Topic 1: Risk Management: A Helicopter View

Question #1 of 5

Question ID: 438568

The risk of sustaining significant losses due to the inability to take or exit a position at a fair price is most likely:

A) credit event risk.
B) operational risk.
C) liquidity risk.
D) market risk.

Question #2 of 5

Question ID: 438569

Funding liquidity risk refers to the risk:

A) that a counterparty to a financial transaction will default.
B) that an institution will not be able to raise cash necessary to make debt payments.
C) that the government will decide to terminate a government-funded program.
D) resulting from a large position size in an asset relative to the asset's typical trading lot size.

Question #3 of 5

Question ID: 438572

Value at risk (VaR) is the:

A) average loss exceeding a specified threshold.
B) the worst possible loss for an asset.
C) maximum expected loss for a given confidence level.
D) minimum expected loss for a given confidence level.

Question #4 of 5

Question ID: 492007

Unexpected volatility in an asset is often called:

A) risk.
B) an upward earnings surprise.
C) asset price instability.

D) biased expectations.

Question #5 of 5

Question ID: 438566

The risk that a counterparty will fail to deliver its obligation is:

A) delivery risk.

B) model risk.

C) settlement risk.

D) people risk.

Topic 2: Corporate Risk Management: A Primer

Question #1 of 5

Question ID: 495057

The board of directors should help a company determine whether to hedge specific risk factors. Regarding the role of the board, which of the following statements is incorrect?

A) The board needs to help set and communicate the firm's risk appetite in a quantitative and/or qualitative manner.

B) The board should clarify its objectives in terms of whether it is accounting or economic profits that are to be hedged.

C) The board should ignore time horizon when determining its risk management goals for management to achieve.

D) The board must ensure that its goals are stated in a clear and actionable manner.

Question #2 of 5

Question ID: 495060

Management at Bank ABC is attempting to determine which types of instruments to use for risk management. When comparing exchange-traded instruments to over-the-counter (OTC) instruments, which characteristic should the bank associate with exchange-traded instruments? Exchange-traded instruments:

A) contain credit risk by either of the counterparties in the transaction (e.g., default risk).

B) are privately traded between a bank and a firm.

C) cover only certain underlying assets and are standardized.

D) can be customized to suit the firm's risk management needs.

Question #3 of 5

Question ID: 495059

When evaluating methods to hedge operational and financial risks, including pricing, foreign currency, and interest rate risk, which of the following risks primarily pertain to the income statement?

I. Hedging operational risk
II. Hedging financial position risk

A) Both I and II.

B) II only.

C) Neither I nor II.

D) I only.

Question #4 of 5

Question ID: 495058

Taylor Lawson is giving a presentation on the differences between static and dynamic hedging strategies. Which of the following statements is correct regarding these two hedging strategies?

A) A static hedging strategy recognizes that the attributes of the underlying risky position may change with time.

B) A static hedging strategy is a complex process in which the risky investment position is initially determined and an appropriate hedging vehicle is used to match that position as close as possible and for as long as required.

C) Significantly more time and monitoring efforts are required with a dynamic hedging strategy compared to a static hedging strategy.

D) A dynamic hedging strategy is a more simple process than a static hedging strategy.

Question #5 of 5

Question ID: 495056

Abe Osbourne is a risk analyst who is evaluating the advantages and disadvantages of hedging risk exposures. Which of the following statements does not reflect an advantage of hedging?

A) Hedging through the use of derivatives instruments such as swaps and options may be cheaper than purchasing an insurance policy.

B) Hedging may decrease the variability of the firm's earnings due to the difference between accounting earnings and cash flows.

C) Hedging may allow management to control its financial performance to meet the requirements of the board of directors.

D) Hedging may result in operational improvements within a firm.

Topic 3: Corporate Governance and Risk Management

Question #1 of 5

Question ID: 495062

Which of the following actions correctly reflect a specific duty of the risk advisory director? The risk advisory director should review and analyze:

A) risk management practices of competitors, but not risk management practices of the industry.

B) the firm's risk appetite and its impact on business strategy.

C) the firm's financial statements, but not the firm's disclosures.

D) any audit reports from internal audits, but not from external audits.

Question #2 of 5

Question ID: 495063

Regarding the relationship between a firm's risk appetite and its business strategy, which of the following statements is true?

A) Consideration must be given to the downside risks of only risky business strategies.

B) Business strategy planning meetings require input from the risk management team.

C) A firm's risk appetite reflects its ability to minimize risk.

D) Business planning activities that exceed risk appetite should be maintained.

Question #3 of 5

Question ID: 495064

Stella Webster, FRM, is assessing the role and responsibilities of her firm's audit committee. Which of the following statements is incorrect regarding the audit committee? The audit committee (as part of the board):

A) has traditionally been responsible for the accuracy of the firm's financial statements and its regulatory reporting requirements.

B) must ensure that the firm has taken all steps to avoid the risk that the financial statements are materially misstated as a result of undiscovered errors and/or fraud.

C) discusses and approves the remuneration of key management personnel.

D) monitors the underlying systems in place regarding financial reporting, regulatory compliance, internal controls, and risk management.

Question #4 of 5

Question ID: 495065

Regarding the interdependence of risk management related functional units within a firm, which of the following list of activities are most likely associated with senior management?

A) Approves business plans and targets, sets risk tolerance, and ensures performance.

B) Establishes and manages risk exposure, ensures timely, accurate, and complete deal capture, and signs off on official P&L.

C) Books and settles trades, reconciles front- and back-office positions, and prepares and decomposes daily P&L.

D) Develops valuation and finance policy, ensures integrity of P&L, and manages business planning process.

Question #5 of 5

Question ID: 495061

When adhering to best practices in corporate governance, the board of directors should most likely:

I. watch out for the interests of the debtholders.

II. maintain its independence from management.

A) Both I and II.

B) I only.

C) Neither I nor II.

D) II only.

Topic 4: What is ERM?

Question #1 of 5

Question ID: 495070

Steven Marsh is assisting with the implementation of an enterprise risk management (ERM) program for his firm. Specifically, he is analyzing the main components of a strong ERM framework. Which of the following activities is closely associated with the ERM component of portfolio management?

A) Quantifies risk exposures for use in risk analysis, measurement, and reporting.

B) Provide a holistic view of the firm's risks if these risks are viewed as individual components of the aggregate risks facing the firm.

C) Reduces or transfers out risks that are either undesirable risks or are desirable but considered concentrated.

D) Communicates a firm's internal risk management process to external stakeholders, including shareholders, creditors, regulators, and the public.

Question #2 of 5

Question ID: 495067

Regarding the primary motivations for a firm to implement an enterprise risk management (ERM) initiative, which of the following motivations are most likely associated with the benefit of improved business performance?

A) Integration of risk transfer.

B) Integration of business processes.

C) Integration of portfolio management.

D) Integration of risk organization.

Question #3 of 5

Question ID: 495069

The chief risk officer (CRO) generally reports to the CEO but could also have a dotted line relationship to both the CEO and to the board of directors in order to minimize any potential friction between the CRO and the CEO due to:

I. basis risk hedging.
II. regulatory issues.

A) Both I and II.

B) Neither I nor II.

C) I only.

D) II only.

Question #4 of 5

Question ID: 495066

Bank XYZ's senior management and its board of directors currently receive fragmented risk management information from various functional units. Given the shortcomings of this approach, the chief risk officer (CRO) suggests a more centralized risk management system. Which of the following statements is correct regarding the implementation of an enterprise risk management (ERM) program?

I. ERM is crucial in establishing a firm-wide, integrated set of policies, procedures, and standards.
II. ERM is often defined as a process or activity to manage risks.

A) I only.

B) II only.

C) Both I and II.

D) Neither I nor II.

Question #5 of 5

Question ID: 495068

The chief risk officer (CRO) is responsible for all risks facing a company, and is specifically responsible for developing and implementing an enterprise risk management (ERM) strategy. Which of the following statements is correct regarding the role and responsibilities of the CRO?

A) The CRO typically reports to the heads of credit, market, operational, and insurance risks.

B) The CRO develops a framework of management policies, including setting the overall risk appetite of the firm.

C) The creation of the CRO role is the only solution to establishing risk oversight.

D) The CRO is a mid-level management responsible for assisting with ERM.

Topic 5: Risk Management, Governance, Culture and Risk Taking in Banks

Question #1 of 5

Question ID: 641289

Regarding implications for a bank if it takes too little or too much risk compared to its optimal level, which of the following statements represents a result from taking on too little risk?

A) The bank may generate superior returns for its shareholders.

B) The bank may fail to capitalize on enough profitable opportunities.

C) The bank may become distressed, which could result in losses for other banks that are counterparties to the subject bank.

D) Ultimately, too little risk may increase the value of the subject bank.

