

Question #1 of 10

Question ID: 1577663

A return index that tracks the Nasdaq Composite—a stock market index—could likely be subject to the problem of:

- A) appraisal data, and hence, upward biased returns.
- B) survivorship bias, and hence, downward biased returns.
- C) survivorship bias, and hence, upward biased returns.**

**Explanation**

Survivorship bias can result when a return series is based on a stock index. The returns will be biased upward if the return calculation excludes firms that have been dropped from the index due to delisting; in other words, the index only includes the firms that survived.

Some assets are less liquid, such as real estate; therefore, appraisal data is used as an alternative. Appraised values are usually less volatile than actual values, which results in measured volatilities being downward biased. The items comprising the Nasdaq Composite are generally more liquid, so they would not likely be subject to the problem of appraisal data.

(Module 1.1, LOS 1.b)

Question #2 of 10

Question ID: 1580646

Which of the following statements about variance-covariance (VCV) matrices is *most accurate*?

- A) Although factor-based VCV matrices are biased, on average, they will be a predictor of true returns.
- Using a shrinkage estimate by combining information in the sample VCV matrix and the factor-based VCV matrix will result in reduced estimation error.**
- B) matrix and the factor-based VCV matrix will result in reduced estimation error.
- C) Factor-based VCV matrices are superior to sample VCV matrices because factor-based VCV matrices are unbiased and consistent.

**Explanation**

Combining information in the sample VCV matrix and the factor-based VCV matrix will result in more precise data—and therefore, reduced estimation error.

Factor-based VCV matrices are both biased (their expected values do not equal the true matrix returns, not even on average) and inconsistent (as the sample size increases in the factor-based VCV matrix, the model does not converge to the true matrix).

(Module 2.7, LOS 2.g)

Question #3 of 10

Question ID: 1551581

Which of the following would indicate that a country is less affected by global events? The country is:

A) small and has a diversified economy.



B) small and has an undiversified economy.



C) large and has a diversified economy.



Explanation

Larger countries with diverse economies are less affected by events in other countries. Small countries with undiversified economies are more susceptible to global events.

(Module 1.4, LOS 1.j)

Question #4 of 10

Question ID: 1577664

Which of the following is *most* representative of an exogenous economic shock?

A) Ongoing expansionary fiscal policy by the federal government, leading to higher inflation and interest rates.



B) Anticipated loose monetary policy by a country's central bank, leading to inflation and to depreciation in the country's currency.



C) A hurricane hitting the Gulf of Mexico, resulting in the shutdown of many oil wells and refineries and to higher oil prices.



Explanation

An exogenous shock is something that occurs outside the normal course of an economy, such as a natural disaster or unanticipated government policy. The shock is unanticipated and is not part of a trend, as would be characterized by ongoing monetary or fiscal policy.

(Module 1.2, LOS 1.c)

Question #5 of 10

Question ID: 1551615

Which of the following *best* describes an advantage of using factor-based variance/covariance matrices versus sample variance/covariance matrices in estimating volatility? A factor-based variance/covariance matrix:

A) requires fewer observations.



B) is consistent.



C) is unbiased.



Explanation

The use of a few common factors greatly reduces the number of observations needed to produce a variance-covariance matrix and is a strength of the factor-based approach. Disadvantages of the factor-based approach are that the matrix is not unbiased and is not consistent.

(Module 2.7, LOS 2.g)

Question #6 of 10

Question ID: 1577677

Which of the following is consistent with a flat yield curve?

A) Monetary policy is restrictive, and fiscal policy is restrictive.



B) Monetary policy is expansive, while fiscal policy is restrictive.



C) Monetary policy is restrictive, while fiscal policy is expansive.



Explanation

If monetary policy is restrictive while fiscal policy is expansive, the yield curve will be flat.

(Module 1.4, LOS 1.i)

Question #7 of 10

Question ID: 1580637

Suppose that an equity market has a dividend yield of 3%, real earnings growth of 2%, inflation of 1%, and is experiencing a reduction in shares outstanding of 0.5%. The P/E ratio is expected to rise from 16 to 16.32. The repricing return is expected to be *closest* to:

A) 4%.**B) 3%.****C) 2%.****Explanation**

The repricing component is the percentage change in the P/E ratio.

$$(16.32 / 16) - 1 = 2\%.$$

(Module 2.3, LOS 2.c)

Question #8 of 10

Question ID: 1577676

Suppose that the economy is expected to grow at its long-term trend rate, target inflation is 2%, the inflation index is expected to increase by 3%, and the central bank real neutral short-term interest rate is 1%. The target nominal short-term interest rate should be *closest* to:

A) 6.0%.**B) 4.5%.****C) 3.5%.****Explanation**

Because the real neutral rate is 1% and expected inflation is 3%, the adjustment will be made to the nominal 4% short-term rate. Given that GDP is growing at its long-term trend, this will not impact the adjustment using the Taylor rule. With inflation at 3% and target inflation at 2%, the central bank will increase interest rates by half of the difference, resulting in a nominal target rate of 4.5%.

(Module 1.4, LOS 1.h)

Question #9 of 10

Question ID: 1580638

Consider the following data for emerging Country A:

	Expected Standard Deviation	Correlation With Global Investable Market
Country A bonds	8%	0.38
Country A equities	12%	0.65
Market Sharpe ratio = 0.40		

The amount by which Country A's equity risk premium will exceed its debt risk premium is *closest* to:

A) 4.8%.



B) 1.9%.



C) 3.4%.



Explanation

$$RP_{\text{bonds}} = 8\% \times 0.38 \times 0.40 = 1.22\%$$

$$RP_{\text{equities}} = 12\% \times 0.65 \times 0.40 = 3.12\%$$

$$RP_{\text{equities}} - RP_{\text{bonds}} = 3.12\% - 1.22\% = 1.9\%$$

(Module 2.3, LOS 2.d)

Question #10 of 10

Question ID: 1580645

While making use of the capital mobility approach to exchange rate forecasting, an analyst finds that there are no premiums for term, credit, equity, or liquidity, but she still finds the formula useful. The analyst is essentially using which of the following concepts if she uses the formula?

A) Portfolio balance and composition.



B) Purchasing power parity.



C) Uncovered interest rate parity.



Explanation

The capital mobility approach expands on uncovered interest rate parity by adding terms related to risk premiums for term, credit, equity, and liquidity. Without those premiums, the capital mobility approach reduces to uncovered interest rate parity.

(Module 2.6, LOS 2.f)