

2013 Level I Mock Exam: Afternoon Session

The afternoon session of the 2013 Level I Chartered Financial Analyst (CFA®) Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of 1.5 minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

Questions	Topic	Minutes
1–18	Ethical and Professional Standards	27
19–32	Quantitative Methods	21
33–44	Economics	18
45–68	Financial Statement Analysis	36
69–78	Corporate Finance	15
79–90	Equity Investments	18
91–96	Derivative Investments	9
97–108	Fixed Income Investments	18
109–114	Alternative Investments	9
115–120	Portfolio Management	9
	Total:	180

Questions 1 through 18 relate to Ethical and Professional Standards

1. Carlos Cruz, CFA, is one of two founders of an equity hedge fund. Cruz manages the fund's assets, and the other co-founder, Brian Burkeman, CFA, is responsible for fund sales and marketing. Cruz notices the most recent sales material used by Burkeman indicates assets under management are listed at a higher value than the current market value. Burkeman justifies the discrepancy by stating recent market declines account for the difference. In order to comply with the CFA Institute Standards of Professional Conduct, Cruz should *least likely* take which of the following actions?
 - A. Correct the asset information and provide updates to prospective clients.
 - B. Report the discrepancy to CFA Institute's Professional Conduct Program.
 - C. Provide a disclaimer within marketing material indicating prices are as of a specific date.
2. Linda Chin, CFA, is a member of a political group advocating less governmental regulation in all aspects of life. She works in a country where local securities laws are minimal and insider trading is not prohibited. Chin's politics are reflected in her investment strategy, where she follows her country's mandatory legal and regulatory requirements. Which of the following actions by Chin is *most* consistent with the CFA Institute Standards of Professional Conduct?
 - A. Follow the CFA Code and Standards.
 - B. Continue her current investment strategy.
 - C. Disclose her political advocacy to clients.
3. Wouter Duyck, CFA, is the sole proprietor of an investment advisory firm serving several hundred middle-class retail clients. Duyck claims to be different from his competitors because he conducts research himself. He discloses that to simplify the management of all these accounts, he has created a recommended list of stocks, from which he selects investments for all of his clients based on their suitability. Duyck's recommended list of stocks is obtained from his primary broker, who has completed due diligence on each stock. Duyck's recommended list *least likely* violates which of the following CFA Institute Standards of Professional Conduct?
 - A. Fair Dealing
 - B. Misrepresentation
 - C. Diligence and Reasonable Basis
4. Lisa Hajak, CFA, specialized in research on real estate companies at Cornerstone Country Bank for 20 years. Hajak recently started her own investment research firm, Hajak Investment Advisory. One of her former clients at Cornerstone asks Hajak to update a research report she wrote on a real estate company when she was at Cornerstone. Hajak updates the report, which she had copied to her personal computer without the bank's knowledge, and replaces references to the bank with her new firm, Hajak Investment Advisory. Hajak also incorporates the conclusions of a real estate study conducted by the Realtors Association that appeared in the *Wall Street Journal*. She cites the *Journal* as her source in her report. She provides the

revised report free of charge along with a cover letter for the bank's client to become a client of her firm. Concerning the reissued research report, Hajak *least likely* violated the CFA Institute Standards of Professional Conduct because she:

- A. solicited the bank's client.
- B. did not obtain consent to use the bank report.
- C. did not cite the actual source of the real estate study.

5. Tonya Tucker, CFA, is a financial analyst at Bowron Consolidated. Bowron has numerous subsidiaries and is actively involved in mergers and acquisitions to expand its businesses. Tucker analyzes a number of companies, including Hanchin Corporation. When Tucker speaks with the CEO of Bowron, she indicates many of the companies she has looked at would be attractive acquisition targets for Bowron. After her discussion with the CEO, Tucker purchases 100,000 shares of Hanchin Corporation at \$200 per share. Bowron does not have any pre-clearance procedures, so the next time she meets with the CEO, Tucker mentions she owns shares of Hanchin. The CEO thanks her for this information but does not ask for any details. Two weeks later, Tucker sees a company-wide email from the CEO announcing Bowron's acquisition of Hanchin for \$250 a share. In regard to her purchase of Hanchin stock, Tucker *least likely* violated the CFA Institute Standards of Professional Conduct concerning:

- A. Loyalty.
- B. Priority of Transactions.
- C. Material Nonpublic Information.

