of demand.
    C. The price increase will lead to an increase in total value of Magnim ice cream bars.
    D. Since the price elasticity of demand is less than 1, the demand for Magnim is elastic.

39. Which of the following is NOT a condition that characterizes competitive price-searcher markets (monopolistic competition)?
    A. Low barriers to entry.
    B. Large number of independent sellers.
    C. Each produces a differentiated product.
    D. Producers face horizontal demand curves.

40. International trade and specialization in production is *least likely* to result in:
    A. higher domestic prices and lower domestic consumption for exported products.
    B. lower domestic prices and higher domestic consumption for imported products.
    C. a net benefit to world markets but not necessarily to domestic markets.
    D. an expansion in both output and consumption compared to what could be achieved in the absence of trade.

41. Which of the following events is most likely to increase short-run aggregate supply (shift the curve to the right)?
    A. High unemployment puts downward pressure on money wages.
    B. A rise in resource prices.
    C. Inflation that results in an increase in goods prices.
    D. An increase in government spending intended to increase real output.

42. The quoted rates in the table represent the foreign currency price of one U.S. Dollar. Using the closing midpoint information, calculate the annualized forward premium or discount for the yen to a U.S. investor and determine if the U.S. dollar is trading at a forward discount or premium to the CHF:

Currency/Country	*Closing midpoint*	*Bid/Ask*	*One-month forward rate*
CHF/Switzerland	1.3131	128-134	1.3108
Yen/Japan	108.680	650-710	108.450

	<u>Yen forward premium/discount</u>	<u>U.S. Dollar to CHF</u>
A.	0.21%	Forward discount
B.	0.21%	Forward premium
C.	2.54%	Forward discount
D.	2.54%	Forward premium

43. Ralph Jameson is considering the short-term effects on exchange rates of expansionary monetary and stimulative fiscal policy. The most likely effects on the domestic currency of these policies are:

	Monetary expansion	Fiscal stimulus
A.	Appreciation	Depreciation
B.	Appreciation	Appreciation
C.	Depreciation	Depreciation
D.	Depreciation	Appreciation

44. Assume the spot exchange rate for Polish Zloty (PLN) to the dollar is 4.10 PLN/USD and the one-year forward rate is 4.15 PLN/USD. If interest rate parity (IRP) holds, and the one-year U.S. interest rate is 1.5%, the Polish 1-year interest rate is *closest* to:
A. 0.28%.
B. 1.0%.
C. 2.74%.
D. 3.15%.

The following 34 questions relate to Financial Statement Analysis and Corporate Finance.

45. All of the following refer to potential ways management can manipulate earnings using their discretion under U.S. GAAP EXCEPT:
A. big-bath behavior.
B. income smoothing.
C. changing accounting methods.
D. asset write-ups.

46. Which of the following statements about the appropriate revenue recognition method to use, given the status of completion of the earning process and the assurance of payment, is *least likely correct*? The:
A. completed contract method when the estimate of the total costs of the contract is unreliable.
B. cost recovery method when future cash collection is reasonably assured.
C. percentage-of-completion method when ultimate payment is assured and revenue is earned as costs are incurred.
D. installment sales method when payment is not assured until cash is collected.

47. An analyst gathered the following data about a company:
- Collections from customers are $5,000.
- Depreciation is $800.
- Cash expenses (including taxes) are $2,000.
- Tax rate = 30%.
- Net cash increased by $1,000.

If inventory increases over the period by $800, cash flow from operations equals:
A. $1,600.
B. $2,400.
C. $3,000.
D. $4,000.

48. Which of the following statements about the indirect method of calculating the statement of cash flows is FALSE?
A. Depreciation is added back to net income because it is an expense not requiring cash.
B. No adjustment is needed to account for changes in accounts receivable because no cash is involved.
C. No adjustment is needed for the payment of taxes because the tax payment is already in net income.
D. No adjustment is needed to account for extraordinary items because they are found above net income and are thus already taken into account.

49. A company has debt equal to $35 million and total assets of $105 million. This company makes a commitment to acquire raw materials over the next three years by making annual purchases of 5 million which have a present value of $12 million. For purposes of analysis, the best estimate of the debt-to-equity ratio after the appropriate analyst adjustment of the balance sheet is:
    A. 0.343.
    B. 0.500.
    C. 0.573.
    D. 0.671.

50. The following table contains ratios for 2005 and 2006 for Benrud Company:

	2005	2006
Pre-interest profit margin (EBIT/S)	0.15	0.10
Asset turnover (S/A)	1.00	1.50
Leverage ratio (A/E)	2.00	2.50
Tax retention (1 – t)	0.70	0.70
Interest expense ratio (I/A)	0.05	0.05

    Which of the following statements about Benrud Company's return on equity (ROE) is TRUE? ROE:
    A. decreased, because the company's profit margin fell.
    B. increased, due to the increase in turnover and leverage.
    C. increased, because the company's asset turnover increased.
    D. remained constant, because the fall in profits offset the increase in sales.

51. Which of the following is *most likely* presented on a common-size balance sheet or common-size income statement?
    A. total asset turnover.
    B. operating profit margin.
    C. inventory turnover.
    D. return on common equity.

Use the following data to answer Questions 52 and 53.

During an accounting period a company had the following sequence of transactions:

- Beginning inventory is 0.
- The company purchased 500 units at $15.
- The company purchased 600 units at $16.
- The company sold 400 units at $18.
- The company sold 550 units at $20.

52. If the company uses last-in first-out (LIFO) for inventory accounting, cost of goods sold (COGS) would be:
    A. $14,700.
    B. $14,768.
    C. $14,850.
    D. $18,200.

53. If the company uses first-in first-out (FIFO) for inventory accounting, ending inventory will be:
A. $2,250.
B. $2,332.
C. $2,400.
D. $3,350.

54. During a period of rising prices, a company may change from LIFO to FIFO to:
A. take advantage of tax deferrals and reduce overall taxes paid.
B. increase COGS and, hence, increase the overall cash flow position of the firm.
C. increase reported inventory and, hence, improve various accounting constructs such as working capital.
D. take advantage of FIFO liquidation by dipping into "cheap" inventory and manipulating reported profits.

Use the following data to answer Questions 55 and 56.

Nigella Company has a 3-year contract to build a manufacturing plant for $2,500. They have a reliable estimate that costs will be $2,000 over the life of the contract. The project has the following year-end billing amounts, cash received and costs incurred:

	Year 1	*Year 2*	*Year 3*	*Total*
Billed	$1,000	$1,000	$500	$2,500
Cash received	700	1200	600	2,500
Costs incurred	700	900	400	2,000

55. If Nigella uses the percentage-of-completion method of revenue recognition, what will be the addition to the balance sheet value of retained earnings (equity) at the end of year 2 from the project?
A. $175.
B. $225.
C. $400.
D. $500.

56. Under the completed contract method of revenue recognition, the total liabilities at the end of year 2 for Nigella will be:
A. $0.
B. $100.
C. $300.
D. $400.

57. Which of the following statements about the financial implications of capitalization versus expensing is *incorrect*?
A. Capitalizing will result in smoother reported income than expensing, and expensing will result in higher leverage ratios than capitalizing.
B. Capitalization will result in lower leverage ratios than expensing, but expensing will result in higher later year profitability ratios than capitalization.
C. Cash flow from operations is not affected by the capitalizing versus expensing decision, but the investing and financing cash flows depend on the method the firm chooses.
D. The total cash flows are the same regardless of whether a firm chooses capitalizing or expensing, but profitability is different depending on the method that the firm chooses.

58. If a company is investing in new assets, using straight-line depreciation instead of accelerated depreciation in the early years of an asset's life will lead to lower:
    A. assets and higher net income.
    B. turnover ratios and higher assets.
    C. return on equity and higher cash flow.
    D. net income and higher return on equity.

59. Which of the following is a correct characterization of the effect of treating a lease as a capital lease instead of as an operating lease?

	Indicator	Effect of capitalization
A.	Asset turnover	Higher
B.	Debt-to-equity ratio	Higher
C.	Operating cash flows	Lower
D.	Net income variability over life of lease	Lower

60. A firm needs to adjust the financial statements for a change in the tax rate. Taxable income is $80,000 and pretax income is $100,000. The current tax rate is 50%, and the new tax rate is 40%. The difference in taxes payable between the two rates is:
    A. $7,000.
    B. $8,000.
    C. $9,000.
    D. $10,000.

61. Which of the following describes how issuing zero-coupon bonds affects a company's financial statements?
    A. Company net income is overstated every year until maturity.
    B. Cash flow from operations decreases over the life of the bond.
    C. Cash flow from financing increases in the year of issuance.
    D. Cash flow from investing decreases in the year of maturity.

Use the following data to answer Questions 62 and 63.

An analyst gathered the following data about Bands Forever:

- In 2001 Bands Forever reported net income of $22,500 and had 3,000 shares of stock outstanding for the entire year.
- The company also had 1,200 shares of 10%, $50 par value preferred stock outstanding for the entire year.
- The company had 50, 10% coupon, $1,000 par value convertible bonds that can be converted into 50 shares of stock each, also outstanding for the entire year.
- The company had 1,000 stock options outstanding during the year.
- Each option is convertible into 10 shares of stock at $10 per share.
- The average market price of the stock for 2001 was $20.
- The tax rate is 40%.

62. With respect to the convertible bonds, they are:
    A. dilutive, with an earnings per share (EPS) of $2.45 versus an undiluted EPS of $5.50.
    B. dilutive, with an EPS of $3.55 with an undiluted EPS of $5.50.
    C. antidilutive, with an EPS of $8.50 with an undiluted EPS of $7.50.
    D. antidilutive, with an EPS of $6.50 versus an undiluted EPS of $5.50.

63. Using the treasury stock method, the diluted EPS for Bands Forever is *closest* to:
    A. $1.29.
    B. $1.86.
    C. $3.55.
    D. $5.50.

64. Which of the following statements about a zero-coupon bond is incorrect?
    A. Each year the imputed interest on a zero-coupon bond is amortized to expense, causing cash flow from operations to decrease.
    B. Over time the interest expense on the zero-coupon bond will increase as the discount is amortized to interest expense, and the bond liability increases.
    C. If the zero-coupon bond is reacquired before its maturity, any amount over or under the bond's book value should be listed as a gain or loss on the income statement.
    D. When a zero-coupon bond is issued, the bond account is booked for the actual amount received (the face amount less the discount).

65. Yamaska Mining issued a 5-year, $50 million face, 6% semiannual bond when market interest rates were at 7%. What is the initial balance sheet liability and what is the cumulative interest expense (in dollars) that the company should report following the first half of the 2nd year of the bond's life (the third semiannual period)?

	Initial liability	Cumulative interest expense to end of first half of year 2
A.	$47,920,849	$4,500,000
B.	$47,920,849	$5,051,494
C.	$50,000,000	$9,000,000
D.	$50,000,000	$10,102,988

66. A company's financial statement reads:

Current assets	$2,000
Fixed assets	3,000
Debt	3,000
Equity	2,000

The company sold $500 in receivables, but a review of the footnotes to the financial statements reveals that the credit risk was not transferred on the sale. Which of the following adjustments is an analyst reviewing the company *least likely* to make?

