**Course Title:** Manager Selection Monitoring and Due Diligence

**Test Title:** Manager Selection Monitoring and Due Diligence Review Test  
**Pool Title:** Manager Selection Monitoring and Due Diligence

***Question 1:*** *Question Title: Investment Policy Standards*

**Investment Policy Standards should be established before the Manager Analysis and Selection takes place.**

**True**

***Correct. It is important to have Investment Policy Standards established before the Manager Analysis and Selection process begins.***

Points: 10

False

***Incorrect. Investment Policy Standards should be established prior to embarking on Manager Analysis and Selection.***

Points: 0

***Question 2:*** *Question Title: The primary role of the investment*

**The primary role of the investment fiduciary is to make specific investment decisions and attempt to make specific stock and bond picks.**

True

***Incorrect. The primary role of the investment fiduciary is to manage an investment process. It is not to make the specific investment decisions or an attempt to make individual stock and bond picks.***

Points: 0

**False**

***Correct. The primary role of the investment fiduciary is to manage an investment process. It is not to make the specific investment decisions or an attempt to make individual stock and bond picks.***

Points: 10

***Question 3:*** *Question Title: Five primary topics of evaluation*

**Five primary topics of evaluation when screening and evaluating an investment manager are:**

1. **Philosophy**
2. **People**
3. **Potential**
4. **Performance**
5. **Price**
6. **Process**

A, B, C, D, and E

***Incorrect. Five primary topics of evaluation when screening and evaluating an investment manager are Philosophy, People, Performance, Price and Process***

Points: 0

B, C, D, E, and F

***Incorrect. Five primary topics of evaluation when screening and evaluating an investment manager are Philosophy, People, Performance, Price and Process***

Points: 0

A, C, D, E, and F

***Incorrect. Five primary topics of evaluation when screening and evaluating an investment manager are Philosophy, People, Performance, Price and Process***

Points: 0

**A, B, D, E, and F**

***Correct. Five primary topics of evaluation when screening and evaluating an investment manager are Philosophy, People, Performance, Price and Process.***

Points: 10

***Question 4:*** *Question Title: When evaluating an Investment Manager's*

**When evaluating an Investment Manager's People, which of the following should be considered?**

1. **Credentials**
2. **Skills**
3. **Experience**
4. **Tenure**
5. **Compensation Structure**
6. **Ownership Structure**

A, B, D, E, and F

***Incorrect. Credentials, skills, experience, tenure, compensation structure and ownership structure should all be considered when evaluating an investment manager’s people.***

Points: 0

B, C, D, E, and F

***Incorrect. Credentials, skills, experience, tenure, compensation structure and ownership structure should all be considered when evaluating an investment manager’s people.***

Points: 0

A, B, C, D, and E

***Incorrect. Credentials, skills, experience, tenure, compensation structure and ownership structure should all be considered when evaluating an investment manager’s people.***

Points: 0

A, B, C, D, and F

***Incorrect. Credentials, skills, experience, tenure, compensation structure and ownership structure should all be considered when evaluating an investment manager’s people.***

Points: 0

**All six should be considered.**

***Correct. Credentials, skills, experience, tenure, compensation structure and ownership structure should all be considered when evaluating an investment manager’s people.***

Points: 10

***Question 5:*** *Question Title: When reviewing a firm's philosophy statement*

**When reviewing a firm's philosophy statement, managers should be able to:**

A. Articulate the basis for their firm’s investment approach.

***Incorrect. While articulating the basis for their firm’s investment approach is a characteristic for evaluating a firm’s philosophy statement, there are others that should be considered as well.***

Points: 0

B. Show historical significance relating to how their firm can deliver returns equal to the benchmark.

***Incorrect. Managers should be able to show historical significance relating to how their firm can deliver returns ABOVE the benchmark.***

Points: 0

C. Show a creative perspective on how their firm can exploit market inefficiencies.

***Incorrect. While showing a creative perspective on how their firm can exploit market inefficiencies, there are others that should be considered as well.***

Points: 0

D. Both A. and B.

***Incorrect. Articulating the basis for their firm’s investment approach is important when reviewing a firm’s philosophy statement, but managers should be able to show historical significance relating to how their firm can deliver returns ABOVE the benchmark, not EQUAL to the benchmark.***

Points: 0

**E. Both A. and C.**

***Correct. When reviewing a firm’s investment philosophy, it is important to find managers that can articulate the basis for their firm’s investment approach and show a creative perspective on how they can exploit market inefficiencies. Evidence of how their firm can deliver incremental investment returns above the benchmark is also an important evaluation factor.***

