## Question #1 of 20

Question ID: 1553149

Which of the following are potential risks for a public defined benefit (DB) pension scheme and a private defined contribution (DC) plan, respectively?

**A)** Neither of these.

**B) A public DB plan is exposed to the solvency risk of government pension systems, while a private DC plan could experience poor investment returns in the future.**

**C)** A public DB plan could experience poor investment returns in the future, while a DC private plan is exposed to the solvency risk of government pension systems.

**Explanation**

A public DB plan promises a future income to its beneficiaries, usually based on a mathematical equation, while a DC plan relies on employee contributions and investment returns to fund future retirement obligations. A DB plan is dependent on the local (or national) government to remain solvent and properly fund future income, while the DC plan is highly dependent on the returns of the underlying investments.

(Module 27.3, LOS 27.e)

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## Question #2 of 20

Question ID: 1553072

An analyst observes that a portfolio's capture ratio (CR) is 0.65. This would *most likely* indicate:

**A)** a convex return profile.

**B)** positive return asymmetry.

**C) negative return asymmetry.**

**Explanation**

Because CR = upside capture ratio (UC) / downside capture ratio (DC), a CR that is less than 1 indicates greater downside return or negative return asymmetry. Negative return asymmetry has a concave return profile. (Module 25.2, LOS 25.d)

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## Question #3 of 20

Question ID: 1553112

An investment manager has decided to use a calendar rebalancing strategy for his portfolio with semiannual rebalancing. The manager's *least likely* consideration for selecting this strategy is to:

**A) rebalance within predetermined acceptable ranges.**

**B)** ensure a consistent level of strategic asset allocation.

**C)** maintain a stable level of risk when exposure drifts from targeted exposure.

**Explanation**

Calendar rebalancing strategies help to rebalance the portfolio within predetermined acceptable ranges in order to ensure a consistent level of strategic asset allocation. However, the portfolio rebalancing occurs on specific dates, not necessarily when risk exposures shift. Automated adjustment mechanisms, on the other hand, help to keep the portfolio's risk profile relatively constant when exposure drifts from targeted exposure. (Module 26.1, LOS 26.a)

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## Question #4 of 20

Question ID: 1552938

In a rising market, it will *most likely*:

**A)** make no difference if you are buying or selling as the market price is the market price.

**B)** be more difficult to execute hedge transactions as market prices will be rising.

**C) be more costly to be on the buy side of the market than on the sell side of the market.**

**Explanation**

When there is general price momentum in one direction, it is more difficult to execute trades. In rising markets, investors are unlikely to execute buy trades between the bid and offer prices, and in a declining market, the bids are likely to be softer and apply to fewer shares. The other choices are not correct as market makers are subject to broader market trends, and because hedge transactions can be filled but at a higher price.

(Module 23.1, LOS 23.b)

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## Question #5 of 20

Question ID: 1553153

Dave and Rachel Korell, age 55, plan to retire in about 10 years. They have no dependents. Dave is a self-employed sports consultant and Rachel works as a high school teacher. Because Dave is self-employed, he will not receive a pension during retirement but Rachel will receive a pension. Together with Rachel's pension benefits and assuming a modest rate of return, the amount in their retirement portfolio will likely be just enough for their retirement needs, with only a small buffer to cover any unexpected costs. Their portfolio is currently invested in a diversified mix of fixed income, equity, and alternative investments. The Korells go to see their investment advisor to determine how their investment asset allocation should change for the next 10 years. Which asset class is the investment advisor *most likely* going to recommend a greater allocation?

**A)** Fixed income. ✓

**B) Alternative investments.** ✗

**C)** Equity. ✗

**Explanation**

Because Dave will not be receiving a pension and their retirement portfolio will likely be just enough for their retirement needs (with only a small buffer), then it is recommended that some reallocation from equity and alternative investments be made into fixed income in order to emphasize safety. Reallocating more funds to equity and alternative investments creates shortfall risk should those investments incur losses over the next 10 years (although they also have the potential to produces significant gains, too). Specifically, an increased allocation to inflation-protected bonds is appropriate since the objective of the retirement portfolio is to cover the Korells' retirement living expenses.