A. Decrease equity by $500.
B. Increase debt (short-term liabilities) by $500.
C. Increase current assets (accounts receivable) by $500.
D. Decrease cash flow from operations but increase cash flow from financing.

67. A company sold its receivables but retains the risk associated with bad debts. When reviewing this company, a financial analyst would adjust the company's debt-to-equity ratio and its accounts receivable turnover ratio:

	Debt-to-equity	Receivables turnover
A.	Upward	Upward
B.	Downward	Upward
C.	Upward	Downward
D.	Downward	Downward

68. A firm pays accrued wages with cash. Assuming a current ratio and a quick (acid test) ratio that are both greater than 1.0, what will be the impact on the current ratio, the quick ratio and net income?

	Current ratio	Quick ratio	Net income
A.	Decrease	Decrease	Decrease
B.	Decrease	Increase	Increase
C.	Increase	Increase	Stay the same
D.	Increase	Decrease	Stay the same

Use the following data to answer Questions 69 and 70.

The following data applies to LeVeit Company:

- LeVeit has a target debt-to-equity ratio of 0.5.
- LeVeit's bonds are currently yielding 10%.
- LeVeit is a constant growth firm that just paid a dividend of $3.00.
- LeVeit's stock sells for $31.50 per share.
- Return on Equity (ROE) is 20%.
- The dividend payout ratio is 75%.
- The company's marginal tax rate is 40%.

69. The company's cost of equity capital is:

A. 10.5%.
B. 12.5%.
C. 14.5%.
D. 15.0%.

70. The company's weighted after-tax cost of capital is:
A. 10.5%.
B. 11.0%.
C. 12.0%.
D. 12.5%.

71. Timely Taxis, Ltd. has signed a long-term lease for 20 underground parking spots at $150 each per month for their fleet of taxis. The firm currently has 18 taxis in operation and is performing an NPV analysis on the purchase of a 19th taxi. The cost of parking for the 19th taxi is best described as a(n):
A. sunk cost.
B. opportunity cost.
C. incremental cost.
D. type of cannibalization.

72. If a firm uses the weighted average cost of capital (WACC) to discount cash flows of higher than average risk projects, which one of the following will most likely occur?
A. Project NPVs will be understated.
B. The firm risks rejecting profitable projects.
C. The WACC of the firm should fall over time.
D. The overall risk of the firm's investments will rise over time.

73. Michael Robe, CFA, is a junior analyst for a large financial institution and has been preparing an analysis of United Mines, a coal mining company located in the U.S. As part of his research, he examines the company's proxy voting and rules and practices. Which of the following policies would be considered the *most restrictive* to shareholders?
A. United Mines allows proxy voting.
B. Shareholders of United Mines are allowed to cast confidential votes but must be present to do so.
C. Corporate policy restricts the use of share blocking prior to the United Mines annual meeting.
D. United Mines requires shareowner attendance to vote but coordinates the timing of its annual meeting to hold them on the same day as other companies in the region.

74. Wreathfield, Inc. is choosing between two mutually exclusive projects. The cash flows for the two projects are below. The firm has a cost of capital of 10%, and the risk of the projects is equivalent to the average risk of the firm.

	0	1	2	3	4	5	6
A:	−12,000	4,000	5,000	6,000			
B:	−20,000	3,000	3,000	3,000	5,000	8,000	8,000

The internal rate of return (IRR) of projects A and B respectively are *closest* to:

	Project A	Project B
A.	11.22%	10.50%
B.	12.33%	14.26%
C.	11.22%	14.26%
D.	12.33%	10.50%

75. An unexpected *decrease* in a company's willingness to pay dividends is *most likely* to result from an increase in:
A. its stock price.
B. its earnings stability.
C. the ease with which it can access funds.
D. the total value of available positive net present value projects.

76. According to the "clientele effect" of dividend policy, which of the following groups is *most* attracted to common stocks with low dividends or no dividends?
A. Wealthy individual investors.
B. Pension funds.
C. Corporate investors.
D. Endowments.

77. Two projects being considered by a firm are mutually exclusive and have the following projected cash flows:

Year	Project A Cash Flow	Project B Cash Flow
0	–$4.0	?
1	$3.0	$1.7
2	$5.0	$3.2
3	$2.0	$5.8

The crossover rate of the two projects' NPV profiles is 9%. What is the initial cash flow for Project B?
A. –$4.22.
B. –$4.51.
C. +$4.51.
D. +$8.73.

78. Which of the following statements regarding capital budgeting is *correct*? A firm's optimal capital budget can be found by moving along its investment opportunity schedule until:
A. it exhausts its capital budget.
B. the marginal revenue product is equal to marginal cost.
C. average project return is equal to average cost of capital.
D. the next project's return no longer covers the marginal cost of capital.

The following six questions relate to Portfolio Management.

79. Which of the following equations is *incorrect*?
A. $\beta_{\text{stock}} = \rho_{\text{stock, market}}\left(\dfrac{\sigma_{\text{stock}}}{\sigma_{\text{market}}}\right)$.
B. Total risk = unsystematic risk + nondiversifiable risk.
C. Two-stock portfolio standard deviation = $w_1^2\sigma_1^2 + w_2^2\sigma_2^2 + 2w_1w_2\sigma_1\sigma_2\rho_{1,2}$.
D. $E(R_{\text{stock}}) = RFR + \beta_{\text{stock}}[E(R_{\text{mkt}}) - RFR)]$.

80. Which of the following is NOT an implication of risk aversion for the investment process?
A. The capital market line (CML) is upward sloping.
B. The security market line (SML) is upward sloping.
C. The promised yield on AAA bonds is higher than on A bonds.
D. A positive relationship exists between expected return and expected risk.

81. Which of the following possible portfolios does **NOT** lie on the efficient frontier?

Portfolio	*Expected return*	*Standard deviation*
W	7%	5%
X	9%	12%
Y	11%	10%
Z	13%	15%

A. Portfolio W.
B. Portfolio X.
C. Portfolio Y.
D. Portfolio Z.

82. An investor gathers the following information about two stocks:

	Scenario 1	*Scenario 2*	*Scenario 3*
Probability	0.5	0.3	0.2
	Rate of return		
Security 1	25%	10%	–25%
Security 2	1%	–5%	35%

If the investor plans to invest $60,000 in Security 1 and $40,000 in Security 2, the expected return on the two-asset portfolio is:
A. 5.8%.
B. 8.7%.
C. 12.2%.
D. 16.5%.

83. When the underlying assumption of zero transactions costs is relaxed, the CAPM produces:
A. a capital market line that is no longer straight.
B. several different security market lines.
C. results that are essentially unchanged.
D. a band of returns instead of a security market line.

84. An analyst gathered the following data about three stocks:

Stock	Beta	Estimated return
A	1.5	15.0%
B	1.1	15.7%
C	0.6	14.2%

If the risk-free rate is 8% and the risk-premium on the market is 7%, is each stock undervalued, properly valued, or overvalued?

	Stock A	Stock B	Stock C
A.	Undervalued	Properly valued	Overvalued
B.	Overvalued	Overvalued	Properly valued
C.	Overvalued	Properly valued	Undervalued
D.	Properly valued	Undervalued	Undervalued

The following 36 questions relate to Asset Valuation.

85. Which of the following is most correct with respect to the characteristics of *call* and *continuous* markets?

	Call markets	Continuous markets
A.	Used in larger markets	Price is often set by an auction process
B.	Used in smaller markets	Price may be set by dealer bid-ask quotes
C.	Trades occur at specific times	Smaller markets after the opening price is set
D.	Trades occur at any time market is open	Larger markets after the opening price is set

86. Which of the following statements about indexes is *incorrect*?
A. The Value Line Composite Average is an unweighted index.
B. New York Stock Exchange index is a market-value-weighted index.
C. The Dow Jones Industrial Average is a market-value-weighted index.
D. The Nikkei-Dow Jones average is a price-weighted index of stocks from the first tier of the Tokyo Stock Exchange.

87. Which of the following results of event studies about market anomalies would **NOT** support the semi-strong form of the efficient market hypothesis? Tests showing that:
A. markets react rapidly to announcements of accounting changes.
B. stock splits do not result in short-run or long-run impacts on security returns.
C. pricing adjustments for initial public offerings occur within one day of the offering.
D. short-run profit opportunities occur around the listing date on a national exchange.

88. What are the minimum values of an American-style and a European-style 3-month call option with a strike price of $80 on a non-dividend-paying stock trading at $86 if the risk-free rate is 3%?

	American	European
A.	$6.00	$6.00
B.	$6.00	$5.96
C.	$6.59	$6.00
D.	$6.59	$6.59

89. An analyst gathered the following data about a company:
- A historical earnings retention rate of 60% that is projected to continue into the future.
- A sustainable return on equity of 10%.
- A beta of 1.0.

- The nominal risk-free rate is 5%.
- The expected market return is 10%.

If next year's EPS is $2 per share, what value would be placed on this stock?

A. $20.00.
B. $22.50.
C. $30.50.
D. $35.45.

90. An analyst makes the following predictions for the coming year:
- A stock's earnings per share will be $4.00.
- The dividend payout will be 55%.
- Return on equity will be 15%.
- The required rate of return on the market will be 12%.

The value of the stock would be *closest* to:

A. $25.00.
B. $32.00.
C. $37.00.
D. $42.00.

91. The increase in the number of institutions trading stocks since the 1960s has led to all of the following **EXCEPT**:

A. the super dot system of electronic orders.
B. growth in firms specializing in block trades.
C. increasing price volatility from the increase in large block trades.
D. significant decreases in brokerage commission rates.

92. Which of the following statements about measures of relative value is *least likely correct*?

A. Price/sales (P/S) ratio is calculated as the market value of the company divided by its sales.
B. Companies with low price/book value (P/BV) ratios tend to outperform high P/BV ratio firms on a risk-adjusted basis.
C. P/BV and price/cash flow (P/CF) ratios should be used in conjunction with price/earnings (P/E) ratios in fundamental analysis.
D. A major benefit to relative valuation methods such as P/BV and P/S is the ability to utilize them in comparing firms from different industries.

93. Which of the following is **NOT** an assumption underlying technical analysis?

A. The laws of supply and demand drive stock prices.
B. Stock prices move in trends that persist for long periods of time.
C. Shifts in supply and demand can be observed in market price behavior.
D. Supply is driven by the rational behavior of firms offering their shares, while demand is driven by the irrational behavior of investors.

94. Which of the following regarding technical analysts is *least likely correct*? Technical analysts:

A. do not rely on getting information first.
B. depend heavily on accounting information.
C. recommend investing after the new equilibrium is under way.
D. attempt to determine when to buy, not why investors are buying.

95. Which of the following statements regarding the life cycle of an industry is **TRUE**?
   A. In the pioneering phase, profits are small or negative.
   B. In the mature growth phase, sales growth falls below normal for the first time.
   C. During the stabilization phase, growth rates are still above the growth rates in the aggregate economy.
   D. The growth of substitute products increases total market share and causes continued increase in profits in the deceleration phase.

96. Which of the following statements regarding growth companies and growth stocks is **FALSE**?
   A. A growth stock is one that earns above-average risk-adjusted returns.
   B. A growth stock does not have to be the stock of a growth company.
   C. Management of a growth company has the ability to consistently choose projects with above-average returns.
   D. If growth opportunities are already incorporated into its price, a growth company's stock will earn above-average returns.

