Max and Gloria Smith are in their late 20s. They're married and live in a rented apartment. Gloria is a nurse, while Max works in the marketing department for a national car manufacturer. They work full-time with a combined household income of 110,000 EUR. They have a modest lifestyle and are both in excellent health. Gloria is about two years away from paying off her student debt. In her free time, she has been actively volunteering for a local charity for children with autism. Together with Max, they're considering buying a home and starting a family in the next 2 to 3 years.

Gloria and Max have been careful about their spending habits and managed to accumulate 25,000 EUR in their taxable brokerage account consisting of various public equity index funds as suggested by their robo-advisor.

The Smiths are meeting with their new financial advisor, Andrew Colins, CFA, to discuss their financial future and goals. Gloria is eager to take on more control of their portfolio and want the financial advisor to focus on selecting a few individual stocks that could generate sufficient returns in the next 2 to 3 years.

During the initial assessment with the advisor, Max mentioned,

> "We would like to retire in our mid-60s and would like to have sufficient funds to maintain a comfortable lifestyle when we are older."

Gloria added,

> "It would be ideal if I could partly retire and work part-time in my early 50s. I would like to focus more of my time on the local charity."

Question #1 - 5 of 32

Question ID: 1570877

Based on the information provided, the Smiths have:

	Risk willingness:	Risk capacity:
A)	Low	High
B)	**High**	**High**
C)	High	Low

Explanation

The Smiths' willingness to take risk is high as expressed by their preference to design a more concentrated portfolio. However, their risk capacity (ability) is below average. They still need to pay off Gloria's student loan and are looking to buy a house and have a baby. This will likely require a very aggressive savings plan given their current income and lower risk in their portfolio if they wish to fulfill their goals during potentially adverse market conditions.

(Module 19.5, LOS 19.h)

Question #2 - 5 of 32

Question ID: 1570878

When evaluating their investment objectives, how many time horizons should the investment advisor consider?

A) Four.

B) Three.

C) Two.

Explanation

The Smiths have multiple time horizons: buying a home/starting a family/paying off student debt (time horizon of 2-3 years), semiretirement for Gloria (time horizon of approximately 10 years), full retirement in their mid-60s (time horizon exceeding 20 years).

(Module 19.5, LOS 19.h)

Question #3 - 5 of 32

Question ID: 1570879

Given that the Smiths have no retirement accounts, which tax strategy should the investment advisor suggest?

A) Tax deferral.

B) Tax reduction.

C) Tax avoidance.

Explanation

By utilizing a tax deferral strategy, the Smiths can defer recognition of taxes on portfolio returns well into the future. The Smiths can utilize a retirement savings account that enables tax-free contributions or tax-free withdrawals upon retirement.

(Module 19.5, LOS 19.h)

Question #4 - 5 of 32

Question ID: 1570880

Which of the following missing financial information would be required to construct a net worth statement for the Smiths?

A) Specific return or investment objectives.

B) Contributions over the investment horizon.

C) Life insurance policies with a cash value.

Explanation

A net worth statement of a private client provides a comprehensive understanding of the client's financial profile in terms of assets and liabilities. A life insurance policy with a cash value could be a big part of client's net worth statement.

(Module 19.5, LOS 19.h)

Question #5 - 5 of 32

Question ID: 1570881

Which of the following *best* describes the financial stage of life for the Smiths?

A) Career development.

B) Peak accumulation.

C) Early career.

Explanation

They're both in the early career stage. They recently entered the workforce and are starting to plan a family. They are also concerned about other financial goals (buying a house) and retirement.

(Module 19.5, LOS 19.h)

Question #6 of 32

Question ID: 1552689

Which of the following statements about Monte Carlo simulation is correct? Monte Carlo simulation:

A) is best when it uses only historical data.

B) typically produces approximately 100 trials.

C) forecasts a more accurate risk/return tradeoff than a deterministic approach.

Explanation

History provides a view of only one possible path among the many that might occur in the future. It is difficult to estimate expected returns using historical figures because of the volatility factor. Monte Carlo analysis produces probability distribution by tabulating the outcomes of a large number (often 10,000) of simulated trials.

(Module 19.4, LOS 19.g)

Question #7 of 32

Question ID: 1552693

The stage of life before retirement where financial capital growth is the greatest and human capital is converted to financial capital *best* describes:

A) education.