(Module 27.3, LOS 27.f)

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## Question #6 of 20

Question ID: 1553111

A portfolio manager who wishes to use derivatives to modify her portfolio's liquidity profile through leverage *most likely*:

**A) uses a long futures position.** ✓

**B)** uses a short futures position. ✗

**C)** sells options. ✗

**Explanation**

Using a long futures position allows the manager to gain economic exposure to (long-term) assets. At the same time, the manager can use the cash not required for posting margin to buy assets with different liquidity profiles, or use the cash for other short-term liquidity needs.

A short futures position and selling options would not meet the manager's objective of modifying the portfolio's liquidity profile through leverage. (Module 26.1, LOS 26.a)

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## Question #7 of 20

Question ID: 1552990

What is the goal of performance appraisal?

**A)** Identification of the sources of differences between portfolio and benchmark risk and return.

**B)** Identification of overall risk and return.

**C) Interpretation of performance attribution.**

**Explanation**

Performance appraisal involves the interpretation of performance attribution. A judgment is made about manager's decisions and skill, in an effort to differentiate between returns attributable to luck and those attributable to skill.

(Module 24.1, LOS 24.a)

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## Question #8 of 20

Question ID: 1553073

John Addams manages three large cap equity funds. Fund A has a capture ratio (CR) of 1.6, Fund B 1.0, and Fund C 0.8. Which fund has a concave return profile?

**A)** Fund B.

**B) Fund C.**

**C)** Fund A.

**Explanation**

A CR that is less than 1 implies that the downside capture is greater than the upside capture. That means there is a negatively asymmetrical (concave) return profile in that there is more downside capture than upside capture.(Module 25.2, LOS 25.d)

## Question #9 of 20

Question ID: 1553160

Which of the following are two important aspects of illiquid asset classes?

**A) Uncertain cash flows and return smoothing issues.**

**B)** Lack of cash flows and return smoothing issues.

**C)** Zero cash flows and return unsmoothing issues.

**Explanation**

The two important aspects of illiquid asset classes discussed in this reading are uncertain cash flows and return smoothing issues. The uncertain cash flows especially relate to the private equity and infrastructure asset classes over the medium to long term. Smoothing results from relying upon appraisal estimates due to the lack of actual transactions. Smoothed returns result in downward biased estimates of return volatility.

(Module 28.1, LOS 28.a)

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## Question #10 of 20

Question ID: 1552937

Dark pools are effective trading systems because:

**A) they limit information leakage due to the low level of pre-trade transparency.**

**B)** they enable hedge funds to accumulate shares without trigger 13-D filings.

**C)** traders that subscribe to the venues can see both sides of impending trades while nonmembers of dark pools cannot.

**Explanation**

Dark pools are beneficial as participants are able to limit pre-trade disclosure and information leakage. The problems are that participants in dark pools cannot see the other side of the trades so they have no ability to predict whether they will be filled on the trade. The other answer choices are false statements.

(Module 23.1, LOS 23.a)

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## Question #11 of 20

Question ID: 1570884

Which of the following *most accurately* describes monitoring an ESG investment?

**A)** The portfolio manager discloses material ESG issues in a timely manner.

**B)** A formal policy exists on how ESG factors are incorporated into the investment process.

**C)** **Compare ESG ratings or scores for portfolio companies from industry providers with peer companies and the policy benchmark.**

**Explanation**

Monitoring of ESG metrics for a portfolio includes the following: metrics comparing ESG ratings or scores for portfolio companies from industry providers with peer companies and the policy benchmark; assessing portfolio sensitivities to a range of climate-related risks by developing an analytical framework; and aggregate data on the carbon footprint of portfolio companies. The metrics are then monitored over time for changing trends. The other two incorrect answer choices relate to due diligence in ESG investing and manager selection, which includes the following:

- If a formal ESG integration policy exists
- How ESG factors are incorporated into the investment process
- The manager's commitment to disclosing material ESG issues in a timely manner

(Module 26.3, LOS 26.g)

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## Question #12 of 20

Question ID: 1553002

Ha-yoon Kim is a stock analyst with Yeongli Securities Co. She uses the Carhart Factor Model to perform attribution analysis. Output from the model indicates the benchmark Kim uses has the following factor sensitivities:

| Factor | Benchmark |
|---|---|
| RMRF | +1.00 |
| SMB | −1.00 |
| HML | 0.05 |
| WML | −0.95 |

Assuming that she is using a benchmark that most closely resembles her portfolio attributes, we can conclude that Kim is *most likely* a:

**A) momentum investor.**

**B)** large cap investor.

**C)** small cap investor.

**Explanation**

The negative coefficient of the benchmark's sensitivities to a market-capitalization factor (SMB) and a momentum factor (WML) indicate that the portfolio has a large cap tilt and does not seek momentum strategies.