97. Consider the following treasury spot rates expressed as annual bond equivalent yields:

Maturity	*Spot rate*
6 months	3.0%
1 year	3.5%
1.5 years	4.0%
2 years	4.5%

Two Treasury notes each with $1,000 par values have 2 years remaining to maturity. Allowing for rounding to the nearest dollar, Treasury note #1 has a 4% semiannual coupon and is priced at $991, and Treasury note #2 has a 5% semiannual coupon and is priced at $1,008. What can you conclude about the market prices of these two notes?

	Treasury note #1	Treasury note #2
A.	Correctly priced	Underpriced
B.	Overpriced	Underpriced
C.	Correctly priced	Correctly priced
D.	Underpriced	Overpriced

98. Which of the following is **NOT** a disadvantage of a callable bond to an investor? The:
   A. investor is exposed to reinvestment rate risk.
   B. cash flow pattern of a callable bond is not known with certainty.
   C. issue often offers a higher coupon rate than a comparable option-free bond.
   D. price appreciation potential of callable bond will be reduced relative to an otherwise comparable option-free bond.

99. An investor is considering the purchase of Security X, which matures in 10 years with a par value of $1,000. During the first five years X has a 6% coupon with quarterly payments. During the remaining five years X has an 8% coupon with quarterly payments. The face value is paid at maturity.

   A second 10-year security, Security Z, has a 6% semiannual coupon and is selling at par. Assuming that X has the same bond equivalent yield as Z, what is the price of Security X?
   A. $943.
   B. $1,009.
   C. $1,036.
   D. $1,067.

100. A bond has a yield-to-maturity of 8%. If its effective duration is 7.41 years, a 25 basis point increase in rates will result in an approximate:
   A. 7.41% decrease in price.
   B. 1.85% decrease in price.
   C. 7.41% increase in price.
   D. 12.85% increase in price.

101. The full price of a bond:
   A. is the price that includes accrued interest.
   B. is also known as the "clean" price.
   C. includes commissions and taxes.
   D. is equivalent to a bond trading "flat."

102. Which statement regarding sinking funds is least likely correct?
   A. Sinking fund provisions require the retirement of a portion of a bond issue in specified amounts prior to the maturity date.
   B. Sinking fund redemptions can be accomplished by making cash payment to the trustee who will then retire the applicable proportion of the bonds.
   C. The right to retire a greater portion of the bond issue than is stipulated in the indenture is called an "accelerated sinking fund provision."
   D. If rates have declined since the bond was issued, companies are likely to choose to retire a proportion of the debt through the delivery of securities.

103. The bank discount yield for a $1,000 face value U.S. Treasury bill (T-bill) trading at $983.10 with 160 days to maturity is approximately:
   A. 1.69%.
   B. 1.72%.
   C. 3.80%.
   D. 3.90%.

104. Consider a 25-year, $1,000 par semiannual-pay bond with a 7.5% coupon and a 9.25% YTM. Based on a yield change of 50 basis points, the effective duration of the bond is *closest* to:
   A. 8.73.
   B. 10.03.
   C. 11.45.
   D. 12.50.

105. For a bond currently priced at $1,018 with an effective duration of 7.48, if rates moved down 75 basis points, the new price would be approximately:
   A. $942.
   B. $961.
   C. $1,075.
   D. $1,094.

106. Consider a $1,000-face value, 12-year, 8%, semiannual coupon bond with a YTM of 10.45%. The change in value for a decrease in yield of 38 basis points is:
   A. $21.18.
   B. $22.76.
   C. $23.06.
   D. $24.14.

107. Which of the following statements about Treasury Inflation Protected Securities (TIPS) is FALSE?
   A. Inflation adjustments are made semiannually.
   B. The coupon rate on TIPS is effectively a real rate of interest.
   C. The coupon rate adjusts upward for inflation.
   D. Adjustments to the principal value of the bond reflect inflation.

108. The least amount of data required to calculate the implied forward rate for three years beginning three years from now would be:
   A. the 6-year and 3-year spot rates.
   B. spot rates at 1-year intervals for the 6-year period.
   C. spot rates at 6-month intervals for the 6-year period.
   D. spot rates at 6-month intervals for three years in addition to the 6-year spot rate.

Use the following data to answer Questions 109 and 110.

Sarah Paul is speculating with interest rate futures and takes a long position in one U.S. T-bond future with a $100,000 principal amount. She puts up an initial margin deposit of $1,000 and has a maintenance margin of 75% of that. The contract was quoted at 108:14 (quoted in 32nds) at the time of purchase. The T-bond's settle prices over the next four days are as follows:

Day	Price
1	108:18
2	108:12
3	108:26
4	108:31

109. At the end of the second and fourth days, Paul's margin account is *closest* to:

	Day 2	Day 4
A.	$890.00	$1,531.25
B.	$937.50	$1,531.25
C.	$937.50	$1,170.00
D.	$890.00	$1,170.00

110. Which of the following is the price at which Paul's margin would be $750?
   A. 108.
   B. 108:06.
   C. 108:08.
   D. 108:22.

111. Janet Powers is getting exasperated with the continually falling stock market and decides to increase her current income by writing a covered call on a stock she owns, Billings, Inc. The current price of the stock is $45, and Powers writes the call at a strike price of $50. The call option premium is $3.50. Which of the following statements regarding Powers' covered call strategy is TRUE?
   A. Powers is trading the stock's upside potential in exchange for current income.
   B. The price of the stock must rise to at least $50 before Powers will lose money.
   C. The price of the stock would have to fall to $41.50 before Powers would benefit from the covered call strategy.
   D. Powers is eliminating downside risk at the same time she is increasing her current income with the covered call strategy.

112. A portfolio manager holds a long position on a forward contract on $20 million face value 80-day T-bills priced at 1.85% on a discount yield basis. At settlement, 80-day T-bills are priced at 1.95% on a discount yield basis. How much will the portfolio manager have to pay at settlement for the T-bills?
A. $19,630,000.
B. $19,773,890.
C. $19,917,780.
D. $19,913,333.

113. Two analysts are considering the effects of accelerated depreciation on the after-tax cash flows for an investor in the 30% marginal tax bracket who purchases an apartment house with a 20% down payment and a fixed-rate fully-amortizing 20-year mortgage for the balance of the purchase price. Assume rents, maintenance, property taxes, insurance, and vacancy are the same every year.

Analyst One states: "If we use straight line depreciation the after-tax cash flows will be the same in every year prior to sale under those assumptions."

Analyst Two states: "If we use accelerated depreciation after-tax cash flows will increase each year as depreciation expense goes down."

Are Analyst One and Analyst Two correct or incorrect?

	Analyst One	Analyst Two
A.	Correct	Incorrect
B.	Correct	Correct
C.	Incorrect	Incorrect
D.	Incorrect	Correct

114. Which of the following is typically **NOT** an advantage of using a price-to-sales (P/S) ratio for valuation purposes?
A. P/S ratios are positive even when price-to-book and price-to-earnings ratios are not.
B. Sales growth is the best measure of value creation.
C. P/S ratios are more stable than price-earnings ratios.
D. Empirical studies have shown that firms with low P/S ratios tend to have greater long-term average returns.

115. Which of the following similarities between distressed security investing and venture capital investing is *least likely correct*? Both:
A. asset classes are illiquid.
B. assets have reasonably short expected investment horizons.
C. situations require significant analytical work to avoid valuation errors.
D. assets may require significant involvement by investors in order to be successful.

116. An open-end fund has the following holdings at the end of the business day:
- 500,000 shares of A valued at $20 each.
- 100,000 shares of B valued at $10 each.
- 200,000 shares of C valued at $15 each.
- $1,000,000 in cash.
- The fund currently has one million shares outstanding.

The fund's net asset value per share is:
A. $10.
B. $13.
C. $14.
D. $15.

117. An analyst has gathered the following data regarding a property:
- The property, if fully occupied, would earn \$200,000.
- Operating expenses on the property are \$25,000.
- The vacancy rate is 7%.
- The investor is in a 40% marginal tax bracket.
- The required rate of return on the property is 11%.

Using the income approach to estimate the market value of the real estate investment, the value of the property is *closest* to:
A. \$878,182.00.
B. \$1,463,636.00.
C. \$1,590,909.00.
D. \$1,818,182.00.

118. An investor is interested in the following piece of property:
- The property will cost \$200,000 at time zero.
- It will provide cash flows of \$50,000 in year 1, \$60,000 in year 2, \$70,000 in year 3, \$80,000 in year 4.
- A \$20,000 investment will be required in year 5 as the property will have some environmental contamination and will have to be restored to its original condition.

What is the NPV of the project if the investor's required rate of return is 10%?
A. –\$18,208.
B. –\$10,144.
C. \$14,693.
D. \$15,232.

119. An investor buys 2 gold futures contracts at \$350 per ounce. Each gold futures contract is based on 5,000 ounces of gold. At the same time he collateralizes his position by buying the required amount of 10-year notes paying 3%. Two months later the price of gold is \$347.40 and the price of the 10-year notes has not changed. What is the net gain or loss on the value of the investor's position?
A. \$8,500 loss.
B. \$26,000 loss.
C. \$26,000 gain.
D. \$34,500 gain.

120. A venture capital firm is considering a \$2 million investment in a firm developing home health care apparatus. The conditional failure rate is 20% per year over a 5-year horizon with an expected payoff of \$5.5 million at the end of year 5. The NPV of this investment, using a discount rate of 20%, is *closest* to:
A. –\$1,275,000.
B. –\$275,700.
C. \$230,000.
D. \$607,500.

SAMPLE EXAM 3
AFTERNOON SESSION

Calculating Your Score

Topic	*Maximum Score*	*Your Score*
Ethics	18	
Quantitative Methods	14	
Economics	12	
Accounting & Corporate Finance	34	
Asset Valuation	36	
Portfolio Management	6	
Total	120	

The morning and afternoon exams are identically weighted over the topics and readings. You can therefore treat the morning and afternoon exams as independent events.

If you took more than three hours (180 minutes) to complete this portion of the exam, you should adjust your score downward by one point for each minute you ran over.

Remember: the real exam *will be more difficult* than these sample exams. The main reason for this is the general anxiety and stress that you will be feeling on exam day, coupled with the time pressure you will be under. Many of the questions on this practice exam and the real exam are not individually difficult, so if you take extra time to answer the questions on this practice exam, your score will go up significantly. However, if you want an accurate measure of your potential performance on the exam, adhere to the 3-hour time limit.

After you have finished grading your sample exam, you may find it useful to use the exam questions and recommended solutions for review purposes (as flash review points). Many of these questions were specifically written for your use as study tools. Once again, I feel I should remind you not to memorize these questions; you will not see them on the actual exam. What you will see on the exam, though, are the concepts, terms, and procedures presented in these questions.

Your actual exam will most likely "look different" than what you see in this book. Please remember, no study provider knows the content of the actual exam. These sample exams are our "best guess" as to the structure and content of your actual exam.