Question #2 of 5

Question ID: 641291

Which of the following statements is most likely incorrect regarding structural challenges and limitations to effective risk management?

A) Effective risk management requires the risk management function within a bank to depend on the activities of its business lines.

B) In practice, many risks are nearly or entirely impossible to hedge (e.g., terrorism risk),

C) Some risk takers within the bank are motivated to maximize their compensation by taking excessive risks that may ultimately reduce the value of the bank.

D) Real-time risk measures do not exist for entire banks.

Question #3 of 5

Question ID: 641290

In which of the following ways can risk management add value for a bank? Risk management adds value:

A) when requiring all business units to ignore the perspective of the entire bank when making decisions regarding risks.

B) if taking on incremental risk would otherwise result in excessive total risk and a significant decrease in the bank's value.

C) if there is a very low cost of having incremental risk above the optimal level.

D) if incremental changes in risk taken do not result in much change in the value of a bank.

Question #4 of 5

Question ID: 641288

When a bank is attempting to determine their optimal level of risk exposure, which of the following statements is most likely incorrect when targeting a certain default probability?

A) A bank should always aim to earn the highest credit rating possible.

B) Aiming for low credit rating (e.g., BBB) may result in lost customers due to the perception that the bank is taking excessive risk.

C) Aiming for a high credit rating (e.g., AAA) may constrain the bank's risk-taking ability.

D) Earning a AAA rating would likely involve a large opportunity cost.

Question #5 of 5

Question ID: 641292

Regarding the potential impact of a bank's risk culture on its risk profile and performance, which of the following statements is/are correct?

I. Companies where managers were perceived as honest and trustworthy were more profitable and were given higher valuations.

II. Shareholder governance improvements would change a firm's culture from focusing on end results to focusing on employee integrity and customer service.

A) I only.

B) Neither I nor II.

C) II only.

D) Both I and II.

Topic 6: Financial Disasters

Question #1 of 15

Question ID: 438690

The head of the government bond trading desk at Kidder Peabody, Joseph Jett, misreported trades, which allowed him to report substantial profits. Which of the following statements is incorrect regarding the Kidder Peabody case?

A) This case demonstrated the importance of investigating large profits from unknown trading strategies.

B) The series of events resulted in $350 million in realized losses for Kidder Peabody.

C) Jett's profits came under fire after Kidder Peabody realized that no individual trading strategy could produce the substantial profits that were being reported.

D) The trades triggered a loss of confidence in the management of Kidder Peabody.

Question #2 of 15

Question ID: 438684

The high degree of operational risk in the Sumitomo case was illustrated by which of the following?
I. Lack of informed supervisors to approve large trades.
II. The trader's ability to keep two sets of trading books and hide trading losses.

A) II only.

B) Both I and II.

C) Neither I nor II.

D) I only.

Question #3 of 15

Question ID: 438685

All of the following affect the role of operational risk management in preventing large trading losses except:

A) multiple approvals for large trades by senior management.

B) the degree of supervision and oversight.

C) the breadth of responsibilities and power given to traders.

D) marked-to-market losses.

Question #4 of 15

Question ID: 438681

Metallgesellschaft's mismanagement in its long-term fixed contract strategy was evidenced by which of the following?
I. Refunding payments to customers who willingly paid to cancel their long-term obligations.
II. Canceling the program too soon while the positive legs of the contracts could have been sold at a profit or used to secure additional financing.

A) Neither I nor II.
B) II only.
C) I only.
D) Both I and II.

Question #5 of 15

Question ID: 438689

The high degree of operational risk in the Sumitomo case was illustrated by which of the following?
I. Model risk.
II. High degree of autonomy, allowing the trader to execute highly levered positions.

A) Both I and II.
B) II only.
C) Neither I nor II.
D) I only.

Question #6 of 15

Question ID: 438682

Metallgesellschaft could have addressed the cash flow crisis created by their stack-and-roll hedge strategy by:
I. Selling puts.
II. Requiring periodic cash settlements from customers.

A) I only.
B) II only.
C) Neither I nor II.
D) Both I and II.

Question #7 of 15

Question ID: 438678

Banker's Trust used derivative trades, which promised corporate clients a high-probability, small reduction in funding costs in exchange for a low-probability, large loss. Unfortunately, the derivative trades only resulted in significant losses for its clients. This case demonstrated the importance of:

A) matching trades with a client's needs and providing price quotes that are independent from the front office.

B) investigating large profits from unknown trading strategies.

C) developing more accurate methods for computing collateral when borrowing bonds.

D) incorporating liquidity risk into risk models.

Question #8 of 15

Question ID: 438686

All of the following are reasons that Nick Leeson engaged in aggressive speculative trading in the Barings Bank collapse except:

A) his authority over settlement operations allowed him to hide trading losses.

B) Barings' risk management models were flawed.

C) he was attempting to recover previous trading losses.

D) Barings' lack of risk management oversight.

Question #9 of 15

Question ID: 438688

Which of the following choices is an example of operational risk in the collapse of Barings?

A) Failure to supervise the actions of its trader.

B) Much of a company's assets were in illiquid derivative products.

C) The Nikkei collapsed due to an earthquake.

D) The default of Japanese industrial firms.

Question #10 of 15

Question ID: 438679

Between 1997 and 2002, a currency trader for Allied Irish Bank (AIB), John Rusnak, hid $691 million in losses from management. Rusnak used a number of deceptive means to hide these losses including:

I. bullying back-office workers into not following-up on trade confirmations for imaginary trades.
II. reporting substantial fake gains from small currency arbitrage positions.

A) I only.

B) Both I and II.

C) II only.

D) Neither I nor II.

Question #11 of 15

Question ID: 438676

Which of the following are examples of model risk illustrated in the Long-Term Capital Management (LTCM) case?
I. Poor management oversight.
II. Financial reporting standards.

A) II only.

B) Neither I nor II.

C) I only.

D) Both I and II.

Question #12 of 15

Question ID: 438677

Which of the following factors contributed to the collapse of Barings Bank?

A) Basis risk.

B) A trader having authority in the settlement process.

C) Japanese financial reporting requirements.

D) A maturity mismatch between the hedging instrument and the risk being hedged.

Question #13 of 15

Question ID: 438691

In general, the bankruptcy of Barings Bank might have been avoided with:

A) a more moderate use of leverage.

B) maturity matching between the hedging instrument and the asset being hedged.

C) pricing models less vulnerable to model risk.

D) stronger reporting and control systems.

Question #14 of 15

Question ID: 438687

Information systems at Barings Bank were deficient for all of the following reasons except:

A) technological limitations that hindered accurate financial reporting.

B) management's failure to audit reporting quality.

C) incomplete account information on gains and losses.

D) management's inability to detect the inconsistency of Leeson's trading strategy and profits.

Question #15 of 15

Question ID: 438683

Nicholas Leeson is identified with which of the following?

A) Nikkei stock index futures.

B) Metallgesellschaft AG.

C) Commodity Futures Trading Commission.

D) Sumitomo.

Topic 7: Deciphering the Liquidity and Credit Crunch 2007-2008

Question #1 of 10

Question ID: 726916

The financial crisis that stemmed from rising mortgage delinquencies and falling housing prices led to a worldwide liquidity crisis because institutions had:

A) become less interconnected.

B) generated large maturity mismatches between assets and liabilities.

C) held too much equity capital.

D) not taken enough leverage.

Question #2 of 10

Question ID: 738570

Suppose that two investors, investor A and investor B, each have an original investment position of $100, with $10 of equity capital and $90 of borrowing (i.e., their leverage ratio is 10). Suppose that the investment assets of investor A experience a 5% decline in asset value, from $100 to $95, while investor A's leverage ratio remains at 10. Investor B experiences no decline in asset value; however, investor B experiences a decline in the permitted leverage ratio from 10 to 6. Which of the investors would be forced to sell more assets to maintain their leverage ratio?

A) Both investors would be forced to sell the same amount of assets.

B) Neither investor would be forced to sell assets.

C) Investor A.

D) Investor B.

Question #3 of 10

Question ID: 726914

Regarding the key factors that led to the housing bubble in 2007-2008, which of the following statements is correct?

A) The Federal Reserve adopted a strict interest rate policy that promoted low interest rates to fend off inflation after the bursting of the internet bubble.

B) An increase in lending standards and abundance of cheap credit led banks to offer credit at low interest rates and lenient terms.

C) Cheap money and plentiful borrowing opportunities led to a flood of real estate purchases, which generated a housing boom.

D) A decrease in demand for U.S. securities by foreign governments experiencing trade surpluses put upward pressure on interest rates.

Question #4 of 10

Question ID: 720226

In a recent report on the 2007-2009 liquidity and credit crunch, there are several concepts that describe various factors of the credit crisis. Which of the following statements accurately defines these concepts?

