## Question #1 of 10

Question ID: 1587538

Ruby Pascal is an institutional money manager managing a $200 million portfolio. The cost basis of each of five selected assets from the portfolio is above market value, and Pascal decides to sell those assets. The *least likely* reason for the sale is:

**A)** to realize capital gains to generate profits for the portfolio. ✓

**B) to engage in tax loss harvesting.** ✗

**C)** to realize capital losses against current or future realized capital gains. ✗

**Explanation**

Before a sale, when the cost basis of an asset *exceeds* its market value, the asset has an unrealized *loss*. The primary reason for selling assets with unrealized losses is to engage in tax loss harvesting. Tax loss harvesting involves realizing capital losses against current or future realized capital gains to reduce the portfolio's overall tax liability.

(Module 5.1, LOS 5.b)

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## Question #2 of 10

Question ID: 1587537

The rebalancing ranges for a taxable portfolio, compared to a tax-exempt portfolio with similar risk characteristics, are typically:

**A)** narrower, because after-tax volatility is lower than pretax volatility. ✗

**B) wider, because after-tax volatility is lower than pretax volatility.** ✓

**C)** narrower, because it takes smaller asset class movements to shift the risk profile of a taxable portfolio. ✗

**Explanation**

A taxable portfolio must pay taxes when the portfolio is profitable (or receive a tax loss carryforward when the portfolio has a loss). The effects of reduced returns in profitable periods and reduced losses in loss periods demonstrates that after-tax volatility is lower than pretax volatility.

For taxable portfolios, lower after-tax volatility means that larger asset class movements are required to affect the risk profile of a portfolio, so the rebalancing ranges can be wider.

(Module 5.1, LOS 5.b)

## Question #3 of 10

Question ID: 1587529

A 30-year-old wealthy investor wants to maximize her allocation to commodity investments.

Which of the following approaches to asset allocation would *best* achieve her objective?

**A)** 120 minus age rule.

**B) 1/N rule, with 10 asset classes.**

**C)** Endowment model.

**Explanation**

The endowment model (or Yale model) allows for higher allocation to alternative investments, including commodities, real estate, and private equity, than recommended under mean-variance optimization (MVO). The investor should select managers with significant exposure to these alternative asset classes. The model does not cap the allocation to alternative investments.

The 120 minus age rule considers only two asset classes: equities and fixed income, with the equity allocation percentage determined as 120 minus age, but it does not consider alternative investments.

The 1/N rule considers an equally weighted portfolio to each selected asset class. If commodities is one of the 10 asset classes selected, then this approach caps the commodities allocation at 1/10 = 0.10, or 10%, which may be insufficient for the investor.

(Module 4.7, LOS 4.n)

## Question #4 of 10

Question ID: 1587528

Which of the following heuristic and other approaches to asset allocation is *most closely* associated with the assumption of a lack of informationally efficient markets?

**A) 60/40 stock/bond heuristic model.**

**B)** Endowment model.

**C)** Norway model.

**Explanation**

The endowment model has large allocations to alternative assets as well as support for active management. The endowment model also seeks to earn illiquidity premiums. Those three factors suggest that there is the assumption of a lack of informationally efficient markets.

The Norway model's asset allocation emphasizes publicly traded securities, which reflects a belief in the market's informational efficiency.

(Module 4.7, LOS 4.n)

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## Question #5 of 10

Question ID: 1587536

Dan Vustings, 51, is a senior account executive at an advertising agency in San Francisco. He currently has sufficient capital in his two investment portfolios to retire in 14 years. His capital is evenly split between a taxable portfolio, which he uses to fund current consumption goals and a tax-deferred retirement account. Vustings received advice from an investment manager last year who suggested the following asset allocation:

- High-yield bonds: 15%
- High-dividend-yield equities: 50%
- High growth equities: 35%

Vustings has the same allocation in both the taxable and the retirement account. Which of the following allocations would be *most likely* to improve the efficiency of the portfolios, ignoring rebalancing or withdrawal penalties?

**A)** **Increase the allocation to high-yield bonds in the retirement account, and increase the allocation to high growth equity investments in the taxable account.** ✓

**B)** Increase the allocation to high-yield bonds in the taxable account, and increase the allocation to high growth equities in the retirement account. ✗

**C)** Increase the allocation to high-dividend yield equities in the taxable account, and increase the allocation to high growth equities in the retirement account. ✗

**Explanation**

Assets subject to the highest rates of tax should be first allocated to tax-advantaged accounts. Interest on high-yield bonds is typically taxed at a higher rate than dividend income —which, in turn, is taxed at a higher rate than capital gains. Vustings should, therefore, allocate high-yield bonds first to the retirement account, and leave the high growth equity in the taxable account.