Test Answers

1. A B C D
2. A B C D
3. A B C D
4. A B C D
5. A B C D
6. A B C D
7. A B C D
8. A B C D
9. A B C D
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98. A B C D
99. A B C D
100. A B C D
101. A B C D
102. A B C D
103. A B C D
104. A B C D
105. A B C D
106. A B C D
107. A B C D
108. A B C D
109. A B C D
110. A B C D
111. A B C D
112. A B C D
113. A B C D
114. A B C D
115. A B C D
116. A B C D
117. A B C D
118. A B C D
119. A B C D
120. A B C D

SAMPLE EXAM 3
AFTERNOON SESSION

The following 18 questions relate to Ethics.

1. Roger Baker, CFA, is a fixed-income portfolio manager for a medium-sized investment firm and has been asked to serve on the board of directors for Cold Delight Inc., a national chain of ice cream shops. Baker personally owns stock in Cold Delight, but the firm has no debt securities outstanding. Baker's former college roommate is the CEO of the company. As a member of the board of directors, Baker would attend four meetings each year and receive $15,000 a year in director's fees, and he and his immediate family will also receive a 50% discount in all Cold Delight stores. According to Standard IV(B) – Additional Compensation Arrangements, which of the following actions is **CORRECT**?
   A. Baker must provide written disclosure and obtain written permission from his employer before accepting the board position and its accompanying benefits.
   B. Baker must provide written disclosure and receive permission from his employer, but it needs not be written.
   C. Baker may accept the position without permission but must disclose the duties of the position and compensation to his employer.
   D. Baker does not need to disclose the offer or receive permission.

2. Peter Wellington is a client relationship manager for Huntington Financial Services who references his status as a "CFA candidate" in current client presentation materials. Wellington completed the Level II CFA examination two years ago, regularly reads research materials prepared by CFA Institute, and attends continuing education seminars for employees who are CFA charterholders. Wellington plans to register for the Level III CFA exam next year. Current and prospective clients are receptive to Wellington's presentations and feel that given his status, he can understand complex financial issues affecting their accounts. Which of the following *best* describes Wellington's actions under the CFA Institute Code and Standards? Wellington's reference to his status as a CFA candidate in presentation materials:
   A. does not violate any CFA Institute Standards of Professional Conduct.
   B. violates Standard V(B) – Communication with Clients and Prospective Clients.
   C. violates Standard VII(A) – Conduct as a CFA Institute Member or CFA Candidate.
   D. violates Standard VII(B) – Reference to the CFA Institute, the CFA Designation, and the CFA Program.

3. Which of the following statements relating to the Global Investment Performance Standards (GIPS®) is **FALSE**?
   A. Only investment management firms may claim compliance with GIPS.
   B. GIPS represent standards that members of CFA Institute and CFA candidates must adhere to.
   C. To claim GIPS compliance, a firm must present at least five years (or since its inception if less than five years) of annual investment performance that complies with GIPS.
   D. GIPS must be applied to the entire firm, where the firm can be defined as an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business unit.

4. Ed Michaels, CFA, is a compliance officer with oversight responsibilities for research analysts, traders, and securities brokers in multiple offices at Gaslight Broker-Dealer. Upon accepting the compliance officer position two years ago, Michaels implemented written compliance procedures for employees working in all of Gaslight's offices and made all covered employees aware of the procedures. He has recently been informed by an external auditor hired by the board of directors that, on several occasions over the past two years, two different employees have been trading in recommended securities ahead of trades made in managed client accounts and ahead of the release dates. On his recommendation, both employees are fired in accordance with their employment agreements, as a lesson to others. He also recirculates the written compliance procedures that explain very clearly which activities are prohibited. Michaels has:
   A. violated only Standard IV(A) – Loyalty by firing the employees instead of restricting their activities since they had not been previously written up for the behavior.
   B. violated Standard I(D) – Misconduct because he was associated with the unethical activity.
   C. not violated any Standards since he implemented compliance procedures that effectively detected a violation of the Code and Standards.
   D. violated Standard IV(C) – Responsibilities of Supervisors.

5. Mitch Sherwood, CFA, is a portfolio manager for Oak Investments, a large hedge fund in New York. He is considering leaving his current position and starting his own firm. Because of financial constraints, Sherwood will need to make some preparations for his new business venture while he is still employed in his current position, including setting up offices, phones, and building a website. In addition, Sherwood is considering taking on a couple client portfolios to manage on his own time in order to begin establishing his own investment track record. Which of the following statements about Standard IV(A) – Loyalty (to employer) is TRUE? Sherwood:
   A. is prohibited from taking on the clients and from making preparations for his new business venture while still employed, without permission from his employer.
   B. must obtain Oak Investment's consent to take on the clients and disclose this activity to his employer, but doesn't need to do either regarding the preparations to begin his own business.
   C. is prohibited from making arrangements or preparations to go into a competitive business before terminating his employment with Oak Investments but can take on the client accounts as long as he finds the clients independently of his work at Oak and doesn't charge them a fee.
   D. must simply disclose to Oak Investments the types of services to be performed, the duration of services, and the compensation to be received as a result of the consulting.

6. Patricia Nelson, CFA, was informed by one of her clients that if Nelson could get the performance of the firm's pension portfolio above that of the Standard & Poor's (S&P) average by year end, the client would give her a free trip to Singapore to visit the firm's offices. If Nelson agrees to this arrangement, which of the following actions complies with CFA Institute Standards of Professional Conduct? Nelson:
   A. may inform her employer orally of this agreement but does not need permission.
   B. may inform her employer by email of this agreement and needs written consent.
   C. is not required to inform her employer of this arrangement.
   D. may inform her employer orally of this agreement but must receive written consent.

7. Bill Fox, CFA, has been preparing a research report on New London Wire and Cable for one of his major investment clients. He had completed much of his analysis and had planned on having his report typed and bound today. Unfortunately, his briefcase was stolen while he ate breakfast, and he lost all his notes and working papers. The lost materials included his notes from management interviews, conversations with suppliers and competitors, dates of company visits, and his flash drive containing much of his quantitative analysis. Fox's client needs this report tomorrow. In a panic Fox called New London's vice president of finance and was faxed a copy of the company's most recent financial projections. Fox remembered that his own analysis showed that management's estimates were too high. He did not remember the exact amount, so he revised New London's figures downward by 10%. Fox also incorporated, without acknowledgement, some charts and graphs on New London from a research report he had received last week from a small regional research firm and used some information from an S&P reference work. With the help of his secretary, a copy machine, and some creative word processing, Fox got the "Buy" recommendation done in time for the evening overnight delivery pick up. Which of the CFA Institute Standards of Professional Conduct did Fox violate?
   A. Standard I(C) – Misrepresentation only.
   B. Standard V(A) – Diligence and Reasonable Basis only.
   C. Standard I(C) – Misrepresentation and Standard V(A) – Diligence and Reasonable Basis.
   D. Neither Standard I(C) – Misrepresentation nor Standard V(A) – Diligence and Reasonable Basis.

8. Roger Smith, CFA, has been invited to join a group of analysts in touring the riverboats of River Casino Corp. For the tour, River Casino has arranged chartered flights from casino to casino since commercial flight schedules are inconvenient and not practical for the group's time schedule. River Casino has also arranged to pay the hotel bill for the three nights of the tour. The trip is purely business. According to CFA Institute Standards of Professional Conduct, Smith:
   A. may accept the arrangements as they are.
   B. may accept the flight but should pay his own hotel bill.
   C. must offer to pay for his share of the airfare and his own hotel bill.
   D. must decline to accept the trip because the arrangements are inappropriate.

9. Samuel Parkin, a principal of Argor Advisors, is in charge of preparing the firm's performance history in accordance with GIPS. Parkin is careful to include every portfolio managed into a composite for reporting. At the end of each year, he assigns each portfolio to a single composite. He calculates the total return on each portfolio and averages them to calculate the composite performance for the year. With respect to his assignment of portfolios to composites and his calculation of composite total returns has Parkin violated the requirements of GIPS?

	Portfolio assignment	Composite calculation
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	No

10. Susan Smart, CFA, is about to change her "Buy" recommendation on RollinsCo to "Sell." RollinsCo had been growing rapidly over the past year, but Smart believes the growth potential is now gone. She believes that due to increased competition, RollinsCo will face serious pricing pressures. Smart took the liberty of first selling the shares held in her discretionary client accounts and then selling the shares she held in her own personal account before issuing her hold report. According to CFA Institute Standards of Professional Conduct, which of the following statements about her actions is TRUE? Smart:
   A. did not violate any standards.
   B. violated only Standard III(B) – Fair Dealing.
   C. violated only Standard VI(B) – Priority of Transactions.
   D. violated Standard III(B) – Fair Dealing and Standard VI(B) – Priority of Transactions.

11. Matt Jacobs, CFA, is an investment advisor to several university endowment funds. Jacobs previously recommended to a client that he buy shares in Timeco. The shares have underperformed the market this year, and the client has spoken with Jacobs about closing out the position. Jacobs firmly believes Timeco is still a worthy investment and that the client should not sell. Since the stock is thinly traded, Jacobs buys 1,000 Timeco shares in his personal account in order boost the company's share price, with the intent of reversing the trade a few days later. After making the purchase, the share price rises, allowing Jacobs to convince his client to hold on to his Timeco shares. Has Jacobs violated Standard II(B) – Market Manipulation?
    A. No, because he made the trades for the benefit of his client.
    B. Yes, because he intended to interfere with the market price of Timeco.
    C. Yes, because he failed to consider the stock's current price in relation to its true value.
    D. No, because he will reverse the trades in a few days and negate any effects of the purchase with no harm to the client.

12. William Rex, CFA, has just distributed materials referencing his performance results since he is the only portfolio manager at the firm he has founded. In the presentation, Rex has included a total of five years of investment performance, four of which were with a previous employer. To keep things simple, the presentation does not make a distinction between the first four years and the most recent year of performance. Also included in the presentation are the simulated results of a stock selection model Rex has recently developed and tested. The fact that the results are simulated is disclosed in the presentation. Has Rex violated any CFA Institute Standards of Professional Conduct?
    A. No.
    B. Yes, failing to disclose that four years of his performance results were with another employer is a violation, but including the simulated results is acceptable.
    C. Yes, both failing to disclose that four years of his performance results were with another employer and including the simulated results are violations.
    D. Yes, including simulated results in a marketing piece is a violation, but showing his five years of performance is acceptable.

13. William Lambert is a research analyst for an investment advisory firm. Last year, he put a "Buy" recommendation on Lincoln Industries, a manufacturing company. His recommendation was in part due to an analyst conference call with Lincoln's CEO, who predicted a substantial increase in sales for the upcoming year. Lambert also conducted research on Lincoln Industries, its industry environment, and general market expectations. Lincoln Industries, in fact, underperformed in the year following Lambert's recommendation due to sagging sales and increases in supply costs. Lambert's boss asked Lambert to meet with him to discuss this particular recommendation. For the meeting, Lambert gathered his files on Lincoln Industries, including his notes detailing his conference call with Lincoln's CEO. According to the CFA Institute Code and Standards, Lambert is:
    A. in violation of Standard III(A) – Loyalty, Prudence, and Care for failing to exercise reasonable care.
    B. in violation of Standard II(A) – Material Nonpublic Information for utilizing material nonpublic information.
    C. not in violation of any Standard because he retained records to substantiate his initial investment recommendation.
    D. in violation of Standard V(A) – Diligence and Reasonable Basis for not having a reasonable basis to make the initial recommendation.