B) peak accumulation.

C) early career.

Explanation

Peak accumulation is the decade before retirement where a person earns the most money and thus experiences the most growth in financial capital. Education is a stage where a person develops human capital. Early career is a stage where a person begins developing financial capital, but capital growth is slower than a later career stage.

(Module 19.5, LOS 19.h)

Question #8 of 32

Question ID: 1552669

Regarding investment governance structures, it would be *most* accurate to state that:

A) private clients, in general, have less formal investment governance structures than institutional clients.

B) private clients that utilize private wealth managers have a stricter governance structure than institutional clients.

C) institutional clients need not rely on a formal investment governance structure if they already have a corporate governance program.

Explanation

Although private wealth managers have many responsibilities, including performance reporting, formulating the IPS, and implementing the investment strategy, institutional clients, in general, have a much stricter (more formal) investment governance structure. Investment governance structure is separate from corporate governance.

(Module 19.1, LOS 19.a)

Question #9 of 32

Question ID: 1552710

An investor hires a portfolio manager and stipulates a maximum value at risk for the portfolio. This is an example of the use of the value at risk framework to:

A) measure performance.

B) set risk limits.

C) build portfolios.

Explanation

The investor has used the value at risk framework to set risk limits for the portfolio.

(Module 19.7, LOS 19.l)

Question #10 of 32

Question ID: 1552688

Deterministic approaches differ from Monte Carlo approaches in that deterministic approaches:

A) use probability forecasts whereas Monte Carlo approaches use best estimates.

B) generate ranges of outcomes whereas Monte Carlo approaches generate single numbers.

C) **generate single numbers whereas Monte Carlo approaches generate a range of outcomes.**

Explanation

Monte Carlo approaches rely on probabilistic inputs to generate a range of outcomes that may provide better information than any method that generates a single number, like deterministic approaches.

(Module 19.4, LOS 19.g)

Question #11 of 32

Question ID: 1552675

A private wealth manager who helps a client reevaluate their financial goals after an alteration in financial circumstances is facilitating the goal formulation process *most closely* associated with:

A) changing goals.

B) **prioritizing goals.**

C) quantifying goals.

Explanation

Wealth managers can assist clients in modifying their investment strategy as a result of a client's changing financial circumstances. Prioritizing goals refers to when a client's goals are difficult to reconcile (i.e., saving for retirement vs. paying for a child's education). Quantifying goals refers to when a client needs help calculating specific retirement goals, such as how much is required to save to retire comfortably.

(Module 19.3, LOS 19.d)

Question #12 of 32

Question ID: 1552723

Objectives of the Know Your Customer (KYC) rule for private wealth managers *most likely* includes which of the following?

A) Democratizing access to client information.

B) Preventing conflicts of interest.

C) Determining if a client is the victim of fraud.

Explanation

Private wealth managers are required to follow the KYC rule to obtain relevant personal and financial information for portfolio management purposes as well as for regulatory compliance purposes. A manager should check to ensure they do not have any potential conflicts of interest in the advice they provide clients. Democratizing access to client information goes against the standard of maintaining client confidentiality. Diligence may uncover that a client has been defrauded, but that is not an explicit objective of the KYC procedure.

(Module 19.9, LOS 19.o)

Question #13 of 32

Question ID: 1552691

Elif Yilmaz wishes to retire from her job as chief accountant sometime in the next 20 years. She has accumulated an investment portfolio of 500,000 lira, and wishes to retire when she has achieved a wealth level of 1.5 million lira. Her wealth manager has put together estimates of what Yilmaz's portfolio value is expected to be after running a Monte Carlo simulation, as below:

Percentile	Year 10 Portfolio Value (in lira)	Year 15 Portfolio Value (in lira)	Year 20 Portfolio Value (in lira)
40th	1.4 million	1.9 million	2.3 million
60th	1.2 million	1.7 million	2.1 million
80th	1.0 million	1.5 million	1.9 million
Successful trials	30%	75%	90%

Given these results, Yilmaz's wealth manager should *most appropriately* advise her that she:

A) can most likely retire in 15 years.

B) can definitely retire in 20 years.

C) won’t be able to retire in 10 years.