6. When a client asks her how she makes investment decisions, Petra Vogler, CFA, tells the client she uses mosaic theory. According to Vogler, the theory involves analyzing public and nonmaterial nonpublic information, including the evaluation of statements made to her by company insiders in one-on-one meetings where management discusses new earnings projections not known to the public. Vogler also gathers general industry information from industry experts she has contacted. Vogler *most likely* violates the CFA Institute Standards of Professional Conduct because of her use of:

- A. industry expert information.
- B. one-on-one meeting information.
- C. nonmaterial nonpublic information.

7. Lin Liang, CFA, is an investment manager and an auto industry expert. Last month, Liang sent securities regulators an anonymous letter outlining various accounting irregularities at Road Rubber Company. Shortly before he sent the letter to the regulators, Liang shorted Road stock for his clients. Once the regulators opened an investigation, which Liang learned about from his sources inside the company, Liang leaked this information to multiple sources in the media. When news of the investigation became public, the share price of Road immediately dropped 30%. Liang then covered the short positions and made \$5 per share for his clients. Liang *least likely* violated which of the CFA Institute Standards of Professional Conduct?

- A. Misconduct
- B. Market Manipulation
- C. Priority of Transactions

8. Sanjay Gupta, CFA, is interviewed by the First Faithful Church to manage the church's voluntary retirement plan's equity portfolio based upon his superior return history. Each church staff member chooses whether to opt in or out of the retirement plan according to his or her own investment objectives. The plan trustees tell Gupta that stocks of companies involved in the sale of alcohol, tobacco, gambling, or firearms are not acceptable investments given the objectives and constraints of the portfolio. Gupta tells the trustees he cannot reasonably execute his strategy with these restrictions and that all his other accounts hold shares of companies involved in these businesses because he believes they have the highest alpha. By agreeing to manage the account according to the Trustees' wishes, does Gupta violate the CFA Institute Standards of Professional Conduct?

- A. No
- B. Yes, because the manager was hired based upon his previous investment strategy
- C. Yes, because the restrictions provided by the Trustees are not in the best interest of the members

9. Jorge Lopez, CFA, is responsible for proxy voting on behalf of his bank's asset management clients. Lopez recently performed a cost-benefit analysis, showing that proxy-voting analysis might not benefit the bank's clients. As a result, Lopez immediately changes the proxy-voting policies and procedures without informing anyone else of the change. Lopez now votes client proxies on the side of management on all issues with the exception of major mergers where a significant impact on the stock price is expected. Lopez *least likely* violated the CFA Institute Standards of Professional in regard to:

- A. cost-benefit analysis.
- B. voting with management.
- C. proxy-voting policy disclosures.

10. Tamlorn Mager, CFA, is an analyst at Pyallup Portfolio Management. CFA Institute recently notified Mager that his CFA Institute membership was suspended for a year because he violated the CFA Code of Ethics. A hearing panel also came to the same conclusion. Mager subsequently notified CFA Institute he does not accept the sanction, or the hearing panel's conclusion. Which of the following actions by Mager is *most* consistent with the CFA Institute Professional Conduct Program?

- A. Presenting himself to the public as a CFA charterholder
- B. Providing evidence for his position to an outside arbitration panel
- C. Using his CFA designation upon expiration of the suspension period

11. Edo Ronde, CFA, an analyst for a hedge fund, One World Investments, is attending a key industry conference for the microelectronics industry. At lunch in a restaurant adjacent to the conference venue, Ronde sits next to a table of conference attendees and is able to read their nametags. Ronde realizes the group includes the president of a publicly traded company in the microelectronics industry, Fulda Manufacturing, a company Ronde follows. Ronde overhears the president complain about a production delay problem Fulda's factories are experiencing. The president mentions the delay will reduce Fulda earnings more than 20% during the next year if not solved. Ronde relays this information to the portfolio manager he reports to at One World explaining that in a recent research report he recommended Fulda as a buy. The manager asks Ronde to write up a negative report on Fulda so the fund can sell the stock. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, Ronde should *least likely*:

- A. revise his research report.
- B. leave his research report as it is.
- C. request the portfolio manager not act on the information.