14. Judy Blush is a CFA candidate and is recommending the purchase of a mutual fund that invests solely in long-term U.S. Treasury bonds (T-bonds) to one of her clients. She states that, "Since the U.S. government guarantees payment of both the bond's principal and interest, risk of loss with this investment is virtually zero." To support her investment recommendation, Blush presents her client with an in-depth and well-researched report prepared by another analyst at her firm but with her name and contact information on the cover. In a footnote on the last page, the source of the report is disclosed in detail. Which of the following statements is **CORRECT**? Blush:
A. violated Standard I(C) – Misrepresentation.
B. violated Standard V(A) – Diligence and Reasonable Basis.
C. violated Standard V(B) – Communication with Clients and Prospective Clients.
D. did not violate any CFA Institute Standards of Professional Conduct.

15. Alyssa Wilcox is a registered representative for Comprehensive Brokers and a CFA Level I candidate. Wilcox usually makes investment recommendations for clients based on a semiannual mailing to clients that requests an update on clients' investment objectives, financial situations, and investment experience. Wilcox regularly attends new issue road shows offered by her colleagues in investment banking, who will give her shares of a new issue if the issue is purchased by at least half of her client accounts. Without disclosing it to her clients, Wilcox has personally received shares in half of the company's new issue underwritings for the year but will only allocate shares to large client accounts. Wilcox's employer is aware of her participation in the underwritings and the fact that she allocates new issue shares to all accounts with assets in excess of $1 million. Which of the following *best* describes Wilcox's actions under the CFA Institute Code and Standards? Wilcox has:
A. fulfilled her responsibility under Standard III(C) – Suitability.
B. fulfilled her responsibility under Standard III(B) – Fair Dealing.
C. not fulfilled her responsibility under Standard VI(A) – Disclosure of Conflicts.
D. not fulfilled her responsibility under Standard III(E) – Preservation of Confidentiality.

16. Lilly Marlow is an elderly widow with a moderate risk tolerance who depends on her investment portfolio to meet her living expenses. Marlow keeps her investments in an account at People's Trust Bank. Marcus Pate, CFA, has been her investment advisor for years and has always managed Marlow's account to her satisfaction. Pate has a lunch meeting with Marlow quarterly and has always used their discussions as a basis for selecting investments for her account over which he has full discretion to set the investment strategies. Since he has investment discretion, Pate often invests in risky derivative strategies to increase the return on Marlow's account. As Marlow's son is reviewing her recent year-end statement, he is shocked to discover that Pate has invested a significant amount of the account's assets in illiquid derivative products. The son calls Pate, demanding to know why he has taken such a risky action. According to the CFA Institute Code and Standards, Pate is:
A. in violation of Standard III(C) – Suitability.
B. in violation of Standard I(B) – Independence and Objectivity.
C. in violation of Standard V(B) – Communication with Clients and Prospective Clients.
D. not in violation of any standard because Marlow has been satisfied with the portfolio performance to date.

17. Byland Advisors is an investment management firm that has reported performance results since 2000 in compliance with the country version of GIPS (CVG) applicable to their country, where they operate exclusively. There are differences between that CVG and the current version of GIPS, which became effective January 1, 2006. Which of the following *best* describes the requirements for this firm to present a compliant presentation for 2006?
   A. The firm must recalculate performance for 2001 through 2005 in accordance with GIPS, and report 2006 performance in accordance with GIPS.
   B. The firm must recalculate all prior performance in accordance with GIPS, and report 2006 performance in accordance with GIPS.
   C. The firm may report performance from 2000 to 2005 as it was calculated under the CVG, and report 2006 performance in accordance with GIPS.
   D. The firm may continue to report in accordance with the CVG for periods prior to January 1, 2008.

18. Byron Bell, CFA, is an investment manager for Sally Fillmore, president of the local branch of First Bank. Fillmore, in a conversation with Bell's trading assistant, mentions that she is considering moving her account to another investment manager and confides that she has been diagnosed with the early signs of Alzheimer's disease. The trading assistant relays the conversation to Bell. According to the CFA Institute Code and Standards, the trading assistant is:
   A. not in violation of any Standard.
   B. in violation of Standard III(E) – Preservation of Confidentiality by disclosing confidential client information.
   C. in violation of Standard III(A) – Loyalty, Prudence, and Care by putting her employer's interests before the client's.
   D. in violation of Standard I(B) – Independence and Objectivity for not maintaining objectivity in her professional activities.

The following 14 questions relate to Quantitative Methods.

19. A client is celebrating his 50th birthday today and wants to start saving for his anticipated retirement at age 65. He wants to be able to withdraw $20,000 from his savings account on each birthday for 20 years following his retirement. The first withdrawal will be on his 66th birthday.

   After extensive research, the client determines that he can invest his money in an account that offers 5% interest per year with quarterly compounding. He wants to make equal annual payments on each birthday into the account—the first payment on his 51st birthday and the last on his 65th birthday.

   In addition, the client's employer will contribute $2,000 to the account at the end of every year as part of the company's profit-sharing plan (a total of 15 contributions).

   What amount must the client deposit personally into the account each year on his birthday to enable him to make the desired withdrawals at retirement?
   A. $9,377.
   B. $10,559.
   C. $12,212.
   D. $19,760.

20. A company reports its past 6-years' earnings growth at 10%, 14%, 12%, 10%, –10%, and 12%. The company's arithmetic mean, geometric mean, and median growth rates are *closest* to:

	Arithmetic	Geometric	Median
A.	8.0%	8.5%	11.0%
B.	11.3%	8.5%	10.0%
C.	8.0%	7.7%	11.0%
D.	11.3%	7.7%	12.0%

Use the following data to answer Questions 21 and 22.

The following table summarizes the results of a poll (hypothetically) taken of CFA charterholders and CFA candidates regarding the importance of a continuing education requirement after the CFA designation is obtained:

Group	*In Favor of a Continuing Education Requirement*	*Against a Continuing Education Requirement*
CFA charterholders	235	765
CFA candidates	180	820

21. Given the information that a member of the group is in favor of a continuing education requirement, what is the probability that she is a CFA candidate?
    A. 37%.
    B. 43%.
    C. 50%.
    D. 57%.

22. What is the probability that a randomly selected individual from this group will be either a CFA charterholder or someone who would **NOT** favor the adoption of a continuing education requirement?
    A. 0.76.
    B. 0.81.
    C. 0.86.
    D. 0.91.

23. Which of the following statements about common probability distributions is *most likely correct*?
    A. A probability distribution specifies the probabilities of the possible outcomes of a random variable.
    B. In a binomial probability distribution, each observation has only two possible outcomes that are mutually exclusive.
    C. A discrete uniform distribution, the simplest of all probability distributions, is the distribution of equally likely outcomes.
    D. A normal distribution is a discrete symmetric probability distribution that is completely described by two parameters: its mean and variance.

24. For a binomial random variable B (n = 12, p = 0.4), what are the mean and variance?

	Mean	Variance
A.	4.8	2.88
B.	4.8	1.70
C.	7.2	2.88
D.	7.2	1.70

25. Which of the following statements about the univariate, multivariate, and standard normal distributions is *least likely correct*?
    A. A univariate distribution describes a single random variable.
    B. A multivariate distribution specifies the probabilities for a group of related random variables.
    C. The standard normal random variable, denoted Z, has mean equal to 1 and variance equal to 1.
    D. The need to specify correlations is a distinguishing feature of the multivariate normal distribution in contrast to the univariate normal distribution.

26. An investor currently has \$1.2 million and is considering investing in one of the four following portfolios:

Statistical Measures	*Portfolio A*	*Portfolio B*	*Portfolio C*	*Portfolio D*
Expected annual return	10%	12%	17%	22%
Standard deviation of return	9%	14%	20%	25%

At the end of the year, the investor may need to take out \$60,000 without invading the initial capital of \$1.2 million. The optimal portfolio using Roy's safety-first criterion is:
A. Portfolio A.
B. Portfolio B.
C. Portfolio C.
D. Portfolio D.

27. An analyst is testing the hypothesis that the variance of 50 monthly returns for the S&P 500 equals the variance of 50 monthly returns for the Wilshire 5000. The variance of the S&P 500 returns is 0.085, whereas the variance of the Wilshire 5000 returns is 0.084. Assuming the samples are independent and the returns are normally distributed, which of the following represents the **CORRECT** test statistic?

A. $\frac{\text{sample variance of the S\&P 500}}{\text{sample variance of the Wilshire 5000}}$.

B. $\frac{\text{variance of S\&P 500} - \text{variance of Wilshire 5000}}{\text{standard error of squared differences}}$.

C. $\frac{(\text{degrees of freedom}) \times (\text{sample S\&P 500 variance})}{\text{sample Wilshire 5000 variance}}$.

D. $\frac{\text{variance of S\&P 500} - \text{variance of Wilshire 5000}}{\text{degrees of freedom}}$.

28. An analyst plans to use the following test statistic: $t_{n-1} = \frac{\overline{x} - \mu_0}{s/\sqrt{n}}$. This test statistic is appropriate for a hypothesis about the:
A. mean difference of two normal populations.
B. variance of a normally distributed population.
C. population mean of a normal distribution with unknown variance.
D. the equality of two population means of two normally distributed populations based on independent samples.

29. Based on 20 observations, an analyst calculates the sample correlation coefficient between the annual returns of large- and mid-cap stocks as 0.6. The analyst wants to test the null hypothesis, H_0, that the true correlation in the population is 0 against the alternative hypothesis, H_A, that the correlation in the population is different from 0. Assume that the critical *t*-value is 2.101 at the 0.05 level of significance. What is the computed *t*-value, and should the analyst reject the null hypothesis?

	Computed *t*-Value	Reject H_0
A.	3.182	Yes
B.	3.182	No
C.	4.237	Yes
D.	4.237	No

Use the following data to answer Questions 30 and 31.

A regression of a stock's returns on the returns of an industry index provides the following results:

	Coefficient	*Standard Error*	*t-Value*
Intercept	2.1	2.01	1.04
Industry index	1.9	0.31	6.13

- The t-statistic critical value at the 0.01 level of significance is 2.58.
- Standard error of estimate = 15.1.
- Correlation coefficient = 0.849.
- F-statistic = 1.0816.

30. If the return on the industry index were 4%, the stock's expected return would be:
   A. 4.0%.
   B. 7.6%.
   C. 9.7%.
   D. 11.2%.

31. The percentage of the variation in the return on the stock explained by the variation in the industry index return is *closest* to:
   A. 51.1%.
   B. 63.2%.
   C. 72.1%.
   D. 84.9%.

32. The standard deviation of dispersion of observations about the regression line is equal to:
   A. one minus the correlation coefficient.
   B. the standard error of estimate.
   C. the standard error of the regression coefficient.
   D. the percent variability of the dependent variable not explained by the independent variable.

The following 12 questions relate to Economics.

33. If investors' expected future incomes increase, all else constant, interest rates will:
   A. fall, while an increase in the demand for financial capital will cause rates to rise.
   B. rise, while an increase in the demand for financial capital will cause rates to fall.
   C. rise, while an increase in the demand for financial capital will also cause rates to rise.
   D. fall, while an increase in the demand for financial capital will also cause rates to fall.