Explanation

Wealth managers use a 75–90% success ratio as a rule of thumb when determining whether private clients can achieve their investment goals. This criteria is met in year 15. Yilmaz may be able to retire in year 10, provided she increases contributions or reduces the goal amount. Although likely, there is no assurance that Yilmaz could retire in 20 years.

(Module 19.4, LOS 19.g)

Question #14 of 32

Question ID: 1552683

Which measure of risk is determined in the *most* objective manner?

A) Willingness to take risk. ✗

B) Ability to take risk. ✓

C) Tolerance for risk. ✗

Explanation

Ability to take risk is determined objectively, while willingness to take risk is a far more subjective, emotional matter. Risk tolerance is a combination of ability and willingness so it is not as objective as ability alone.

(Module 19.3, LOS 19.e)

Question #15 of 32

Question ID: 1552703

Mark Muller is 67 years old and retired. He recently had a discussion with his financial advisor and told her that he would like his $2 million investment portfolio to have an increased allocation to fixed income investments and to dividend-paying stocks together with a decreased allocation to non-dividend-paying stocks and to alternative investments. Muller made the request as he requires additional funds to cover his higher expected spending needs in the coming years. At the same time, he would like to maintain the portfolio value at a minimum of $2 million to provide an inheritance to his children. Which of the following behavioral biases is likely exhibited by Muller?

A) Lack of self-control. ✓

B) Consumption gap. ✗

C) Mental accounting. ✗

Explanation

Retirees prefer to meet their spending needs from investment income (e.g., interest income from bonds and dividends from stocks) rather than by liquidating securities. This preference can be attributed to a lack of self-control when it comes to spending and is called self-control bias.

(Module 19.5, LOS 19.h)

Question #16 of 32

Question ID: 1552667

Which of the following statements regarding the investment policy statement is *least* accurate? An individual's investment policy statement:

A) differs from an institution's in that time horizon plays a more prominent role.

B) is exactly the same as that of an institution's.

C) differs from an institution's in that taxes play a more prominent role.

Explanation

An individual's investment policy statement differs from an institution's in that time horizon, taxes, and unique circumstances play a more prominent role. The overall process is the same.

(Module 19.1, LOS 19.a)

Question #17 of 32

Question ID: 1552706

Which of the following statements distinguishes the ability to take risk from the willingness to take risk? The:

A) willingness to take risk is connected with primary goals and objectives.

B) ability to take risk is more amenable to quantitative measures whereas the willingness to take risk is more qualitative in nature.

C) ability to take risk is more qualitative in nature whereas the willingness to take risk can be measured in a quantitative nature.

Explanation

The ability to take risk is usually associated with specific goals and time horizons and is more quantitative than willingness to take risk. Willingness to take risk is more subjective from the investor's perspective and is therefore more qualitative in nature.

(Module 19.6, LOS 19.j)

Question #18 of 32

Question ID: 1552712

One advantage of applying a goals-based investment approach is that clients are *most likely* to:

A) create a more diversified optimal portfolio than one created using the traditional approach.

B) find it simpler to specify their risk tolerance.

C) enhance their overall portfolio through mean-variance optimization.

Explanation

Clients generally find it easier to express their risk tolerance when using a goals-based investment approach. In this approach, mean-variance optimization (MVO) is conducted for each portfolio goal independently, rather than for the entire portfolio. As a result, the portfolio is likely to be *less* diversified than an optimal portfolio obtained using a traditional investing approach.

(Module 19.7, LOS 19.l)

Question #19 of 32

Question ID: 1552673

An individual, aged 40, is currently in the 25% marginal tax bracket, and he expects to be in the 15% bracket when he retires. Making contributions today to a tax-deductible individual retirement account is an example of:

A) tax reduction and tax deferral.

B) tax reduction only.

C) tax deferral only.

Explanation

The individual's action is an example of both tax deferral and tax reduction. He will reduce taxes by converting income that would have been taxed at a 25% rate today to a lower 15% rate in the future. Furthermore, he will defer taxes payable until the funds are withdrawn from the account in the future.

(Module 19.2, LOS 19.c)

Question #20 of 32

Question ID: 1552711

Oscar DeLaNueva is a wealthy fashion designer based in Colombia. He is very conservative about investing in that he prefers to invest in safe securities, and he does not have a need for current income. DeLaNueva also has a very favorable view of global markets as he is undeterred by recent political turmoil in his region.