(Module 5.1, LOS 5.b)

## Question #6 of 10

Question ID: 1580661

An investor mentions to her portfolio manager that her main goal is to maximize her portfolio's Sharpe ratio while also considering her risk tolerance and constraints. Which of the following asset allocation approaches is *most appropriate* for the investor?

**A)** Liability-based approach.

**B)** Goals-based approach.

**C) Asset-only approach.**

**Explanation**

By looking to maximize her portfolio's Sharpe ratio, the investor is focusing on the portfolio assets only. As a result, an asset-only approach is most appropriate. The asset-only approach will consider both the investor's risk tolerance and constraints.

Both the liability-based and goals-based approaches consider assets in the context of liabilities.

(Module 3.3, LOS 3.c)

## Question #7 of 10

Question ID: 1580687

The following information is a partial list of corner portfolios and asset class weights:

| Portfolio | Exp. Return | Std. Dev. | Asset Class Weights | | |
|---|---|---|---|---|---|
| | | | 1 | 2 | 3 |
| 1 | 12.00% | 10.50% | 65.00% | 0.00% | 35.00% |
| 2 | 16.50% | 14.00% | 15.00% | 20.00% | 50.00% |
| 3 | 18.00% | 20.00% | 30.00% | 20.00% | 25.00% |
| 4 | 23.00% | 24.00% | 15.00% | 20.00% | 55.00% |

Which asset class is the most significant for an efficient portfolio with an expected return of 15% and the approximate standard deviation of this efficient portfolio?

**A)** Asset Class 2, 12.85%.

**B) Asset Class 3, 12.85%.**

**C)** Asset Class 1, 15.00%.

**Explanation**

The expected return of 15% lies between Corner Portfolios 1 and 2 with expected returns of 12% and 16.50%. We solve for *w* in the following equation:

15 = w(12) + (1 – w)(16.50)

w = 0.33

In other words, the efficient portfolio with an expected return of 15% has 33% weight of Corner Portfolio 1 and 67% weight of Corner Portfolio 2. With respect to the asset classes, the weights are then derived as follows:

Weight of Asset Class 1 = (0.33)(65%) + (0.67)(15%) = 31.50%

Weight of Asset Class 2 = (0.33)(0%) + (0.67)(20%) = 13.4%

Weight of Asset Class 3 = (0.33)(35%) + (0.67)(50%) = 45.05%

Asset Class 3 has the highest weight and is the most significant.

Approximate standard deviation = (0.33)(10.50) + (0.67)(14) = 12.85%.

(Module 4.3, LOS 4.b)

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## Question #8 of 10

Question ID: 1551655

Strategic asset allocation reflects what systematic risk exposure?

**A)** Asset class systematic risk.

**B) Investor's desired systematic risk exposure.**

**C)** Long-term systematic risk exposure.

**Explanation**

Strategic asset allocation reflects the investor's desired systematic risk exposure.

(Module 3.5, LOS 3.g)

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## Question #9 of 10

Question ID: 1580658

Mark Zedon, a financial consultant, prepares a strategic asset allocation for his client based on the client's risk/return preferences. This approach to strategic asset allocation is called the:

**A)** efficient frontier approach. ✗

**B)** asset-only approach. ✓

**C) investment policy statement approach.** ✗

**Explanation**

Because the consultant only takes into account the investor's risk and return preferences, he is using the asset-only approach to strategic asset allocation.

(Module 3.3, LOS 3.d)

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## Question #10 of 10

Question ID: 1551716

Which of the following statements about using investment factors in constructing asset allocations is *correct*?

**A)** The investment factors are market-neutral, long/short portfolios. ✗

**B)** The factors are constructed to have high correlation with each other. ✗

**C) The use of investment factors is consistent with factor return models.** ✓

**Explanation**

The use of investment factors is consistent with factor return models, including the three-factor Fama-French model (where the factors are size, value and market).

The investment factors are *zero-dollar*, long/short portfolios that are long the outperforming attribute and short the underperforming attribute.

The investment factors are constructed to have *low* correlation with each other and with the market portfolio, which results in superior risk-return tradeoff.

(Module 4.5, LOS 4.i)