34. Assume that the reserve requirement is 20%, and banks currently have no excess reserves. If excess reserves stay at zero and the Federal Reserve buys $100 million of Treasury bills from the public, the money supply could potentially increase by:
   A. $20 million.
   B. $100 million.
   C. $500 million.
   D. $600 million.

35. The economy is in recession, and countercyclical fiscal policy has been enacted. If the policy has been effective and the AD curve has moved upward to the right, the result is:
   A. lower prices and more output.
   B. higher prices and more output.
   C. lower prices and lower unemployment.
   D. higher prices and higher unemployment.

36. The firm's demand curve for labor is:
   A. identical to the supply curve of the output product.
   B. the mirror image of the supply curve of the output product.
   C. the mirror image of the marginal cost of labor curve, assuming all other resource inputs are constant.
   D. the downward sloping portion of the marginal revenue product of labor curve.

37. Which of the following is NOT an automatic stabilizer?
   A. Property taxes.
   B. Corporate profit taxes.
   C. Unemployment compensation.
   D. Progressive personal income taxes.

38. A central bank bases its long-run strategy for achieving price stability on targeting the growth rate of the money supply to equal the difference between the 10-year average growth rate of real GDP and the 4-year average growth rate in the velocity of money. The bank also attempts to reduce the magnitude of business cycles. When the bank's governing board perceives a significant difference between actual real GDP and full-employment real GDP, they adjust the money supply in the countercyclical direction. Which type of monetary policy is the central bank following?
   A. Fixed-rule.
   B. Discretionary.
   C. New Keynesian feedback rule.
   D. New Monetarist feedback rule.

39. An analyst collects the following currency information:
   - USD/GBP quote is 1.5435 bid, 1.5489 ask.
   - CAD/USD quote is 1.4532 bid, 1.4594 ask.
   - USD/ZAR quote is 0.4523 bid, 0.4592 ask.

   Given the above information, the ask CAD/ZAR quote is *closest* to:
   A. 0.6573.
   B. 0.6702.
   C. 3.1781.
   D. 3.2266.

40. Oligopolists have an incentive to cheat on collusive agreements in order to:
   A. avoid competitive practices.
   B. restrain trade and hinder trade relationships.
   C. increase their individual share of the joint profit.
   D. restrict output and put upward pressure on price.

41. The impact of higher rates of inflation in the long run on real interest rates and on nominal interest rates is:

	Real rates	Nominal rates
A.	Increase	Increase
B.	Increase	No change
C.	No change	Increase
D.	No change	No change

42. The demand for U.S. dollars in foreign exchange markets would *most likely* increase as a result of:
   A. spending by U.S. tourists in Spain.
   B. sale of U.S. wheat to French consumers.
   C. U.S. change to more restrictive fiscal policy.
   D. an increase in U.S. inflation.

43. An individual sees her income rise from $80,000 to $88,000, and along with it, her consumption of macaroni has decreased from 8 dozen packages per year to 6 dozen packages per year. Which of the following is *closest* to the income elasticity of her demand for macaroni, and should macaroni be classified as a normal good or an inferior good?

	Income elasticity	Type of good
A.	–3.0	Inferior
B.	–3.0	Normal
C.	–0.33	Inferior
D.	–0.33	Normal

44. Assume that the domestic nominal rate of return is 4%, and the foreign nominal rate of return is 5%. If the current exchange rate is 2.500 F/D, the forward rate at this time (expressed in D/F) consistent with interest rate parity is:
   A. 0.396.
   B. 0.404.
   C. 2.476.
   D. 2.524.

The following 34 questions relate to Financial Statement Analysis and Corporate Finance.

45. Under the accrual concept of income, which of the following are sufficient for revenue recognition to take place?
   A. Completion of the earnings process and actual receipt of cash.
   B. Completion of the earnings process and assurance of payment.
   C. Delivery of goods and services and passage of risk of ownership from seller to buyer.
   D. Delivery of goods and services and the absence of significant contingent obligation on the part of the seller.

46. Which revenue recognition method is NOT consistent with the assurance of revenue and completion of the earnings process given?

	Revenue recognition method	Assurance of revenue	Completion of earnings process
A.	Installment sales	Not assured	Complete
B.	Cost recovery	Assured	Complete with contingencies
C.	Sales basis	Assured	Complete
D.	Percentage of completion	Not assured	Incomplete and costs can be estimated

Use the following data to answer Questions 47 and 48.

• Net income	$100
• Depreciation expense	$25
• Purchase of machine	$50
• Sale of company trucks	$30
• Sale of common stock	$45
• Decrease in accounts receivable	$10
• Increase in inventory	$20
• Issuance of bonds	$25
• Increase in accounts payable	$15
• Increase in wages payable	$10

47. Cash flow from operating activities is:
   A. $125.
   B. $135.
   C. $140.
   D. $185.

48. Cash flow from financing activities is:
   A. $35.
   B. $50.
   C. $70.
   D. $85.

Using the following data to answer Questions 49 through 52.

Smith Corp. common-sized
Income statement

Sales ($900)	100%
Cost of goods sold	65
Operating exp	15
Interest exp	5
Income tax	5
Net income	10

Smith Corp. common-sized
Balance sheet

Cash	5%
Accounts receivable	20
Inventory	25
Fixed assets	50
Total assets ($700)	100%
Short term-debt	20%
Long term-debt	30
Common equity	50
Debt and equity	100%

49. Smith's quick ratio is:
   A. 1.00.
   B. 1.25.
   C. 1.50.
   D. 2.50.

50. Smith's times interest earned (interest coverage) ratio is:
   A. 0.2%.
   B. 5.0%.
   C. 4.0 times.
   D. 5.0 times.

51. Smith's total asset turnover is *closest* to:
A. 1.00.
B. 1.12.
C. 1.20.
D. 1.29.

52. Assuming the firm would like a debt ratio of 40% and is willing to issue new stock and retire debt with the proceeds, which of the following is *closest* to the necessary change in common equity?
A. Increase by $50.
B. Decrease by $50.
C. Increase by $70.
D. Decrease by $70.

53. A hierarchical model of accounting diversity is a model which:
A. standardizes the classification of assets, liabilities and equity on foreign financial statements so that they conform with U.S. Generally Acceptable Accounting Principles (GAAP).
B. classifies the accounting practices of many countries into successive layers according to the various factors that drive differences in accounting practices.
C. sets the accounting rules of continental Europe and Japan in a codified legal system in which governmental bodies write the law.
D. places the accounting practices of various countries in a hierarchy based on their level of readability, ease of use, and reliability so that international investors feel more secure in making international investments.

54. Which of the following is *least likely* to be an argument for harmonization of accounting standards and practices around the world? Harmonization would:
A. decrease the expense of preparing consolidated financial statements when foreign subsidiaries are subject to different accounting rules than their parent.
B. increase the comparability of financial statements and results.
C. decrease the expense of raising capital in foreign markets.
D. increase the cost of capital in general because of the significant differences in inflation rates between developed countries and developing countries.

55. An analyst gathered the following data about a company:
- 1,000,000 shares of common are outstanding at the beginning of the year.
- 10,000 6% convertible bonds (conversion ratio is 20 to 1) were issued at par June 30 of this year.
- The company has 100,000 warrants outstanding all year with an exercise price of $25 per share.
- The average stock price for the period is $20, and the ending stock price is $30.

If the convertible bonds are considered dilutive, the number of shares of common stock that the analyst should use to calculate diluted earnings per share is:
A. 1,000,000.
B. 1,016,667.
C. 1,100,000.
D. 1,266,667.

56. A company has the following sequence of events regarding its stock:
- The company had 1,000,000 shares outstanding at the beginning of the year.
- On June 30, the company declared and issued a 10% stock dividend.
- On September 30, the company sold 400,000 shares of common stock at par.

The number of shares that should be used to compute basic earnings per share at year end is:
A. 1,000,000.
B. 1,100,000.
C. 1,200,000.
D. 1,600,000.

57. Which of the following statements about the approaches for calculating earnings per share (EPS) in simple versus complex capital structure is *least likely correct*?
A. If convertible bonds are dilutive, the numerator in the diluted EPS calculation is increased by the interest expense on the bonds.
B. If convertible preferred stock is dilutive, the convertible preferred dividends must be added back to the numerator to calculate diluted EPS.
C. The numerator in the basic EPS equation is net income less preferred dividends.
D. The denominator in the basic EPS equation contains the number of shares of common stock issued, weighted by the days that the shares have been outstanding.

58. In periods of rising prices and stable or increasing inventory quantities, a company using last in, first out (LIFO) rather than first in, first out (FIFO) will report inventory turnover and net profit margin that are:

	Inventory turnover	Net profit margin
A.	Lower	Higher
B.	Lower	Lower
C.	Higher	Lower
D.	Higher	Higher

59. A research analyst has collected the following information regarding a long-term construction project. The company uses the percentage-of-completion methodology to account for this project:

	2004	*2005*	*2006*	*Totals*
Invoiced amounts	$1,000	$500	$500	$2,000
A/R collections	$800	$600	$600	$2,000
Construction expenses	$700	$500	$400	$1,600

Given this information, the *net construction-in-progress* balance sheet value at the end of 2005 equals:
A. $0.
B. $100.
C. $300.
D. $1,500.

60. Which of the following relations is *most likely correct*?
A. $COGS_L = COGS_F$ – (LIFO reserve ending – LIFO reserve beginning).
B. $COGS_L = COGS_F$ + (LIFO reserve ending – LIFO reserve beginning).
C. $COGS_L = COGS_F$ – [(LIFO reserve ending + LIFO reserve beginning)/2].
D. $COGS_L = COGS_F$ + [(LIFO reserve ending + LIFO reserve beginning)/2].

61. Two growing companies are identical except that Company A capitalized significant marketing costs in year 1, whereas Company B expenses all marketing costs. For these two companies, which of the following statements about financial statement effects is *least likely correct*? Company A will show:
A. lower income variability over time and equal total cash flows, compared to Company B.
B. lower D/A and D/E ratios and lower investing cash flows than Company B.
C. lower ROE in year 1 and lower income variability over time than Company B.
D. higher operating cash flows and higher ROA in year 1 than Company B.

62. Which of the following statements regarding deferred taxes is *least likely correct*?
A. A permanent difference is a difference between taxable and pretax income that will not reverse.
B. A deferred tax asset occurs when a temporary difference results in taxable income that exceeds pretax income.
C. A valuation allowance is a reserve measured against deferred tax assets based on the likelihood that a deferred tax asset will be realized.
D. Under the liability method (SFAS 109), deferred tax assets and liabilities are not adjusted for changes in future tax rates.

63. A company has beginning gross investment of \$400,000 and ending gross investment of \$480,000 in a period when the depreciation expense was \$25,000 and accumulated depreciation was \$250,000. The average depreciable life and average age of the company's assets are *best* estimated as:

	Depreciable life	Average age
A.	19.20 years	3.5 years
B.	17.60 years	10.0 years
C.	17.60 years	3.5 years
D.	19.20 years	10.0 years

64. There are several important requisite skills a qualified board member should possess. Many qualities are critical. Which of the following is a sign of a well-qualified board member?
A. Long tenure on the board.
B. Major supplier to the firm.
C. Has other board experience.
D. Does not have a significant stock position.