Points: 10

***Question 6:*** *Question Title: When evaluating a manager's*

**When evaluating a manager's fees and expenses, management fees should be the ONLY fees considered.**

True

***Incorrect. Management fees, along with trading expenses, custody fees and 12b-1 fees (should the vehicle be a mutual fund), should be considered when evaluating a manager’s fees and expenses.***

Points: 0

**False**

***Correct. Management fees, along with trading expenses, custody fees and 12b-1 fees (should the vehicle be a mutual fund), should be considered when evaluating a manager’s fees and expenses.***

Points: 10

***Question 7:*** *Question Title: Which of the following performance*

**Which of the following performance calculations would typically be used in calculating investment performance over time?**

Arithmetic Returns

***Incorrect. The standard for calculating investment performance over time would be to use geometrically-linked, time-weighted returns.***

Points: 0

Geometric Returns

***Incorrect. The standard for calculating investment performance over time would be to use geometrically-linked, time-weighted returns.***

Points: 0

Time-Weighted Returns

***Incorrect. The standard for calculating investment performance over time would be to use geometrically-linked, time-weighted returns.***

Points: 0

**Both Geometric and Time-Weighted Returns**

***Correct. The standard for calculating investment performance over time would be to use geometrically-linked, time-weighted returns.***

Points: 10

Both Arithmetic and Time-Weighted Returns

***Incorrect. The standard for calculating investment performance over time would be to use geometrically-linked, time-weighted returns.***

Points: 0

***Question 8:*** *Question Title: In the Capital Asset Pricing Model*

**In the Capital Asset Pricing Model, the risk of a security relative to that of the market is measured by:**

Standard Deviation

***Incorrect. Beta is used in the Capital Asset Pricing Model to measure the risk of a security relative to that of the market.***

Points: 0

Mean Variance

***Incorrect. Beta is used in the Capital Asset Pricing Model to measure the risk of a security relative to that of the market.***

Points: 0

**Beta**

***Correct. Beta is used in the Capital Asset Pricing Model to measure the risk of a security relative to that of the market.***

Points: 10

Randomization

***Incorrect. Beta is used in the Capital Asset Pricing Model to measure the risk of a security relative to that of the market.***

Points: 0

Dispersion

***Incorrect. Beta is used in the Capital Asset Pricing Model to measure the risk of a security relative to that of the market.***

Points: 0

***Question 9:*** *Question Title: Two securities have a correlation of 1.0*

**Two securities have a correlation of 1.0. If one security appreciates by 5%, the other security will be expected to:**

**Appreciate by 5%**

***Correct. Two securities are said to be perfectly correlated when their correlation coefficient is 1.0. In such cases, when one security appreciates by 5.0%, the other security is expected to appreciate by 5.0%.***

Points: 10

Appreciate by 1%

***Incorrect. Two securities are said to be perfectly correlated when their correlation coefficient is 1.0. In such cases, when one security appreciates by 5.0%, the other security is expected to appreciate by 5.0%.***

Points: 0

Be unchanged

***Incorrect. Two securities are said to be perfectly correlated when their correlation coefficient is 1.0. In such cases, when one security appreciates by 5.0%, the other security is expected to appreciate by 5.0%.***

Points: 0

Depreciate by 1%

***Incorrect. Two securities are said to be perfectly correlated when their correlation coefficient is 1.0. In such cases, when one security appreciates by 5.0%, the other security is expected to appreciate by 5.0%.***

Points: 0

Depreciate by 5%

***Incorrect. Two securities are said to be perfectly correlated when their correlation coefficient is 1.0. In such cases, when one security appreciates by 5.0%, the other security is expected to appreciate by 5.0%.***

Points: 0

***Question 10:*** *Question Title: Which of the following is required*

**Which of the following is required to comply with AIMR performance calculation standards?**

Cash basis accounting for fixed income securities

***Incorrect. AIMR requires accrual accounting for fixed income securities.***

Points: 0

Calculation of a time-weighted rate of return using a minimum of monthly valuations

***Incorrect. A minimum of quarterly valuations must be used.***

Points: 0

Returns from cash and cash equivalents are excluded from total return calculations

***Incorrect. Cash and cash equivalents must be included in all return calculations.***

Points: 0

Composites must be asset-weighted using end-of-the-period weightings

***Incorrect. Beginning-of-period weightings should be used.***

Points: 0

**Trade date accounting should be used**

***Correct.***

Points: 10

***Question 11:*** *Question Title: A high Sharpe ratio is preferable*

**A high Sharpe ratio is preferable to a low Sharpe ratio.**

**True**

***Correct. A higher Sharpe ratio implies the portfolio is achieving higher returns for each unit of risk.***

Points: 10

False

***Incorrect. A higher Sharpe ratio implies the portfolio is achieving higher returns for each unit of risk.***

Points: 0

***Question 12:*** *Question Title: A low Treynor ratio is preferable to a high*

**A low Treynor ratio is preferable to a high Treynor ratio.**

True

***Incorrect. A higher Treynor ratio is preferable because the Treynor ratio measures investment return adjusted for market risk.***