(Module 24.2, LOS 24.e)

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## Question #13 of 20

Question ID: 1553181

You are conducting due diligence before investing in a fund containing long-term illiquid assets. Which of the following is not critical to evaluate before investing as part of the due diligence process?

**A)** Quality of the non-executive directors.

**B)** Independence of the external auditors.

**C) Track record of the brokerage firm.**

**Explanation**

As part of the due diligence process, it is critical to cover the quality of the non-executive directors, the integrity and independence of the auditors, and the character of the decision makers. The track record of the brokerage firm is not specifically listed, although it is important to consider the independence of the firm from the manager as evidenced from the Madoff fraud.

(Module 28.4, LOS 28.c)

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## Question #14 of 20

Question ID: 1553201

With an external manager approach, which of the following is a good starting point in planning and developing liquidity parameters at the portfolio level?

**A)** The liquidity horizon report.

**B)** The legal terms in place.

**C) The stress test results.**

**Explanation**

A good starting point for developing liquidity parameters with external managers is to look at the legal terms in place governing redemption notices and lockups. In the case of internal investment management, a more granular assessment can be made on the types of securities being held and gauging what can be sold over different time frames during a financial crisis.

(Module 28.4, LOS 28.e)

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## Question #15 of 20

Question ID: 1553203

In relation to institutional investors with an explicit active risk budget in public equities, which of the following is *most accurate* of the desired investment strategy?

**A)** Allocate to momentum factors.

**B)** Allocate to stock pickers.

**C) Allocate to growth and value factors.**

**Explanation**

Allocating to factors is a passive investment strategy. Allocating to stock pickers is an active approach.

(Module 28.4, LOS 28.e)

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## Question #16 of 20

Question ID: 1553052

An example of a Type I error is:

**A) retaining a manager who underperforms expectations.**

**B)** firing a portfolio manager who outperforms expectations.

**C)** not firing a manager who outperforms expectations.

**Explanation**

A Type I error consists of rejecting a correct null hypothesis, therefore hiring or retaining a manager who underperforms. (Module 25.1, LOS 25.b)

## Question #17 of 20

Question ID: 1553174

Which of the following is a social issue within ESG definitions?

**A) Data security.** ✓

**B)** Air pollution. ✗

**C)** Waste management. ✗

**Explanation**

Data security and privacy is a social issue; air pollution and waste management are environmental issues.

(Module 28.3, LOS 28.b)

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## Question #18 of 20

Question ID: 1552961

Which of the following statements regarding the fixed-income market is *most accurate*?

**A) Fixed-income markets tend to have low liquidity and large order size.** ✓

**B)** Fixed-income markets tend to trade in a large number of homogeneous securities. ✗

**C)** Electronic trading is commonplace for most fixed-income securities. ✗

**Explanation**

Because there is such a large number of issues, there tends to be few buyers and sellers in any given fixed-income security. This creates a dynamic where liquidity is low but the average order size is high. Electronic trading in fixed income is currently limited to a small slice of liquid securities. Fixed-income markets are characterized by a large number of heterogeneous securities. (Module 23.3, LOS 23.f)

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## Question #19 of 20

Question ID: 1553074

Last month, a fund manager's upside and downside captures were both 80%. This implies that the manager underperformed the benchmark:

**A) regardless of market movement.**

**B)** only when the benchmark return was negative.

**C)** only when the benchmark return was positive.

**Explanation**

Upside capture of 80% indicates that the manager captured 80% of the benchmark's positive return and, therefore, underperformed on the upside. Downside capture of 80% means that the manager captured 80% of the benchmark's negative return and, therefore, outperformed on the downside. The manager only underperformed the benchmark when the benchmark return was positive. (Module 25.2, LOS 25.d)

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## Question #20 of 20

Question ID: 1570883

Which of the following statements is *least likely* representative of an ESG investing policy?

**A)** Being transparent on material ESG issues affecting the investment activities.

**B)** Promoting long-term sustainability for companies and markets where investments are made.

**C) Acknowledging that the risk and return of the investments are affected by ESG factors.**

**Explanation**

A complete ESG investing policy would be to acknowledge that the risk and return of the investments are affected by ESG *and* traditional financial factors.

(Module 26.3, LOS 26.g)