A) A narrowing of the bid-ask spread results in an increase in market liquidity.

B) A liquidity backstop is a temporary halt in funding liquidity to structured investment vehicles (SIVs) in order to minimize credit losses.

C) The credit protection buyer in a credit default swap (CDS) receives cash flows from the portfolio that underlies the CDS.

D) Because of the forced sale of assets due to declining asset values, a loss spiral generates a lower new position value than a margin spiral.

Question #5 of 10

Question ID: 726917

Which of the following liquidity definitions is most likely associated with market liquidity?

A) The risk that investors may not be able to roll over short-term debt to finance the purchase of an asset.

B) The loss that would be sustained by a trader who sells an asset and then immediately buys it back.

C) The risk that arises when a decline in the collateral value of an asset results in an increase in margin requirement, requiring additional equity capital.

D) The risk that depositors will withdraw funds from banks, or that investors will redeem their shares.

Question #6 of 10

Question ID: 726918

Which of the following liquidity definitions is most likely associated with funding liquidity?

A) The risk that investors may not be able to roll over short-term debt to finance the purchase of an asset.

B) The number of units of an asset a trader can buy or sell at the current market quote (bid and ask prices).

C) The length of time it will take an asset to regain its price after the price has fallen temporarily.

D) The loss that would be sustained by a trader who sells an asset and then immediately buys it back.

Question #7 of 10

Question ID: 895765

Regarding the evaporation of liquidity during a financial crisis, which of the following statements is correct in terms of funding liquidity and market liquidity?

A) A loss spiral is a positive function of market liquidity.

B) In a margin spiral, a trader initiates a sale in order to maintain the leverage ratio (i.e., constant margins).

C) A decline in a source of funding has the same effect as an increase in margin.

D) The use of a purchased asset effectively as collateral to borrow money against it is referred to as market liquidity.

Question #8 of 10

Question ID: 495077

From a risk perspective, which of the following asset-backed security (ABS) tranches will most likely absorb the first losses in the ABS asset pool?

A) Mezzanine tranche.

B) Equity tranche.

C) Senior tranche.

D) Super-senior tranche.

Question #9 of 10

Question ID: 720300

Investors frequently raise money to finance an investment purchase by using leverage and part of their equity to finance the purchase. During the 2007-2009 credit crisis, however, these investors were often forced to sell these investments or other assets due to a decline in their value while maintaining a constant leverage ratio. Raising money to finance investments and the forced sale of assets due to a decline in their value while maintaining a constant leverage ratio, respectively, refer to:

	Raising Money to Finance Investments	Forced Sale of Assets
A)	Funding liquidity	Loss spiral
B)	Market liquidity	Margin spiral
C)	Market liquidity	Loss spiral
D)	Funding liquidity	Margin spiral

Question #10 of 10

Question ID: 726915

The creation collateralized debt obligations (CDOs) most likely involves:

A) the CDO issuer retaining the most senior tranches to give that bank incentive to monitor the loan.

B) slicing the cash flows from a portfolio of collected debt securities into a number of investable tranches.

C) selling the equity tranche to institutions that desire or require instruments with high credit ratings.

D) forming an undiversified portfolio from a small sample of debt securities.

Topic 8: Getting Up to Speed on the Financial Crisis: A One-Weekend-Reader's Guide

Question #1 of 5

Question ID: 726921

The two main panic periods of the financial crisis were:

I. August of 2007 with runs on asset backed commercial paper (ABCP).
II. September 2008 with the filing of bankruptcy by Lehman Brothers.

A) II only.
B) I only.
C) Neither I nor II.
D) Both I and II.

Question #2 of 5

Question ID: 726922

The International Monetary Fund (IMF) studied 13 developed countries and their responses to the 2007-2009 financial crisis. They grouped responses into the following measures: interest rate change, liquidity support, recapitalization, liability guarantees, and asset purchases. Which one of these measures was most effective at stabilizing the interbank markets before the Lehman Brothers failure?

A) Liquidity support.
B) Liability guarantees.
C) Asset purchases.
D) Interest rate change.

Question #3 of 5

Question ID: 726920

A study of previous major banking crises in developed countries would most likely reveal which of the following events leading up to each crisis?

A) decline in private debt.
B) significant decrease in housing prices.
C) significant increase in credit supply.
D) decline in public debt.

Question #4 of 5

Question ID: 726923

Which of the following statements best describes a result of the financial crisis on firms and the economy?

I. Reduced supply of credit by syndicated lenders.
II. An increase in borrowing from regulated banks.

A) Neither I nor II.

B) Both I and II.

C) II only.

D) I only.

Question #5 of 5

Question ID: 726919

Regarding the consequences of the Lehman Brothers failure on the global financial markets, which of the following statements is correct? The failure:

A) increased confidence in surviving financial institutions.

B) is considered the ending point of the financial crisis.

C) resulted in banks spending more cash.

D) caused a run on money market mutual funds.

Topic 9: Risk Management Failures: What Are They and When Do They Happen?

Question #1 of 7

Question ID: 438696

Which of the following statements is incorrect regarding the importance of effectively communicating the results of the risk management process?

A) Timely communication that has not been distorted by intermediaries is required to effective communication.

B) The risk management process may be harmful if there is miscommunication, and the senior managers get a false sense of security from the information that is provided.

C) Risk management efforts are wasted unless the results can be effectively communicated to the appropriate decision makers.

D) The purpose of risk management is to allow senior managers of the firm to make the optimal strategic decisions to maximize firm stock price.

Question #2 of 7

Question ID: 438695

One of the severe consequences of either ignoring or not adequately using data in risk models is that the firm might expand its operations in areas where risks are not being properly considered. Which of the following statements are examples of ignoring or not adequately using data?

I. The firm assumes global market correlations stay constant during financial crises.

II. The firm accepts the assumption that AAA-rated assets are very low risk.

A) II only.

B) I only.

C) Neither I nor II.

D) Both I and II.

Question #3 of 7

Question ID: 438694

All of the following occurrences are examples of risk mismeasurement, except when risk managers:

A) do not understand the relationships of the distributions among different positions.

B) take known and unknown risks into account.

C) do not understand the distribution of returns of a single risky position.

D) use subjectivity when measuring extreme and rare events.

Question #4 of 7

Question ID: 438693

It is important for a firm to recognize all relevant risks. Failing to manage risk exposure could result from all of the following actions except:

A) not communicating risks to top management.

B) not using appropriate risk metrics.

C) not monitoring risk adequately.

D) not measuring unknown risks correctly.

Question #5 of 7

Question ID: 438692

The role of risk management does not involve performing which of the following tasks?

A) Communicate all risks to risk-taking decision makers.

B) Monitor and manage all risks.

C) Make sure the firm takes greater than the necessary amount of risk in order to achieve higher returns.

D) Assess all risks faced by the firm.

Question #6 of 7

Question ID: 438697

Which of the following statements does not illustrate how firms can fail to correctly monitor and manage risk on an ongoing basis?

A) Some securities have complex relationships with market variables such as interest rate changes.

B) Portfolio risk profiles do not change over time.

C) A firm does not have an adequate incentive structure.

D) A firm does not have an adequate culture that promotes effective risk management.

Question #7 of 7

Question ID: 438698

Predatory trading occurs when:

A) a firm with small loss in a given market can influence the activity in that market.

B) a borrower becomes worse off after a loan than before.

C) other firms in a market see that a large player in the market is in trouble and the other firms attempt to push the price down further in order to hurt the large player.

D) there is a misrepresentation in the mortgage application from the borrower side.

Topic 10: The Standard Capital Asset Pricing Model

Question #1 of 50

Question ID: 438614

The market portfolio in the Capital Market Theory contains which types of investments?

A) All risky assets in existence.

B) All stocks in existence.

C) All risky and risk-free assets in existence.

D) All stocks and bonds in existence.

Question #2 of 50

Question ID: 438591

Given a beta of 1.10 and a risk-free rate of 5 percent, what is the expected rate of return assuming a 10 percent market return?

A) 21.5%.

B) 10.5%.

C) 15.5%.

D) 5.5%.

Question #3 of 50

Question ID: 438581

The expected rate of return is 1.5 times the 16% expected rate of return from the market. What is the beta if the risk free rate is 8%?

A) 3.

B) 2.

C) 4.

D) 5.

Question #4 of 50

Question ID: 438612

All portfolios on the capital market line are:

A) perfectly negatively correlated.

B) distinct from each other.

C) unrelated except that they all contain the risk-free asset.

D) perfectly positively correlated.

Question #5 of 50

Question ID: 438593

Which of the following statements about the security market line (SML) is *least* accurate?

A) Securities that plot above the SML are undervalued.

B) The market portfolio consists of all risky assets.

C) The risk-free rate defines where the SML intersects the vertical axis.