65. Which of the following statements regarding leasing is *least likely correct*?
A. Under an operating lease, the entire lease payment is treated as a reduction to cash from operations.
B. Under a capital lease, the present value of future lease payments is posted to the balance sheet as a long-term liability.
C. The current ratio of a company that capitalizes leases will not differ from the current ratio of a company that uses operating leases.
D. Under a sales-type lease, the lessor recognizes gross profit equal to the present value of minimum lease payments minus the cost of the leased asset.

66. A company leased an airplane under the following terms:
    - The lease is a 10-year capital lease.
    - The present value of the lease payments discounted at the appropriate interest rate (10%) is $3,000,000.
    - The company uses the straight-line depreciation method.
    - The company does not own the asset or have a purchase option at the end of the lease.

    In the first year, the reported lease related expense is:
    A. $300,000.
    B. $360,000.
    C. $548,000.
    D. $600,000.

67. An analyst should consider whether a company acquired assets through a capital lease or an operating lease because a company may structure:
    A. operating leases to look like capital leases in order to enhance their leverage ratios.
    B. operating leases to look like capital leases in order to enhance their cash conversion cycle.
    C. capital leases to look like operating leases in order to enhance their leverage ratios.
    D. capital leases to look like operating leases in order to enhance their cash conversion cycle.

68. Which of the following is *least likely* a type of off-balance-sheet financing?
    A. Sale of receivables with recourse.
    B. Issuance of debt with warrants to finance expansion.
    C. Use of finance subsidiaries to borrow funds to finance parent company receivables.
    D. Use of take-or-pay agreements to ensure the long-term availability of raw materials and other inputs necessary for operations.

69. The following information applies to a corporation:
    - The company has $200 million in equity and $100 million in debt.
    - The company recently issued bonds at 9%.
    - The corporate tax rate is 30%.
    - The company's beta is 1.125.

    If the risk-free rate is 6% and the expected return on the market portfolio is 14%, the company's after-tax weighted average cost of capital is:
    A. 10.50%.
    B. 11.21%.
    C. 11.75%.
    D. 12.10%.

70. An analyst gathered the following information about a capital budgeting project:
    - The proposed project cost $10,000.
    - The project is expected to increase pre-tax net income and cash flow by $3,000 in each of the next eight years.
    - The company has 50% of its capital in equity at a cost of 12%.
    - The cost of new debt is 6%.
    - The company's tax rate is 33%.

    What is the project's net present value (NPV)?
    A. $959.
    B. $1,551.
    C. $6,604.
    D. $7,240.

71. In order to properly protect shareholders' long-term interests, the *most appropriate* characteristic for a board is that:
A. the board meets regularly with management present.
B. the chairman of the board is also the CEO.
C. the majority of board members are not firm executives.
D. board members represent firm suppliers, customers, and/or pension advisors.

72. A company issues $10,000,000 of 5-year, annual, 10% coupon bonds. Upon issuance, their YTM was 9%. Based on this information, the initial balance sheet valuation and the first year's income statement amortization are:

	Initial balance	Amortization
A.	$10,000,000	$0
B.	$10,388,965	$64,993
C.	$10,395,636	$395,636
D.	$10,798,542	$38,896

73. A firm has a change in sales from 1,500,000 to 1,600,000 units. The resulting change in earnings before interest and tax (EBIT) is $100,000 (from $400,000 to $500,000), and EPS increases from $1.50 to $2.00. The firm's degree of operating leverage is:
A. 1.05.
B. 2.50.
C. 3.75.
D. 5.00.

74. HiTekCo has $5 million in sales, variable costs are 80% of sales, fixed costs are $400,000, and annual interest expense is $100,000. If HiTekCo's sales increase by 10%, by how much will the company's earnings per share (EPS) increase?
A. 12.0%.
B. 16.7%.
C. 20.0%.
D. 22.5%.

75. Which of the following statements about the risks facing creditors and owners is *correct*?
A. A creditor of a firm has a priority claim on the assets of the business in the event of bankruptcy, and the creditor's potential reward is not limited.
B. A firm's owners have a residual claim on the firm's assets and earnings, bear less risk, and have less potential upside returns than creditors.
C. A creditor of a firm has priority claim on the assets of the business in the event of bankruptcy, but the creditor's potential reward is limited.
D. A firm's owners have a residual claim on the firm's assets and earnings, bear greater risk, but have less potential upside returns than creditors.

76. Which of the following statements about stock splits is *incorrect*?
A. Because of higher brokerage fees on low-priced stocks, stock splits tend to reduce liquidity.
B. If a good earnings report does not follow a stock split, prices tend to revert to their original levels, adjusted for the split.
C. Reverse stock splits do change a firm's value whereas stock dividends do not.
D. Stock prices tend to rise after a stock split because investors interpret them as a positive signal from management about future earnings.

77. The share prices of Finn Industries and Terracotta Masonry are both $50 per share, and each company has 40 million shares outstanding. On September 30, both companies announced a $20 million stock buyback. Finn Industries has a book value of $600 million, while Terracotta Masonry has a book value of $1.4 billion. What is the book value per share (BVPS) of each company after the share repurchase?

	Finn Industries	Terracotta Masonry
A.	$12.85	$33.75
B.	$14.65	$34.85
C.	$15.45	$36.77
D.	$18.25	$43.44

78. Croix Felix, a French cosmetics company has annual pretax earnings of €300. The corporate tax rate on retained earnings is 40%, and the corporate tax rate that applies to earnings paid out as dividends is 25%. Croix Felix pays out 50% of its earnings as dividends and the individual tax rate that applies to dividends is 40%. What is the effective tax rate on corporate earnings paid out as dividends?
A. 25%.
B. 40%.
C. 55%.
D. 64%.

The following six questions relate to Portfolio Management.

79. An analyst gathers the following information about four stocks.

	Stock A	*Stock B*	*Stock C*	*Stock D*
Estimated return	8.0%	12.0%	18.0%	22.5%
Beta	0.6	1.0	1.2	1.8

The analyst estimates that the risk-free rate is 5%, and the return on the market portfolio is 12%. Based on the above inputs and the capital asset pricing model (CAPM), which of the following statements about the valuation of the four stocks is **TRUE**?

	Stock A	Stock B	Stock C	Stock D
A.	Undervalued	Overvalued	Properly valued	Undervalued
B.	Undervalued	Properly valued	Overvalued	Overvalued
C.	Overvalued	Properly valued	Undervalued	Undervalued
D.	Overvalued	Undervalued	Undervalued	Properly valued

80. An investment policy statement is important to the portfolio management process because it:
A. specifies allocations across assets and countries.
B. forces the investor and advisor to articulate the investment strategy they will employ.
C. creates a record of the benchmark against which performance will be judged.
D. provides a clear understanding of the level of risk a client is willing to accept.

81. The investment objective of earning a return on an investment that is at least equal to the inflation rate is called:
A. total return.
B. current income.
C. capital appreciation.
D. capital preservation.

82. An analyst gathered the following return information over a 10-year period for two funds: Fund X and Fund Y:

$$\sum^{10}[R_X - E(R_X)]^2 = 376.56;\ \sum^{10}[R_Y - E(R_Y)]^2 = 126.43;\ \text{Correlation } (R_X, R_Y) = 0.34$$

Based on this information, the population covariance of the returns between the two funds is *closest* to:
A. 4.35.
B. 7.42.
C. 31.61.
D. 94.14.

83. Combining a risk-free asset with a portfolio of risky assets results in all of the following EXCEPT:
A. the standard deviation of the expected return for the newly created portfolio is the linear proportion of the standard deviation of the risky asset portfolio.
B. the expected return for the newly created portfolio is the weighted average of the return on the risk-free asset and the expected return on the risky asset portfolio.
C. the efficient frontier becomes the line that connects the point in the risk-return plane representing the risk-free asset, with the point representing the risky asset portfolio.
D. all risk-return combinations between the risk-free asset and the risky asset portfolio can be represented by a straight line that connects the point in the risk-return plane representing the risk-free asset, with the point representing the risky asset portfolio.

84. A stock has a beta of 0.9 and an estimated return of 10%. The risk-free rate is 7%, and the expected return on the market is 11%. According to the CAPM, this stock:
A. is overvalued.
B.. is undervalued.
C. is properly valued.
D. may be overvalued or undervalued.

The following 36 questions relate to Asset Valuation.

85. Which of the following statements about markets is *least likely correct*?
A. Dealer markets are referred to as order-driven markets.
B. The over-the-counter market is a call market.
C. Auction markets, such as the New York Stock Exchange, are referred to as price-driven markets.
D. Continuous markets are markets where trades occur any time the market is open.

86. Closing prices on four consecutive days of trading:

	Stock Price $			*Number of Shares*		
Date/stock	X	Y	Z	X	Y	Z
January 13	25	40	30	1,000	2,000	1,000
January 14	25	42	7	1,000	2,000	5,000[1]
January 15	27	42	8	1,000	2,000	5,000
January 16	14	44	10	2,000[2]	2,000	5,000

[1] There is a 5-for-1 stock split for stock Z prior to the opening of the market on January 14.

[2] There is a 2-for-1 stock split for stock X prior to the opening of the market on January 16.

An analyst is asked to set up a price-weighted index for three stocks based on the information given in the table. If the initial divisor is 3, the divisor at the beginning of the day on January 14 is:

A. 2.2421.
B. 2.2734.
C. 2.4138.
D. 3.0000.

87. Robert Higgins is estimating the price-earnings ratio that will be appropriate for an index at the end of next year. He has estimated that:

- Expected annual dividends will increase by 10% compared to this year.
- Expected earnings per share will increase by 10% compared to this year.
- The expected growth rate of dividends will be the same as the current estimate of 5%.
- The required rate of return will rise from 8% to 11%.

Compared to the current P/E, the end-of-the-year P/E will be:

A. 2% higher.
B. 10% higher.
C. 50% lower.
D. 37.5% lower.

88. An analyst gathered the following data about a stock:

- The stock paid a $1 dividend last year.
- Next year's dividend is projected to be 10% higher.
- The stock is projected to sell for $25 at the end of the year.
- The risk-free rate of interest is 8%.
- The expected return on the market is 13%.
- The stock's beta is 1.2.

The value of the stock today is *closest* to:

A. $19.45.
B. $22.89.
C. $24.00.
D. $26.74.

89. A stock has a steady 5% growth rate in dividends. The required rate of return for stocks of this risk class is 15%. The stock is expected to pay a $1 dividend this coming year. The expected value of the stock at the end of the fourth year is:
A. $10.00.
B. $12.16.
C. $14.21.
D. $16.32.

90. A stock has the following data associated with it:
- A required rate of return of 14%.
- A return on equity of 15%.
- An earnings retention rate of 40%.

The stock's price-to-earnings ratio should be:
A. 4.4.
B. 5.0.
C. 6.7.
D. 7.5.

91. A firm has a constant growth rate of 7% and just paid a dividend of $6.25. If the required rate of return is 12%, what will the stock sell for two years from now based on the dividend discount model?
A. $127.06.
B. $133.75.
C. $149.80.
D. $153.13.

92. Which of the following statements about the tests used to examine different forms of the Efficient Market Hypothesis (EMH) is **FALSE**?
A. Statistical and trading rule tests generally support the weak form of the EMH.
B. Autocorrelation tests test the weak form of the EMH.
C. The superior historical performance of exchange specialists and corporate insiders is inconsistent with the semi-strong form of the EMH.
D. Event studies on stock splits and announcements of accounting changes are tests of the semi-strong form of the EMH.