DeLaNueva's wealth manager has proposed three potential asset allocations. Allocation 1 was generated by using mean variance optimization (MVO), while the other two asset allocations are currently used by other clients of the wealth manager.

	MVO Allocation 1	**Asset Allocation 2**	**Asset Allocation 3**
Investment-grade corporate bonds	15%	30%	10%
High-yield bonds	20%	20%	10%
Large-cap global equity	40%	5%	40%
Small-cap global equity	5%	15%	15%
Commodity index fund	5%	20%	20%
Real estate	15%	10%	5%
Total	**100%**	**100%**	**100%**
Expected return	9.0%	7.5%	8.5%
Annual volatility (standard deviation)	9.0%	7.5%	8.5%

Given the above information, which asset allocation would be *most appropriate* for DeLaNueva?

A) Allocation 3.

B) Allocation 2.

C) Allocation 1.

Explanation

DeLaNueva has expressed a desire to invest in safe securities, has low income needs, and has an optimistic view of global markets. Allocation 3 is most likely to meet his objectives because it has a minimal allocation to high yield bonds (which are less safe). While Allocation 3 also has the highest exposure to large cap equity and commodities, those two asset classes tend to perform better in strong global growth scenarios.

(Module 19.7, LOS 19.l)

Question #21 of 32

Question ID: 1552692

For the purposes of analyzing a client's capital sufficiency, which of the following is an advantage of using deterministic forecasting instead of a Monte Carlo simulation?

A) Provides a probability distribution to allow for real world uncertainty.

B) Uses process that is easy to understand and implement.

C) Generates a large number of independent trials.

Explanation

Deterministic forecasting uses linear return analysis to analyze a client's likelihood of meeting their financial objectives. Deterministic forecasting assumes a single compound annual growth rate across the client's investment horizon, which has the advantage that it is simple and easy to understand and implement. Monte Carlo analysis uses a multivariate approach, which generates a probability distribution of potential outcomes and can take into account real world uncertainty.

(Module 19.4, LOS 19.g)

Angela Fox is a 54-year-old marketing director who plans to retire in the next few years. Her current portfolio is valued at $1.2 million and is well diversified. She is concerned that the portfolio won't appreciate much in the next five years, given adverse market conditions. She would like to review the portfolio and take on more risk to have sufficient funds for retirement and leave a $500,000 donation to a local charity in 10 years. Her private wealth manager estimated that, to fulfill both of her goals, the portfolio must appreciate to at least $1.5 million in the next 10 years. He has performed the following Monte Carlo simulation (adjusted for inflation):

Percentile	Year 5 Portfolio Value	Year 10 Portfolio Value	Year 15 Portfolio Value
25th	$1,502,935	$1,750,001	$1,950,051
50th	$1,329,019	$1,689,124	$1,787,129
75th	$1,180,980	$1,560,019	$1,660,014
95th	$1,150,003	$1,480,998	$1,575,928

Fox is physically active and is in great health. Her private wealth manager is concerned about longevity risk and proposed various annuity products that Fox rejected.

Question #22 - 26 of 32

Question ID: 1552718

The probability that the client's charitable donation goal will be met is *closest* to:

A) 25%.

B) 75%.

C) 50%.

Explanation

The simulation results show that the client has a 75% probability of having a portfolio value in excess of $1,560,019 in Year 10. Because the client's goal to fulfill retirement and a charitable donation is $1.5 million, the probability of success of meeting or exceeding that goal is slightly higher than 75%.

(Module 19.8, LOS 19.n)

Question #23 - 26 of 32

Question ID: 1552719

Which of the following is *most likely* the primary consideration of running a Monte Carlo simulation?

A) Limited input requirements.

B) Simulation flexibility.

C) Shortfall magnitude calculation.

Explanation

A Monte Carlo simulation can be tailored to a client's portfolio and used to consider multiple retirement scenarios. It doesn't usually consider the amount by which the investment portfolio falls short of the client's retirement goals. Although not a lot of input is required, the input quality is crucial.

(Module 19.8, LOS 19.n)

Question #24 - 26 of 32

Question ID: 1552720

Fox's willingness to assume risk is *best* determined by:

A) conducting a risk assessment survey.

B) considering the large size of her portfolio.

C) considering her goals and return objectives.

Explanation

A risk assessment survey is the best, unbiased way to approach the client when determining the client's willingness to assume risk.