D) Securities that plot on the SML have no intrinsic value to the investor.

Question #6 of 50

Question ID: 438589

Which of the following statements about systematic and unsystematic risk is *least* accurate?

A) As compared to a less-diversified portfolio, a diversified portfolio has lower unsystematic risk.

B) As an investor increases the number of stocks in a portfolio, the systematic risk will remain constant.

C) The unsystematic risk for a specific firm is similar to the unsystematic risk for other firms in the same industry.

D) Total risk equals market risk plus firm-specific risk.

Question #7 of 50

Question ID: 438607

According to capital market theory, which of the following represents the risky portfolio that should be held by all investors who desire to hold risky assets?

A) The point of tangency between the capital market line (CML) and the efficient frontier.

B) Any point on the efficient frontier and above the CML.

C) Any point on the efficient frontier and to the left of the point of tangency between the CML and the efficient frontier.

D) Any point on the efficient frontier and to the right of the point of tangency between the CML and the efficient frontier.

Question #8 of 50

Question ID: 438574

Which of the following statements about risk is **FALSE**?

A) The market portfolio consists only of systematic risk.

B) Systematic risk is undiversifiable risk.

C) Total risk = systematic risk - unsystematic risk.

D) Unsystematic risk is diversifiable risk.

Question #9 of 50

Question ID: 438605

The Capital Market Line (CML) shows that under certain assumptions, when a portfolio on the Markowitz efficient frontier is combined with an investment in a risk-free asset:

A) there is a positive linear relationship between portfolio risk and expected return.

B) the maximum attainable expected return results from a 100% allocation to the frontier portfolio and a 0% allocation to the risk-free asset.

C) all portfolios on the Markowitz efficient frontier are dominated in terms of risk and return by a portfolio on the CML.

D) a 100% allocation to the risk-free asset results in a portfolio with an expected return and standard deviation of zero.

Question #10 of 50

Question ID: 438620

Luis Green is an investor who uses the security market line to determine whether securities are properly valued. He is evaluating the stocks of two companies, Mia Shoes and Video Systems. The stock of Mia Shoes is currently trading at $15 per share, and the stock of Video Systems is currently trading at $18 per share. Green expects the prices of both stocks to increase by $2 in a year. Neither company pays dividends. Mia Shoes has a beta of 0.9 and Video Systems has a beta of (-0.30). If the market return is 15 percent and the risk-free rate is 8 percent, which trading strategy will Green employ?

> Mia Shoes Video Systems

	Mia Shoes	Video Systems
A)	Buy	Sell

B)	Buy	Buy
C)	Sell	Sell
D)	Sell	Buy

Question #11 of 50

Question ID: 438588

Total Quality Inc. has a beta of 1.15. If the expected return on the market is 12 percent, and the risk-free rate is 6 percent, what is the expected return for Total Quality?

A) 12.90%.

B) 10.15%.

C) 14.00%.

D) 11.69%.

Question #12 of 50

Question ID: 438623

An investor believes Stock M will rise from a current price of $20 per share to a price of $26 per share over the next year. The company is not expected to pay a dividend. The following information pertains:

- R_F = 8%
- ER_M = 16%
- Beta = 1.7

Should the investor purchase the stock?

A) Yes, because it is overvalued.

B) No, because it is undervalued.

C) No, because it is overvalued.

D) Yes, because it is undervalued.

Question #13 of 50

Question ID: 438592

If the standard deviation of the market's returns is 5.8%, the standard deviation of a stock's returns is 8.2%, and the covariance of the market's returns with the stock's returns is 0.003, what is the beta of the stock?

A) 1.07.

B) 1.12.

C) 0.89.

D) 0.05.

Question #14 of 50

Question ID: 438598

Which of the following is an assumption of capital market theory? All investors:

A) have multiple-period time horizons.

B) select portfolios that lie above the efficient frontier to optimize the risk-return relationship.

C) select portfolios that lie below the efficient frontier to optimize the risk-return relationship.

D) see the same risk/return distribution for a given stock.

Question #15 of 50

Question ID: 438597

Which of the following is **NOT** an assumption of capital market theory?

A) Interest rates never change from period to period.

B) There are no taxes or transaction costs.

C) Investors can lend at the risk-free rate, but borrow at a higher rate.

D) The capital markets are in equilibrium.

Question #16 of 50

Question ID: 438577

Which of the following statements regarding the Capital Asset Pricing Model is *least* accurate?

A) Its accuracy depends upon the accuracy of the beta estimates.

B) It is when the security market line (SML) and capital market line (CML) converge.

C) It is useful for determining an appropriate discount rate.

D) It relies on the existence of a risk-free asset.

Question #17 of 50

Question ID: 438615

The capital market line results from combining the efficient frontier with a risk-free asset. Given the availability of risky assets and a risk-free asset, the best combinations of risk and return are represented by:

A) combinations of the market portfolio and minimum variance portfolio of risky assets.

B) combinations of the minimum variance portfolio of risky assets and the risk-free asset.

C) combinations of the market portfolio and risk-free borrowing or lending.

D) the efficient frontier of risky assets.

Question #18 of 50

Question ID: 438596

Which is **NOT** an assumption of capital market theory?

A) There are no taxes or transaction costs.

B) Investments are not divisible.

C) There is no inflation.

D) All investors have homogeneous expectations.

Question #19 of 50

Question ID: 438622

A portfolio manager wants to purchase stocks with betas that are greater than the market beta. He has asked his analyst to evaluate two stocks, Stock X and Stock Y, and determine if their betas are greater than the market beta. The following information about Stocks X and Y is available to the analyst:

	Stock X	*Stock Y*
Standard deviation of returns	0.15	0.16
Covariance between the return on the market and:	0.014	0.021

The return on the market is 0.12 and the standard deviation of returns on the market is 0.13.

Which of the stocks should the analyst recommend?

	Recommend X	Recommend Y
A)	Yes	No
B)	No	No
C)	No	Yes
D)	Yes	Yes

Question #20 of 50

Question ID: 438575

The expected rate of return is twice the 12% expected rate of return from the market. What is the beta if the risk-free rate is 6%?

A) 2.

B) 4.

C) 5.

D) 3.

Question #21 of 50

Question ID: 438610

For an investor to move further up the Capital Market Line than the market portfolio, the investor must:

A) diversify the portfolio even more.

B) borrow and invest in the market portfolio.

C) continue to invest only in common stocks.

D) reduce the portfolio's risk below that of the market.

Question #22 of 50

Question ID: 438599

Which of the following statements about asset pricing models is *most* accurate?

A) It is difficult for the individual investor to achieve the benefits from diversification because significantly reducing risk requires the purchase of approximately 1,000 securities.

B) According to the Capital Asset Pricing Model (CAPM), the expected rate of return of a portfolio with a beta of 1.0 is the market expected return.

C) Assuming assets are not perfectly positively correlated, the systematic risk of a portfolio decreases as more assets are added.

D) Adding the risk-free asset to a portfolio will reduce return and total risk.

Question #23 of 50

Question ID: 438613

The market portfolio in Capital Market Theory is determined by:

A) the intersection of the efficient frontier and the investor's highest utility curve.

B) a line tangent to the efficient frontier, drawn from any point on the expected return axis.

C) a straight line drawn to any efficient portfolio.

D) a line tangent to the efficient frontier, drawn from the risk-free rate of return.

Question #24 of 50

Question ID: 438579

Consider the expected returns and standard deviations for the following portfolios:

	Portfolio 1	*Portfolio 2*	*Portfolio 3*	*Portfolio 4*
Expected Return	10%	12%	11%	14%
Standard Deviation	14%	13%	12%	18%

Relative to the other portfolios, the portfolio that is not mean variance efficient is:

A) Portfolio 4.
B) Portfolio 2.
C) Portfolio 3.
D) Portfolio 1.

Question #25 of 50

Question ID: 438603

The *slope* of the capital market line (CML) is a measure of the level of:

A) risk over the level of excess return.
B) inflation over the level of expected return.
C) expected return over the level of inflation.
D) excess return per unit of risk.

Question #26 of 50

Question ID: 438573

Which of the following is *least likely* considered a source of systematic risk for bonds?

A) Default risk.
B) Purchasing power risk.
C) Interest rate risk.
D) Market risk.

Question #27 of 50

Question ID: 438594

All of the following are assumptions of the capital asset pricing model **EXCEPT**:

A) investors can borrow and lend at the same risk-free rate.

B) each investor seeks to maximize the expected utility of wealth at the end of his horizon.

C) the time horizons of investors are normally distributed.

D) investors have the same expectations concerning returns.

Question #28 of 50

Question ID: 438595

Capital market theory is *least likely* to assume that:

A) it is possible to buy or sell fractional shares of an investment.