93. Which of the following is a limitation of arbitrage in correcting anomalies?
A. Arbitrage is a relatively riskless activity, which has led to consistently reduced profits for many arbitrageurs, thereby reducing their interest in correcting market anomalies.
B. There is no limitation of arbitrage in correcting anomalies because arbitrageurs will use their capital to pursue any trade to exploit perceived mispricing.
C. Arbitrage is not always riskless, so trading based on information that a security is undervalued or overvalued does not ensure a profit.
D. Arbitrageurs are sophisticated traders, but too few of them exist to contribute significantly to the correction of market anomalies.

94. Assume the Wansch Corporation is expected to pay a dividend of $2.25 per share this year. Sales and profit for Wansch are forecasted to grow at a rate of 20% for two years after that, then grow at 5% per year forever. Dividend and sales growth are expected to be equal. If Wansch's shareholders require a 15% return, what is the per-share value of Wansch's common stock based on the dividend discount model?
A. $22.75.
B. $26.00.
C. $28.50.
D. $39.25.

95. Assuming all other factors remain unchanged, which of the following actions would *decrease* a company's earnings multiplier?
   A. The retention rate decreases.
   B. The dividend growth rate increases.
   C. The dividend payout ratio increases.
   D. The required rate of return increases.

96. Jasper Inc. is currently selling for $40. Next period's net income is expected to be $3 million, and depreciation and amortization are expected to total $300,000. The firm expects assets of $45 million and total liabilities of $20 million, and there are 1,200,000 shares of stock outstanding. The firm's price/cash flow and price/book value ratios are:

	Price/cash flow	Price/book value
A.	14.54	1.92
B.	17.20	2.50
C.	17.20	1.92
D.	14.54	2.50

97. Compared to the underlying MBS, a collateralized mortgage obligation (CMO):
   A. has less prepayment risk.
   B. has lower duration.
   C. may have more or less prepayment risk.
   D. allows an investor to select an exact maturity.

98. An analyst collects the following spot rates, stated as annual BEYs:
   - 6-month spot rate = 6%.
   - 12-month spot rate = 6.5%.
   - 18-month spot rate = 7%.
   - 24-month spot rate = 7.5%.

   Given only this information, the value of a 2-year, semiannual-pay, 10% coupon bond with a face value of $1,000 is *closest* to:
   A. $918.30.
   B. $1,000.00.
   C. $1,046.77.
   D. $1,077.48.

99. A bond has an effective duration of 7.5. If the bond yield changes by 100 basis points, the price of the bond will change by:
   A. exactly 7.5%.
   B. exactly 0.75%.
   C. approximately 7.5%.
   D. approximately 0.75%.

100. Which of the following *best* describes the motivation for a corporation to issue an asset-backed security? Securitization of specific assets by a corporation enables the corporation to:
   A. avoid negative covenants of bond indentures.
   B. improve the recovery rate in the event of default.
   C. use the assets as collateral for additional borrowing.
   D. get a credit rating on the ABS that will result in a lower cost of borrowing.

Use the following data to answer Questions 101 and 102.

An analyst is considering two bonds: Bond A yields 7.5%, and Bond B yields 7.0%.

101. Using Bond B as the reference bond, the absolute yield spread is:
A. –7.14%.
B. –0.50%.
C. 0.50%.
D. 7.14%.

102. Using Bond B as the reference bond, the yield ratio is:
A. 0.50.
B. 0.53.
C. 0.93.
D. 1.07.

103. An analyst collects the following information regarding spot rates of interest:
- 1-year rate = 4%.
- 2-year rate = 5%.
- 3-year rate = 6%.
- 4-year rate = 7%.

Utilizing the pure expectations theory of the term structure of interest rates, the expected annualized 2-year interest rate two years from today will be:
A. 7.02%.
B. 8.03%.
C. 9.04%.
D. 18.89%.

104. A $1,000 par value, 10% semiannual, 20-year debenture is currently selling for $1,100. The bond's current yield is:
A. 8.9%.
B. 9.1%.
C. 10.0%.
D. 10.5%.

105. An analyst is comparing two bonds and has collected the following data:
- Bond A: Nominal spread of 125 basis points, zero-volatility spread of 125 basis points, and option-adjusted spread of 65 basis points.
- Bond B: Nominal spread of 95 basis points, zero-volatility spread of 95 basis points, and option-adjusted spread of 95 basis points.

Each bond is similar in all respects except that Bond A is a mortgage passthrough security and Bond B is a noncallable corporate bond. Based only on this information, which of the following statements is TRUE?
A. The yield curve is perfectly flat.
B. Bond A is preferred over Bond B because its nominal spread is 30 basis points higher.
C. The option-adjusted spread measures the relative curvature of the yield curve and its effect on option cost.
D. Bond A is preferred to Bond B because the embedded option in Bond A returns the investor an additional 65 basis points.

106. Which of the following is *least likely* allowed if a bond is non-refundable? A corporation:
   A. refunds bonds by issuing preferred stock.
   B. calls its nonrefundable bonds and issues common equity in their place.
   C. gets a revolving credit line at the bank at a rate lower than that on their bonds and redeems the bonds.
   D. issues zero coupon bonds at a yield that is lower than the current rate on their bonds and redeems the old bond issue.

107. CureAll General Hospital has been forced to file for bankruptcy protection. The company managing the hospital has been allowed to reorganize under the name United Hospital of Hope. The courts have specified that a new indenture should be written to accompany a planned new bond issue. The issue would have 10 years to maturity and carry a 10% coupon that would be paid annually. The new agreement would relieve the company of the obligation to make interest payments during the first 5 years after the bond is issued. For the remaining 5 years, regular interest payments would resume. Finally, at maturity, the principal ($1,000) plus the interest that was not paid during the first 5 years would be paid. However, no additional interest would be payable on the deferred interest. If the bond's YTM is 10%, its value is *closest* to:
   A. $778.31.
   B. $813.69.
   C. $827.54.
   D. $856.28.

108. Which of the following statements regarding the term structure of interest rates is FALSE?
   A. The liquidity preference theory suggests an upward bias for longer-term rates.
   B. Forward interest rates are the best estimates of future short-term interest rates under the pure expectations theory.
   C. The observed yield curve likely contains elements of liquidity preference, market segmentation, and expectations theories.
   D. Under the market segmentation theory, a flat yield curve is likely to become positively sloped if the demand for long-term bonds exceeds supply and if the supply of short-term bonds exceeds demand.

109. An investor has a call option on a stock that is currently selling for $35. The call option is in the money by $3. The call option's strike price is:
   A. $32.
   B. $35.
   C. $38.
   D. $40.

110. A put on a stock with a strike price of $50 is priced at $4 per share, while a call with a strike price of $50 is priced at $6. What is the maximum per share loss to the writer of the put and the maximum per share gain to the writer of the call?

	Maximum loss to put writer	Maximum gain to the call writer
A.	$50	$6
B.	$46	$6
C.	$50	$44
D.	$46	$46

111. Which of the following statements about interest rate swaps and currency swaps is *least likely correct*?
   A. In an interest rate swap, the net interest rate payment is paid on each settlement date by the party owing the greater amount.
   B. A plain-vanilla interest rate swap involves trading fixed interest rate payments for floating-rate payments.
   C. A fixed-for-floating currency swap involves trading floating-rate interest payments on one currency for fixed-rate interest payments on another currency.
   D. In a currency swap, the net difference between the notional principal amounts is exchanged at the beginning and termination of the swap. Full interest rate payments are exchanged on each settlement date.

112. A company has just made a loan of $100 million that pays 90-day LIBOR plus a 1.5% margin. The CFO is concerned that there may be an interest rate decline within the next two months. The CFO obtains the following quotes from a dealer for 3-month FRAs:

Dealer Quotes
60-Day LIBOR = 0.0450
90-Day LIBOR = 0.0440
180-Day LIBOR = 0.0420

The company takes a short position of $100 million in a 3-month FRA, and 90 days later when the contract expires, 90-day LIBOR is 4.50%. What does the company collect from, or pay to, the dealer (long the FRA) at settlement? The company:
   A. pays $24,722.
   B. pays $25,000.
   C. pays $24,728.
   D. collects $25,000.

113. The evaluation of the performance of hedge funds as a class of investments is made more difficult by all of the following EXCEPT:
   A. survivorship bias.
   B. asymmetric returns distributions.
   C. selective disclosure by fund managers.
   D. the use of short sales to hedge market risk.

114. An investor is short a portfolio of stocks that has volatility and return characteristics similar to that of the S&P 500. Which of the following strategies would *best* hedge the market risk of the short portfolio position?
   A. Buy a put option on the S&P 500.
   B. Write a call option on the S&P 500.
   C. Take a short position in the S&P 500 futures contract.
   D. Write a put option and buy a call option on the S&P 500.

115. All of the following are TRUE regarding the cost approach to valuing real estate EXCEPT:
   A. an estimate of the value of land is added to the estimate of the cost of replacing a building.
   B. the approach may be problematic because obtaining a land appraisal may not be straightforward.
   C. the approach is reliable since there is generally a negligible difference between construction cost and market value of an existing property.
   D. it is similar to using the replacement cost of total assets in equity valuation.

116. A major bank has entered into a 4-year, annual-pay, 6% plain-vanilla interest rate payer swap with a notional principal value of $10,000,000. The following spot and forward rates are observed and expected:

- 1-year LIBOR today = 5%.
- Expected 1-year LIBOR in 1 year = 6%.
- Expected 1-year LIBOR in 2 years = 7%.

Based solely on this information, the net payment in 12 months and the expected net payment in 24 months (for the fixed-rate payer) will be:

	12 Months	24 Months
A.	$100,000 outflow	$0
B.	$100,000 outflow	$100,000 inflow
C.	$100,000 inflow	$0
D.	$100,000 inflow	$100,000 outflow

117. The supply of capital to finance companies that are just moving into operation but do not as yet have a product or service available to sell is a description that *best* relates to which of the following stages of venture capital investing?
A. Seed stage.
B. Second stage.
C. Early stage.
D. Mezzanine financing.

118. An apartment complex would earn $2 million annually if fully occupied. The complex has a 10% vacancy rate and annual operating expenses of $200,000 a year. The interest costs of financing the purchase of the building would be $150,000 a year. The investor's marginal tax rate is 40%. The investor wants to earn 10% on this investment. Using the income approach, the value the investor would place on the office building would be *closest* to:
A. $8,700,000.
B. $12,563,333.
C. $14,500,000.
D. $16,000,000.

119. The creation and redemption of "in-kind" shares by authorized participants is a feature that's unique to which of the following types of securities?
A. Hedge funds.
B. Closed-end funds.
C. Exchange-traded funds.
D. Real estate investment trusts.

120. A small apartment building is for sale at an asking price of $720,000. There are 12 units in the building, each of which rents for $800 a month. The building has vacancy and collection losses totaling 5 %, while other operating expenses, including insurance and property taxes, are estimated at $75 per unit per month. If the building is fairly priced, what is its market capitalization rate (cap rate)?
A. 11.2%.
B. 13.7%.
C. 14.5%.
D. 16.0%.