Points: 0

**False**

***Correct. A higher Treynor ratio is preferable because the Treynor ratio measures investment return adjusted for market risk .***

Points: 10

***Question 13:*** *Question Title: The Sharpe ratio is calculated*

**The Sharpe ratio is calculated by dividing the amount of return that exceeds the risk-free return by:**

Alpha

***Incorrect.***

Points: 0

Beta

***Incorrect.***

Points: 0

**Standard Deviation**

***Correct.***

Points: 10

Covariance

***Incorrect.***

Points: 0

Correlation Coefficient

***Incorrect.***

Points: 0

***Question 14:*** *Question Title: Constant changes in investment policy*

**Constant changes in investment policy not associated with changes in the client's situation tend to not only be counterproductive, they can also cause damage to long-term portfolio performance potential.**

**True**

***Correct.***

Points: 10

False

***Incorrect.***

Points: 0

***Question 15:*** *Question Title: Which of the following is an indicator*

**Which of the following is an indicator that a manager's discipline has been compromised?**

Style drift only

***Incorrect. While style drift is an indicator that a manager’s discipline has been compromised, it is not the only indicator listed.***

Points: 0

Tracking error only

***While tracking error is an indicator that a manager’s discipline has been compromised, it is not the only indicator listed.***

Points: 0

Sharpe ratio only

***Incorrect. The Sharpe ratio is not used as an indicator for this purpose.***

Points: 0

**Style drift and Tracking error**

***Correct.***

Points: 10

Style drift, tracking error, and Sharpe ratio

***Incorrect. The Sharpe ratio is not used as an indicator for this purpose.***

Points: 0

***Question 16:*** *Question Title: When monitoring the tracking error of a manager*

**When monitoring the tracking error of a manager, you begin by establishing the r-squared (correlation) to the benchmark that is required of managers. Typically, the r-squared is:**

**Lower for active managers and higher for passive managers**

***Correct.***

Points: 10

Lower for passive managers and higher for active managers

***Incorrect.***

Points: 0

The same for active and passive managers

***Incorrect.***

Points: 0

***Question 17:*** *Question Title: Which of the following would NOT*

**Which of the following would NOT generally be a reason for placing a manager on a Watch List?**

**Performance below median for his or her peer group over two consecutive quarters**

***Correct. A 2-quarter timeframe would generally be too short. A better criterion is to use a 1-, 3-, and/or 5-year cumulative period.***

Points: 10

The 3-year, risk-adjusted return (Alpha and/or Sharpe) falls below the peer group’s median risk-adjusted return.

***Incorrect. This would be a reasonable criterion for placing a manager on a watch list.***

Points: 0

A change in the professionals managing the portfolio

***Incorrect. This would be a reasonable criterion for placing a manager on a watch list.***

Points: 0

A significant decrease in the product’s assets

***Incorrect. This would be a reasonable criterion for placing a manager on a watch list.***

Points: 0

An indication the money manager is deviating from his or her stated style and/or strategy

***Incorrect. This would be a reasonable criterion for placing a manager on a watch list.***

Points: 0

***Question 18:*** *Question Title: It is vital that fiduciaries remove subjective*

**It is vital that fiduciaries remove subjective judgment from the process of terminating money managers. This is best done by adopting a list of criteria for placing managers on a Watch List. Any criteria that is not resolved after a quarter will result in termination of the manager.**

True

***Incorrect. The decision to retain or terminate a manager cannot be made by a formula or black box. It is the fiduciary’s confidence in the money manager’s ability to perform in the future that ultimately determines the retention of a money manager.***

Points: 0

**False**

***Correct. The decision to retain or terminate a manager cannot be made by a formula or black box. It is the fiduciary’s confidence in the money manager’s ability to perform in the future that ultimately determines the retention of a money manager.***

Points: 10

***Question 19:*** *Question Title: For taxable client portfolios*

For taxable client portfolios, issues to keep in mind regarding the rebalancing and re-allocation process are:

1. The rebalancing limits defined in the investment policy statement
2. Possibility of rebalancing through upcoming disbursements
3. Possibility of rebalancing through upcoming contributions