B) all investors have the same one-period time horizon.

C) investors can lend any amount of money at the risk-free rate.

D) all investors desire to be the same location on the efficient frontier.

Question #29 of 50

Question ID: 438587

Which of the following statements about a stock's beta is **TRUE**? A beta greater than one is:

A) risky, while a beta less than one is risk-free.

B) is riskier than the market, while a beta less than one is less risky than the market.

C) overvalued, while a beta less than one is undervalued.

D) undervalued, while a beta less than one is overvalued.

Question #30 of 50

Question ID: 438617

A stock is expected to earn a return of 10%, which is 6% greater than the risk-free rate. If the expected return on the market is 12% and the beta of the stock is 0.75, the stock *most likely*:

A) is properly valued.

B) will plot above the security market line.

C) is overvalued.

D) will plot below the security market line.

Question #31 of 50

Question ID: 438585

A security's systematic risk is proportional to:

A) the covariance of its return with the return on the market portfolio.

B) the standard deviation of its return.

C) the variance of its return.

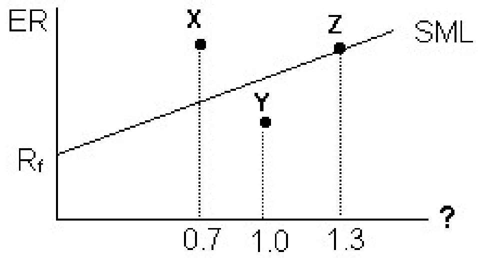
D) its diversifiable risk.

Question #32 of 50

Question ID: 438619

In the graph of the Security Market Line (SML) below (not drawn to scale):

- The letters X, Y, and Z represent risky asset portfolios.
- The SML crosses the y-axis at 5%.
- The market premium is 7.5%.
- Portfolio Y and Z have the same expected return (holding period return).



Using the graph and the list of assumptions, determine which of the following statements is *most* accurate.

A) The expected return on Portfolio Z is greater than the required return.

B) Portfolio X is overvalued.

C) The required return on Portfolio X is 10.25%.

D) The expected return on Portfolio Y is 15%.

Questions #33-34 of 50

An analyst collected the following data for three possible investments.

Stock	*Price Today*	*Forecasted Price**	*Dividend*	*Beta*
Alpha	25	31	2	1.6
Omega	105	110	1	1.2
Lambda	10	10.80	0	0.5

> *Forecasted Price = expected price one year from today.

The expected return on the market is 12% and the risk-free rate is 4%.

Question #33 of 50

Question ID: 438583

According to the security market line (SML), which of the three securities is correctly priced?

A) Omega.

B) None of the securities are correctly priced.

C) Lambda.

D) Alpha.

Question #34 of 50

Question ID: 438584

Which of the three securities identified by Williams would plot on the capital market line(CML)?

A) Omega.

B) None of the securities would plot on the CML.

C) Lambda.

D) Alpha.

Question #35 of 50

Question ID: 438600

According to the capital asset pricing model, a negative risk premium:

A) is an impossibility.

B) would only occur if the covariance of a security's return with the return on the market is zero.

C) would only occur if the covariance of a security's return with the return on the market is positive.

D) would only occur if the covariance of a security's return with the return on the market is negative.

Question #36 of 50

Question ID: 438580

Jim Sheehan manages a diversified portfolio containing forty stocks. The portfolio beta is 1.05. Jim is considering adding the stock of ABC Inc. to the portfolio, and would fund the purchase with cash already in the portfolio. ABC Inc. has a beta of 1.20, and is currently not part of the portfolio. Which statement about the resulting portfolio is **TRUE**?

A) Both systematic risk and unsystematic risk would be unchanged.

B) Systematic risk would decrease, but the unsystematic risk would be unchanged.

C) Systematic risk would increase, but the unsystematic risk would be unchanged.

D) Both systematic risk and unsystematic risk would both increase.

Question #37 of 50

Question ID: 438616

The intercept and slope of the capital market line are:

A) R_F and $[E(R_M) - R_F] / \sigma_M$, respectively.

B) R_M and $[E(R_M) - R_P] / \sigma_M$, respectively.

C) R_M and $[E(R_P) - R_F] / \sigma_P$, respectively.

D) R_F and $[E(R_P) - R_F] / \sigma_M$, respectively.

Question #38 of 50

Question ID: 438602

Under the CAPM, which of the following can investors choose for their portfolios?

I. The risk-free asset.
II. The market portfolio.
III. Assets that maximize return relative to asset-specific risk.
IV. A portfolio (other than the market portfolio) on the efficient frontier of risky portfolios.

A) I, II and IV only.

B) II and III only.

C) I and II only.

D) I only.

Question #39 of 50

Question ID: 438576

Given the following data, what is the correlation coefficient between the two stocks and the Beta of stock A?

- standard deviation of returns of Stock A is 10.04%
- standard deviation of returns of Stock B is 2.05%
- standard deviation of the market is 3.01%
- covariance between the two stocks is 0.00109
- covariance between the market and stock A is 0.002

<u>Correlation Coefficient</u> <u>Beta (stock A)</u>

A)	0.6556	2.20
B)	0.5296	2.20
C)	0.6556	0.06
D)	0.5296	0.06

Question #40 of 50

Question ID: 438621

Charlie Smith holds two portfolios, Portfolio X and Portfolio Y. They are both liquid, well-diversified portfolios with approximately equal market values. He expects Portfolio X to return 13% and Portfolio Y to return 14% over the upcoming year. Because of an unexpected need for cash, Smith is forced to sell at least one of the portfolios. He uses the security market line to determine whether his portfolios are undervalued or overvalued. Portfolio X's beta is 0.9 and Portfolio Y's beta is 1.1. The expected return on the market is 12% and the risk-free rate is 5%. Smith should sell:

A) portfolio Y only.
B) portfolio X only.
C) both portfolios X and Y because they are both overvalued.
D) either portfolio X or Y because they are both properly valued.

Question #41 of 50

Question ID: 438586

The beta of stock D is -0.5. If the expected return of Stock D is 8%, and the risk-free rate of return is 5%, what is the expected return of the market?

A) +3.0%.
B) -4.0%.
C) -1.0%.
D) +3.5%.

Question #42 of 50

Question ID: 438601

The assumption that returns are normally distributed means that investors:

A) have the same horizon.
B) only consider the mean and standard deviation of the returns.

C) are risk averse.

D) do not need to consider transactions costs.

Question #43 of 50

Question ID: 438590

An analyst has developed the following data for two companies, PNS Manufacturing (PNS) and InCharge Travel (InCharge). PNS has an expected return of 15 percent and a standard deviation of 18 percent. InCharge has an expected return of 11 percent and a standard deviation of 17 percent. PNS's correlation with the market is 75 percent, while InCharge's correlation with the market is 85 percent. If the market standard deviation is 22 percent, which of the following are the betas for PNS and InCharge?

	Beta of PNS	Beta of InCharge
A)	0.66	0.61
B)	0.61	0.66
C)	0.92	1.10
D)	1.10	0.92

Question #44 of 50

Question ID: 438609

Portfolios that represent combinations of the risk-free asset and the market portfolio are plotted on the:

A) capital asset pricing line.

B) capital market line.

C) characteristic line.

D) utility curve.

Question #45 of 50

Question ID: 438604

Which of the following is the vertical axis *intercept* for the Capital Market Line (CML)?

A) Efficient frontier.

B) Expected return on the market.

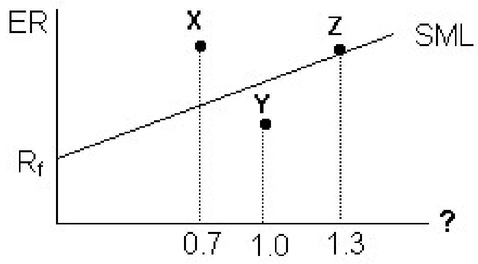
C) Expected return on the portfolio.

D) Risk-free rate.

Question #46 of 50

Question ID: 438618

Consider the following graph of the Security Market Line (SML). The letters X, Y, and Z represent risky asset portfolios. The SML crosses the y-axis at the point 0.07. The expected market return equals 13.0%. *Note: The graph is **NOT** drawn to scale.*



Using the graph above and the information provided, which of the following statements is *most* accurate?

A) Portfolio X's required return is greater than the market expected return.

B) The expected return (or holding period return) for Portfolio Z equals 14.8%.

C) The correct label for the x-axis is total risk.

D) Portfolio Y is undervalued.

Question #47 of 50

Question ID: 438578

Beta is *least* accurately described as:

A) a measure of the sensitivity of a security's return to the market return.

B) the factor by which the market risk premium is multiplied in the Capital Asset Pricing Model.

C) a standardized measure of the total risk of a security.