(Module 19.8, LOS 19.n)

Question #25 - 26 of 32

Question ID: 1552721

The reason Fox is avoiding the annuity proposals is *least likely* related to:

A) having a risk aversion toward annuities.

B) funding a better retirement lifestyle.

C) keeping more control of the assets.

Explanation

Fox might be exhibiting a behavioral bias of the annuity puzzle. Individuals tend to avoid buying annuities to meet their spending needs in retirement. Possible explanations for this annuity puzzle include clinging on to the hope of funding a better retirement lifestyle, a desire to keep control of assets, and the high cost of annuities.

(Module 19.8, LOS 19.n)

Question #26 - 26 of 32

Question ID: 1552722

The criteria used by the financial advisor to evaluate the success of an investment program for Fox is *least likely* to include:

A) portfolio performance.

B) client satisfaction.

C) process consistency.

Explanation

The degree to which a private client's investment program is considered a success is measured in terms of three criteria: goal achievement, process consistency, and portfolio performance. Client satisfaction, although important, is not one of the elements.

(Module 19.8, LOS 19.n)

Question #27 of 32

Question ID: 1552708

Which of the following refers to an active management strategy that specifies a range for each asset class rather than a specific target allocation percentage?

A) Tactical asset allocation.

B) Strategic asset allocation.

C) Dynamic hedging.

Explanation

Tactical asset allocation is an active investment management strategy that manages exposure to different assets classes by specifying a target allocation percentage range. Strategic asset allocation indicates a long-term target allocation for each asset class and calls for periodic rebalancing to maintain target allocations. Dynamic hedging is a portfolio insurance technique used to increase or reduce exposure to underlying securities or asset classes.

(Module 19.6, LOS 19.j)

Question #28 of 32

Question ID: 1552676

Private wealth managers are *most likely* to categorize the potential purchase of a second residence within the next five years as:

A) a planned goal.

B) a secondary goal.

C) an unplanned goal.

Explanation

Planned goals for private clients are those objectives that can be reasonably estimated, within a specific time frame. A purchase of a first or second residence meets these criteria. Unplanned goals are related to meeting unforeseen financial needs. Secondary goals are of lesser importance—there is no evidence to suggest that the second residence is of lesser importance.

The fact that there is a specific time frame attached to the purchase of the second residence makes planned goal the best answer.

(Module 19.3, LOS 19.d)

Question #29 of 32

Question ID: 1552713

Kate Ross, CFA favors a goals-based approach to managing clients' assets. In her portfolio construction process, she *most likely* needs to:

A) assess investment constraints for each goal.

B) develop capital market expectations for each goal.

C) create a separate portfolio for each goal.

Explanation

Goals-based investing follows the same steps as the traditional approach to portfolio construction, the critical difference being that instead of constructing a single portfolio, the private wealth manager creates a separate portfolio for each of the client's goals.

(Module 19.7, LOS 19.l)

Question #30 of 32

Question ID: 1552685

Jonathan Edwards is a wealthy investor based in Tallahassee, Florida. Edwards states that he is happy whenever his portfolio outperforms the S&P 500 index. Edwards' statement is a declaration of his:

A) risk tolerance. ✗

B) risk capacity. ✗

C) risk perception. ✓

Explanation

Risk perception is a subjective measure of risk that is affected by the way risk questions are framed. Risk tolerance depends on both the ability and willingness to take risk. Risk capacity is a relatively objective measure of risk compared to risk tolerance; it is based on the ability to take financial risks.

(Module 19.3, LOS 19.e)

Question #31 of 32

Question ID: 1552686

A private client's ability to bear risk is decreased by:

A) multiple sources of financial support. ✗

B) longer time horizons. ✗

C) higher liquidity needs. ✓

Explanation

Higher liquidity needs decrease a client's ability to bear risk because a client needs capital to pay for short-term expenses and has less capacity to suffer a short-term decline in capital available. A longer time horizon and multiple sources of financial support defer short-term risk constraints.

(Module 19.3, LOS 19.e)

Question #32 of 32

Question ID: 1552671

On a private client's net worth statement, life insurance policies with cash value are *most likely* to be classified as:

A) equity.

B) liabilities.

C) assets.

Explanation

The current cash value of a life insurance policy would be categorized as an asset on a private client's net worth statement.

(Module 19.2, LOS 19.b)