A only

***Incorrect.***

Points: 0

B only

***Incorrect.***

Points: 0

C only

***Incorrect.***

Points: 0

A and B only

***Incorrect.***

Points: 0

**A, B, and C**

***Correct.***

Points: 10

***Question 20:*** *Question Title: The Sortino ration is calculated*

**The Sortino ratio is calculated by dividing the amount of return that exceeds the risk-free return by:**

Alpha

***Incorrect. Remember that the Sortino Ratio is a risk-adjusted return measurement focused on downside volatility.***

Points: 0

Beta

***Incorrect. Remember that the Sortino Ratio is a risk-adjusted return measurement focused on downside volatility.***

Points: 0

Standard Deviation

***Incorrect. Remember that the Sortino Ratio is a risk-adjusted return measurement focused on downside volatility.***

Points: 0

Covariance

***Incorrect. Remember that the Sortino Ratio is a risk-adjusted return measurement focused on downside volatility.***

Points: 0

**Semi-Standard Deviation**

***Correct. The Sortino Ratio is a risk-adjusted return measurement using semi-standard deviation to account for downside volatility.***

Points: 10

***Question 21:*** *Question Title: A low Sortino ratio is preferable to a high Sortino ratio.*

**A low Sortino ratio is preferable to a high Sortino ratio.**

True

***Incorrect. Remember that the Sortino Ratio is a measurement of risk adjusted returns using semi-standard deviation.***

Points: 0

**False**

***Correct. The Sortino Ratio is a measurement of risk adjusted returns using semi-standard deviation and the higher the Sortino Ratio, the higher the risk-adjusted returns the manager delivers in a down market.***

Points: 10

***Question 22:*** *Question Title: Which of the following is NOT one of the Five P’s of Manager Analysis?*

**Which of the following is NOT one of the Five P’s of Manager Analysis?**

**Projection**

***Correct.***

Points: 10

People

***Incorrect. This is one of the five P’s.***

Points: 0

Performance

***Incorrect. This is one of the five P’s.***

Points: 0

Process

***Incorrect. This is one of the five P’s.***

Points: 0

All of the above are part of the five P’s

***Incorrect.***

Points: 0

***Question 23:*** *Question Title: When evaluating a manager’s “people,”*

**When evaluating a manager’s “people,” what you really are trying to understand and evaluate is a manager’s or management team’s history and ability to effectively manage portfolios over time.**

**True**

***Correct.***

Points: 10

False

***Incorrect.***

Points: 0

***Question 24:*** *Question Title: When evaluating a manager’s investment “philosophy,”*

**When evaluating a manager’s investment “philosophy”, your analysis should focus on the ability of the manager to show returns consistently above those of benchmark portfolios.**

True

***Incorrect. Your analysis should focus on the ability of the manager to articulate their specific investment biases and the rationale they have for adding value in efficient investment markets.***

Points: 0

**False**

***Correct. Your analysis should focus on the ability of the manager to articulate their specific investment biases and the rationale they have for adding value in efficient investment markets.***

Points: 10

***Question 25:*** *Question Title: If a manager employs an “eclectic” investment discipline*

**If a manager employs an “eclectic” investment discipline, meaning they are more dynamic in the way they uncover their investment ideas…**

They are using an improper approach and it should not be used

***Incorrect.***

Points: 0

**They should be more greatly scrutinized than managers who use a repeatable discipline**

***Correct!***

Points: 10

They are violating established standards of investment discipline

***Incorrect.***

Points: 0

All of the above

***Incorrect.***

Points: 0

***Question 26:*** *Question Title: A $1,000 portfolio returned 30% in the first year*

**A $1,000 portfolio returned 30% in the first year and -15% in the second year. If the overall return reported is 7.5%, what type of return was used to calculate 7.5%?**

**Arithmetic**

***Correct! The arithmetic return is an average return.***

Points: 10

Geometric

***Incorrect. The geometric return would have been just over 1%.***

Points: 0

Sharpe

***Incorrect.***

Points: 0

Not enough information

***Incorrect.***

Points: 0

***Question 27:*** *Question Title: According to the AIMR*

**According to the AIMR performance calculation standards, accrual accounting must be used for fixed-income and all other securities that accrue income.**

**True**

***Correct!***

Points: 10

False

***Incorrect. This is a true statement.***

Points: 0

***Question 28:*** *Question Title: Changes to long-term investment*

**Changes to long-term investment approaches are appropriate when which of the following change?**

Risk tolerance

***Incorrect. A better choice is available.***

Points: 0

Asset class preferences

***Incorrect. A better choice is available.***

Points: 0

Time horizon

***Incorrect. A better choice is available.***

Points: 0

**All of the above**

***Correct!***

Points: 10

None of the above

***Incorrect.***

Points: 0

***Question 29:*** *Question Title: Tracking error is a measurement*

**Tracking error is a measurement of a manager’s actual performance relative to a policy benchmark. It is defined as the standard deviation of the periodic differences between the manager’s return observations and the return observations of a specific benchmark.**

**True**

***Correct.***

Points: 10

False

***Incorrect.***

Points: 0