D) the covariance of a security's returns with the market return, divided by the variance of market returns.

Question #48 of 50

Question ID: 438611

In the context of the CML, the market portfolio includes:

A) the risk-free asset.

B) 12-18 stocks needed to provide maximum diversification.

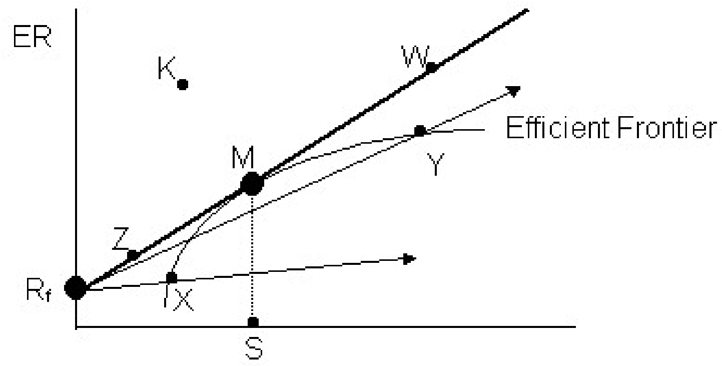
C) risky stocks and bonds only.

D) all existing risky assets.

Question #49 of 50

Question ID: 438606

Consider the following graph of the risk-free asset R_f and the efficient frontier. The letters K, W, X Y, and Z represent risky portfolios. Portfolio M is the market portfolio. The lines R_fX and R_fY represent the combination of the risk-free asset and the risky portfolio.



Which of the following statements about the above graph is *least* accurate?

A) Portfolios W and Z are perfectly positively correlated with each other.

B) Investors on the capital market line to the right of M are leveraged and hold more than 100% of portfolio M.

C) Portfolio K is possible, but not the most efficient because it does not fall on the efficient frontier and is overvalued.

D) Point S represents the standard deviation of returns on the market portfolio.

Question #50 of 50

Question ID: 438608

A portfolio to the right of the market portfolio on the capital market line (CML) is created by:

A) holding more than 100% of the risky asset.

B) fully diversifying.

C) holding both the risk-free asset and the market portfolio.

D) buying the risk-free asset.

Topic 11: Applying the CAPM to Performance Measurement: Single-Index Performance Measurement Indicators

Question #1 of 32

Question ID: 438669

Jenny Rouse has been a portfolio manager for Theta Advisors for the last five years. The performance of her portfolio has had few returns below its benchmarks since its inception. Which of the following risk measures *best* measures Rouse's performance?

A) Range.

B) Sortino ratio.

C) Sharpe ratio.

D) Standard Deviation.

Question #2 of 32

Question ID: 438661

Of the Sharpe, Treynor, and Jensen's Alpha measures, when measuring the risk/return performance of actively managed portfolios, which is the *most appropriate* to use?

A) Treynor measure.

B) All three measures are equally appropriate.

C) Sharpe ratio.

D) Jensen's Alpha.

Question #3 of 32

Question ID: 438642

Which Sharpe ratio indicates that Fund One earned a return on investment that is greater than the risk taken by the fund?

A) 1.5.

B) 1.0.

C) 0.

D) 0.5.

Question #4 of 32

Question ID: 438648

Which of the following measures used to evaluate the performance of a portfolio manager is (are) **NOT** subject to the assumptions of the capital asset pricing model (CAPM)?

A) Sharpe measure.

B) Jensen's alpha.

C) Jensen's alpha and the Treynor measure.

D) Treynor measure.

Questions #5-6 of 32

The following information is available for the Trumark Fund:

- The Trumark Fund has an average annual return of 12 percent over the last five years.
- Trumark has a beta value of 1.35.
- Trumark has a standard deviation of returns of 16.80 percent.
- During the same time period, the average annual T-bill rate was 4.5 percent.
- During the same time period, the average annual return on the S&P 500 portfolio was 18 percent.

Question #5 of 32

Question ID: 438664

What is the Sharpe ratio for the Trumark Fund?

A) 0.80.

B) 0.45.

C) 5.56.

D) 7.50.

Question #6 of 32

Question ID: 438665

What is the Treynor measure for Trumark Fund?

A) -0.04.

B) 0.06.

C) 0.80.

D) 0.45.

Question #7 of 32

Question ID: 438670

In the Sortino ratio, the excess return is divided by the:

A) standard deviation.

B) VAR.

C) maximum drawdown.

D) standard deviation using only the returns below a minimum level

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Question #8 of 32

Question ID: 438643

Over the previous year, the average and variance of a portfolio's returns was 0.18 and 0.09. The risk-free rate over the period was 0.03. The Sharpe ratio for the portfolio for the previous year is:

A) 1.5.

B) 0.5.

C) 0.6.

D) 3.0.

Question #9 of 32

Question ID: 438646

Portfolios X and Y have had an equal average return over the most recent period. Compared to Portfolio Y, Portfolio X had higher total risk, but lower systematic risk. Given this information, which of the following statements is **TRUE**? Compared to Portfolio Y:

A) Portfolio X has a lower Sharpe ratio and a higher Treynor ratio.

B) Portfolio X has both a lower Sharpe ratio and a lower Treynor ratio.

C) Portfolio X has a higher Sharpe ratio and a lower Treynor ratio.

D) Portfolio X has both a higher Sharpe and a higher Treynor ratio.

Question #10 of 32

Question ID: 438638

The mean monthly return on U.S. Treasury bills (T-bills) is 0.42%. The mean monthly return for an index of small stocks is 4.56%, with a standard deviation of 3.56%. What is the Sharpe measure for the index of small stocks?

A) 1.16.

B) 10.60.

C) 16.56.

D) 3.48.

Question #11 of 32

Question ID: 438662

The efficient market portfolio had a return of 12%. The risk-free rate was 6%. A portfolio has a beta of 1.2. If the portfolio return was 12%, which of the following is *closest* to the Treynor ratio for the portfolio?

A) 0.

B) 0.05.

C) 0.20.

D) 1.

Question #12 of 32

Question ID: 438644

Johnson Inc. manages a growth portfolio of equity securities that has had a mean monthly return of 1.4% and a standard deviation of returns of 10.8%. Smith Inc. manages a blended equity and fixed income portfolio that has had a mean monthly return of 1.2% and a standard deviation of returns of 6.8%. The mean monthly return on Treasury bills has been 0.3%. Based on the Sharpe ratio, the:

A) performance of the Smith portfolio is preferable to the performance of the Johnson portfolio.

B) performance of the Johnson portfolio is preferable to the performance of the Smith portfolio.

C) Johnson portfolio has greater excess return per unit of risk than the Smith portfolio.

D) shows that the Johnson and Smith portfolios have exhibited the same risk-adjusted performance.

Question #13 of 32

Question ID: 438666

Annual Returns on ABC Mutual Fund									
1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
11.0%	12.5%	8.0%	9.0%	13.0%	7.0%	15.0%	2.0%	-16.5%	11.0%

If the risk-free rate was 4.0% during the period 1991-2000, what is the Sharpe ratio for ABC Mutual Fund for the period 1991-2000?

A) 0.52.

B) 1.12.

C) 0.68.

D) 0.35.

Question #14 of 32

Question ID: 438652

A higher Sharpe ratio indicates:

A) lower volatility of returns.

B) a lower risk per unit of return.

C) greater diversification in the portfolio.

D) a higher excess return per unit of risk.

Questions #15-16 of 32

The following performance data for an actively managed portfolio and the S&P 500 Index is reported:

	Actively Managed Portfolio	*S&P 500*
Return	50%	20%
Standard deviation	18%	15%
Beta	1.1	1.0

Risk-free rate = 6%.

Question #15 of 32

Question ID: 438655

Determine the Sharpe measure, Treynor measure, and Jensen's alpha for the actively managed portfolio.

A) Sharpe measure = 2.44; Treynor measure = 0.40; Alpha = 0.29.

B) Sharpe measure = 1.04; Treynor measure = 0.14; Alpha = 0.04.

C) Sharpe measure = 1.06; Treynor measure = 0.12; Alpha = 0.02.

D) Sharpe measure = 1.05; Treynor measure = 0.17; Alpha = 0.04.

Question #16 of 32

Question ID: 438656

Based on the results from determining the Sharpe measure, Treynor measure, and Jensen's alpha for the actively managed portfolio, does the portfolio manager outperform or underperform the S&P 500 index?

A) Sharpe measure → underperform; Treynor measure → outperform; Alpha → outperform

B) Sharpe measure → underperform; Treynor measure → underperform; Alpha → underperform.

C) Sharpe measure → outperform; Treynor measure → underperform; Alpha → underperform.

D) Sharpe measure → outperform; Treynor measure → outperform; Alpha → outperform.

Question #17 of 32

Question ID: 438640

Which of the following statements regarding the Sharpe ratio is *most* accurate? The Sharpe ratio measures:

A) total return per unit of risk.
B) peakedness of a return distrubtion.
C) excess return per unit of risk.
D) dispersion relative to the mean.

Question #18 of 32

Question ID: 438649

A portfolio has a return of 14.2% and a Sharpe's measure of 3.52. If the risk-free rate is 4.7%, what is the standard deviation of returns?

A) 2.7%.
B) 3.1%.
C) 2.6%.
D) 3.9%.

Question #19 of 32

Question ID: 438647

	Sharpe Measure	*Treynor Measure*	*Jensen Measure*
Portfolio A	0.25	0.12	0.04
Portfolio B	0.65	0.09	0.03
Portfolio C	0.45	0.11	0.02
Portfolio D	0.75	0.10	-0.02

The table represents risk-adjusted returns across all fund categories. Which of the following represents the best risk-adjusted return?

A) Portfolio A.
B) Portfolio D.
C) Portfolio B.
D) Portfolio C.

Question #20 of 32

Question ID: 438668

The Sortino ratio is a measure of a portfolio's return above:

A) zero divided by the standard deviation.

B) a minimal acceptable return divided by downside deviation.

C) the market return divided by beta.

D) the market return divided by the standard deviation.

Question #21 of 32

Question ID: 438667

The Sortino ratio is most similar to the:

A) relative tracking error ratio.

B) Treynor ratio.

C) information ratio.

D) Sharpe ratio.

Question #22 of 32

Question ID: 438653

Portfolio A earned an annual return of 15% with a standard deviation of 28%. If the mean return on Treasury bills (T-bills) is 4%, the Sharpe ratio for the portfolio is:

A) 1.87.

B) 0.39.

C) 2.54.

D) 0.54.

Question #23 of 32

Question ID: 438641

The efficient market portfolio had a return of 14%. The risk-free rate was 5%. A portfolio has a beta of 0.8. If the portfolio return was 11%, then Jensen's alpha for the portfolio equals:

A) +8.000%.

B) -1.200%.

C) -0.375%.

D) +3.000%.

Question #24 of 32

Question ID: 438659

An analyst has generated the following information about risk/return performance using the Sharpe ratio and the Treynor measure:

	Equity Fund	*S&P 500*
Sharpe ratio	0.47	0.42
Treynor measure	0.31	0.34

Which of the following statements about the relative risk/return performance of the funds is **TRUE?** The:

A) Treynor measure shows the fund outperformed the S&P 500 on a systematic risk-adjusted basis.

B) Sharpe ratio shows the equity fund underperformed the S&P 500 on a systematic risk-adjusted basis.

C) Treynor measure shows the fund underperformed the S&P 500 on a total risk-adjusted basis.

D) Sharpe ratio shows the equity fund outperformed the S&P 500 on a total risk- adjusted basis.

Question #25 of 32

Question ID: 438645

The Treynor and Sharpe ratios will:

A) give identical rankings when the assets have identical correlations with the market.

B) give identical rankings when the same minimum acceptable return is chosen for the calculations.

C) always provide identical rankings.

D) give identical rankings when the assets have identical standard deviations.

Question #26 of 32

Question ID: 438660

An analyst has gathered the following information about the performance of an equity fund and the S&P 500 index over the same time period.

	Equity Fund	*S&P 500*
Return	-12%	-16%
Standard Deviation	15%	19%
Beta	1.18	1.00

Risk-free rate is 6.00%

The difference between the Treynor measure for the equity fund and the Treynor measure for the S&P 500 is:

A) 0.15.

B) 0.07.

C) 0.17.

D) 0.21.

Question #27 of 32

Question ID: 438650

The Treynor measure is correctly defined as a measure of a fund's:

A) return earned compared to its unsystematic risk.

B) excess return earned compared to its total risk.

C) excess earned compared to its systematic risk.

D) return earned compared to its systematic risk.

Question #28 of 32

Question ID: 438657

Jensen's alpha for a portfolio measures the:

A) fund's return in excess of the required rate of return given the unsystematic risk of the portfolio.

B) fund's return in excess of the required rate of return given the systematic risk of the portfolio.

C) difference between the fund's Sharpe ratio and Treynor measure.

D) difference between a fund's return and the market return.

Question #29 of 32

Question ID: 438658

An analyst has gathered the following information about the performance of an equity fund and the S&P 500 index over the same time period.

	Equity Fund	*S&P 500*
Return	13%	10.5%
Standard Deviation	22%	20%
Beta	1.21	1.00

Risk-free rate is 5.25%

The Treynor measure for the equity fund is:

A) 0.048.
B) 0.570.
C) 0.064.
D) 0.071.

Question #30 of 32

Question ID: 438637

For a given portfolio, the expected return is 12% with a standard deviation of 22%. The beta of the portfolio is 1.1. The expected return of the market is 10% with a standard deviation of 20%. The risk-free rate is 4%. The Sharpe measure of the portfolio is:

A) 0.36.
B) 7.27.
C) 20.00.
D) 0.10.

Question #31 of 32

Question ID: 438639

Portfolio A earned a return of 10.23% and had a standard deviation of returns of 6.22%. If the return over the same period on Treasury bills (T-bills) was 0.52% and the return to Treasury bonds (T-bonds) was 4.56%, what is the Sharpe ratio of the portfolio?

A) 0.91.
B) 1.56.
C) 7.71.
D) 0.56.

Question #32 of 32

Question ID: 438651

A portfolio of options had a return of 22% with a standard deviation of 20%. If the risk-free rate is 7.5%, what is the Sharpe ratio for the portfolio?

A) 0.147.
B) 0.725.
C) 0.267.

D) 0.568.

Topic 12: Arbitrage Pricing Theory and Multifactor Models of Risk and Return

Questions #1-2 of 10

Carrie Marcel, CFA, has long used the Capital Asset Pricing Model (CAPM) as an investment tool. Marcel has recently begun to appreciate the advantages of arbitrage pricing theory (APT). She used reliable techniques and data to create the following two-factor APT equation:

> $E(R_P) = 6.0\% + 12.0\%\beta_{p,\Delta GDP} - 3.0\%\beta_{p,\Delta INF}$

Where ΔGDP is the change in GDP and ΔINF is the change in inflation. She then determines the sensitivities to the factors of three diversified portfolios that are available for investment as well as a benchmark index:

Portfolio	*Sensitivity to ΔGDP*	*Sensitivity to ΔINF*
Q	2.00	0.75
R	1.25	0.50
S	1.50	0.25
Benchmark Index	1.80	1.00

Marcel is investigating several strategies. She decides to determine how to create a portfolio from Q, R, and S that only has an exposure to ΔGDP. She also wishes to create a portfolio out of Q, R, and S that can replicate the benchmark. Marcel also believes that a hedge fund, which is composed of long and short positions, could be created with a portfolio that is equally weighted in Q, R, S and the benchmark index. The hedge fund would produce a return in excess of the risk-free return but would not have any risk.

Question #1 of 10

Question ID: 438629

Which of the following statements *least likely* describes characteristics of the APT and the CAPM?

A) Both models require the ability to invest in the market portfolio.

B) Under the framework of CAPM, investors who are more risk averse should hold less of the market portfolio and more of the risk-free asset.

C) The APT is more flexible than the CAPM because it allows for multiple factors.

D) Both models assume firm-specific risk can be diversified away.

Question #2 of 10

Question ID: 438630

What is the APT expected return on a factor portfolio exposed only to ΔGDP?

A) 18.0%.

B) 15.0%.

C) 12.0%.

D) 3.0%.

Question #3 of 10

Question ID: 438632

The factor risk premium on factor j in the arbitrage pricing theory (APT) can be interpreted as the:

A) expected return investors require on a factor portfolio for factor j.

B) expected return on an arbitrage portfolio with j factors.

C) expected risk premium investors require on a factor portfolio for factor j.

D) sensitivity of the market portfolio to factor j.

Question #4 of 10

Question ID: 438635

Which of the following is not an assumption of the arbitrage pricing theory (APT)?

A) Security returns are normally distributed.

B) No arbitrage opportunities exist.

C) The market contains enough stocks so that unsystematic risk can be diversified away.

D) Returns on assets can be described by a multi-factor process.

Question #5 of 10

Question ID: 438634

Which of the following statements regarding the arbitrage pricing theory (APT) as compared to the capital asset pricing model (CAPM) is *least* accurate? APT:

A) does not require that one of the risk factors is the market portfolio; unlike the CAPM.

B) is more flexible than CAPM in its application.

C) has fewer assumptions than CAPM.

D) is often times thought of as a special case of the CAPM.

Question #6 of 10

Question ID: 438636

Which of the following is an assumption of the arbitrage pricing theory (APT)?

A) The process generating asset returns can be represented by a 5-factor model.

B) Security returns are normally distributed.

C) Assets are priced such that no arbitrage opportunities exist.

D) Investors have quadratic utility functions.

Questions #7-8 of 10

Marcie Deiner is an investment manager with G&G Investment Corporation. She works with a variety of clients who differ in terms of experience, risk aversion and wealth. Deiner recently attended a seminar on multifactor analysis. Among other things, the seminar taught how the assumptions concerning the Arbitrage Pricing Theory (APT) model are different from those of the Capital Asset Pricing Model (CAPM). One of the examples used in the seminar is below.

> $E(R_i) = R_f + f_1 B_{i,1} + f_2 B_{i,2} + f_3 B_{i,3.}$ where: f_1 =3.0%, f_2 = −40.0%, and f_3 =50.0%.

Beta estimates for Growth and Value funds for a three factor model			
	Factor 1	*Factor 2*	*Factor 3*
Betas for Growth	0.5	0.7	1.2
Betas for Value	0.2	1.8	0.6

Question #7 of 10

Question ID: 638283

For the model used as an example in the seminar, if the T-bill rate is 3.5%, what are the expected returns for the Growth and Value Funds?

	$E(R_{Growth})$	$E(R_{Value})$
A)	3.1%	−3.16%
B)	93.0%	106.1%
C)	37.0%	−37.9%
D)	33.5%	−41.4%

Question #8 of 10

Question ID: 438627

Which of the following is *least likely* an assumption of the APT model?

A) asset returns are explained by a factor model.

B) a large number of available assets for investment allow investors to eliminate non-systematic risk through diversification.

C) no arbitrage opportunities are available to investors because capital markets are perfectly competitive.

D) asset returns are normally distributed.

Question #9 of 10

Question ID: 438633

Given a three-factor arbitrage pricing theory (APT) model, what is the expected return on the Premium Dividend Yield Fund?

- The factor risk premiums to factors 1, 2 and 3 are 8%, 12% and 5%, respectively.
- The fund has sensitivities to the factors 1, 2, and 3 of 2.0, 1.0 and 1.0, respectively.
- The risk-free rate is 3.0%.

A) 36.0%.

B) 50.0%.

C) 28.0%.

D) 33.0%.

Question #10 of 10

Question ID: 438631

An arbitrage pricing theory (APT) model has the following characteristics:

- The risk free rate is 3.8 percent.
- Factor risk premiums are:

> A. (7 percent)
> B. (4 percent)
> C. (2 percent)
> D. (10 percent)

Assume Silver Linings Fund has the following sensitivities to the factors:

- Sensitivity to A is 0.5.
- Sensitivity to B is 1.2.
- Sensitivity to C is 2.1.

- Sensitivity to D is 0.2.

The expected return on the Silver Linings Fund is:

A) 14.5 percent.

B) 18.3 percent.

C) 20.1 percent.

D) 16.8 percent.

Topic 13: Principles for Effective Data Aggregation and Risk Reporting

Question #1 of 5

Question ID: 440348

Ponder Bank has experienced recent losses resulting from regional home loan concentration. While the national market has recovered, a few regions have suffered. Ponder bank is now undercapitalized because of the losses. The Basel Committee's principles for effective risk data aggregation and reporting can help prevent and deal with situations like what Ponder Bank is experiencing. Which one of the committee's principles most likely recommends that risk management reports include risk data, risk analysis, interpretation of risk, and qualitative explanations of risks?

A) Clarity and Usefulness.

B) Comprehensiveness.

C) Completeness.

D) Accuracy.

Question #2 of 5

Question ID: 444840

The Basel Committee Principles for effective risk data aggregation capabilities include:

A) accuracy and integrity, completeness, timeliness, and adaptability.

B) accuracy and integrity, completeness, competence, and diligence.

C) competence, diligence, and adaptability.

D) competence, diligence, and timeliness.

Question #3 of 5

Question ID: 444839

Which of the following statements is least likely consistent with the Basel Committee's guidance and principles regarding effective risk data aggregation and risk reporting practices?

A) A single data model must be used for data classifications.

B) Risk managers and business managers are responsible for accurately managing and entering relevant data into their data infrastructure.

C) Banks should devote financial and human resources to data aggregation and reporting roles throughout a market cycle.

D) Data architecture should include information on metadata.

Question #4 of 5

Question ID: 440347

The risk aggregation process includes breaking down, sorting, and merging data and datasets. Several benefits accrue to banks that have effective risk data aggregation and reporting systems in place. Which of the following statements least likely describes a benefit of effective risk data aggregation?

A) It is easier to see problems on the horizon when risks are viewed individually rather than as a whole.

B) The bank is better able to make strategic decisions, increase efficiency, reduce the chance of loss, and ultimately increase profitability.

C) Improved resolvability in the event of bank stress or failure.

D) Increase efficiency, reduce the chance of loss, and ultimately increase profitability.

Question #5 of 5

Question ID: 444838

Which of the following statements is least likely consistent with the Basel Committee's guidance and principles regarding data aggregation?

A) Data aggregation and risk reporting capabilities should be independently reviewed and validated.

B) Data aggregation and reporting decisions should be based on a bank's physical location and legal structure.

C) Time frames should be established to integrate data and risk reporting capabilities of acquired firms.

D) A bank's board of directors should be aware of its compliance with key governance principles set forth by the Basel Committee.

Topic 14: GARP Code of Conduct

Question #1 of 7

Question ID: 438701

Charmaine Townsend, FRM, has been managing a growth portfolio for her clients using a screening process that identifies companies that have high earnings growth rates. Townsend has decided that, because she thinks the economy might turn volatile, she is going to adopt a value strategy using a screening process that identifies companies that have low price-earnings multiples. Townsend will violate the GARP Code of Conduct if she makes this change in her investment process without:

A) getting prompt written acknowledgment of the change from her clients within a reasonable time after the change was made.

B) notifying her supervisor before she makes the change.

C) promptly notifying her clients of the change.

D) getting written permission from her clients in advance of the change.

Question #2 of 7

Question ID: 438700

Sue Johnson, FRM, has an elderly client with a very large asset base. The client intends to start divesting her fortune to various charities. Johnson is on the Board of a local charitable foundation. Johnson most appropriately:

A) can make this known to the charitable foundation so that they can solicit the client, since it is the client's wish to divest assets to charities in the future.

B) must not discuss anything regarding her client and her client's intentions with the charitable foundation without permission.

C) can discuss her client's situation with the charitable foundation as long as she informs other local charities of her client's intentions.

D) should solicit the client herself, along with other Board members, to obtain a larger contribution.

Question #3 of 7

Question ID: 438703

Preservation of confidentiality applies to the information that an analyst learns from:

A) former clients and prospects only.

B) current clients and prospects only.

C) current clients and former clients only.

D) current clients, former clients, and prospects.

Question #4 of 7

Question ID: 438699

When an analyst makes an investment recommendation, which of the following statements must be disclosed to clients?

A) The analyst's father-in-law has a material ownership in the security.

B) All of these statements must be disclosed to clients.

C) An employee of the firm holds a directorship with the recommended company.

D) The firm is a market maker in the stock of the recommended company.

Question #5 of 7

Question ID: 438705

Which of the following statements is incorrect regarding GARP Code of Conduct violations?

A) Violations of the Code of Conduct may result in permanent removal from GARP membership.

B) If the Code of Conduct and certain laws conflict, then the GARP Code of Conduct will take priority.

C) Violations of the Code of Conduct could lead to a revocation of the right to use the FRM designation.

D) Violations of the Code of Conduct may result in temporary suspension from GARP membership.

Question #6 of 7

Question ID: 438704

Will Lambert, FRM, is a financial risk analyst for Offshore Investments. He is preparing a purchase recommendation on Burch Corporation. According to the GARP Code of Conduct, which of the following statements about disclosure of conflicts is most correct? Lambert would have to disclose that:

A) Offshore is an OTC market maker for Burch Corporation's stock.

B) he has a material beneficial ownership of Burch Corporation through a family trust.

C) All of these choices require disclosure.

D) his wife owns 2,000 shares of Burch Corporation.

Question #7 of 7

Question ID: 438702

The Investment Banking Department of MLB&J often receives material nonpublic information that could have considerable value to MLB&J's brokerage clients. To comply with the GARP Code of Conduct, MLB&J should most appropriately:

A) ensure that material nonpublic information is not disseminated beyond the firm's investment banking, brokerage, and research departments.

B) contact the firms involved and request that they make this information available to the public before MLB&J allows its clients to trade in these securities.

C) prohibit MLB&J analysts from making buy or sell recommendations on this information until ten business days after the receipt of this information.

D) restrict proprietary trading in the securities of companies about which the Investment Banking Department has access to material nonpublic information.