12. Jennifer Ducumon, CFA, is a portfolio manager for high-net-worth individuals at Northeast Investment Bank. Northeast holds a large number of shares in Baby Skin Care Inc., a manufacturer of baby care products. Northeast obtained the Baby Skin Care shares when it underwrote the company's recent IPO. Ducumon has been asked by the investment-banking department to recommend Baby Skin Care to her clients, who currently do not hold any shares in their portfolios. Although Ducumon has a favorable opinion of Baby Skin Care, she does not consider the shares a buy at the IPO price nor at current price levels. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the *most* appropriate action for Ducumon is to:

- A. ignore the request.
- B. recommend the shares after additional analysis.
- C. follow the request as soon as the share price declines.

13. Heidi Halvorson, CFA, is the chief investment officer for Tukwila Investors, an asset management firm specializing in fixed-income investments. Tukwila is in danger of losing one of its largest clients, Quinault Jewelers, which accounts for nearly one-third of its revenues. Quinault recently told Halvorson that Tukwila would be fired unless the performance of Quinault's portfolio improves significantly. Shortly after this conversation, Halvorson purchases two corporate bonds she believes are suitable for any of her clients based upon third-party research from a reliable and diligent source. Immediately after the purchase, one bond increases significantly in price while the other bond declines significantly. At the end of the day, Halvorson allocates the profitable bond trade to Quinault and the other bond to two of her largest institutional accounts. Halvorson *most likely* violated the CFA Institute Standards of Professional in regard to:

- A. client suitability.
- B. trade allocations.
- C. third-party research.

14. Kelly Amadon, CFA, an investment adviser, has two clients: Ryan Randolph, 65 years old, and Keiko Kitagawa, 45 years old. Both clients earn the same amount in salary. Randolph, however, has a large amount of assets, whereas Kitagawa has few assets outside her investment portfolio. Randolph is single and willing to invest a portion of his assets very aggressively; Kitagawa wants to achieve a steady rate of return with low volatility so she can pay for her child's current college expenses. Amadon recommends investing 20% of both clients' portfolios in the stock of very low yielding small-cap companies. Amadon *least likely* violated the CFA Institute Code of Ethics and Standards of Professional Conduct in regard to his investment recommendations for:
- A. both clients' portfolio.
 - B. only Randolph's portfolio.
 - C. only Kitagawa's portfolio.
15. Thomas Turkman recently hired Georgia Viggen, CFA, as a portfolio manager for North South Bank. Although Viggen worked many years for a competitor, West Star Bank, the move was straightforward because she did not have a non-compete agreement with her previous employer. Once Viggen starts working for Turkman, the first thing she does is to bring a trading software package she developed and used at West Star to her new employer. Using public information, Viggen contacts all of her former clients to convince them to move with her to North South. Viggen also convinces one of the analysts she worked with at West Star to join her at her new employer. Viggen *most likely* violated the CFA Institute Code of Ethics and Standards of Professional Conduct concerning her actions involving:
- A. clients.
 - B. the analyst.
 - C. trading software.
16. Suni Kioshi, CFA, is an analyst at Pacific Asset Management, where she covers small-capitalization companies. On her own time, Kioshi often speculates in low-price thinly traded stocks for her own account. Over the last three months, Kioshi has purchased 50,000 shares of Basic Biofuels Company, giving her a 5% ownership stake. A week after this purchase, Kioshi is asked to write a report on stocks in the biofuels industry, with a request to complete the report within two days. Kioshi wants to rate Basic as a "buy" in this report but is uncertain how to proceed. Concerning the research report, what action should Kioshi *most likely* take to prevent violating any of the CFA Institute Code of Ethics and Standards of Professional Conduct?
- A. Sell her shares.
 - B. Do not recommend a buy.
 - C. Disclose her stock ownership.
17. Solomon Sulzberg, CFA, is a research analyst at Blue Water Management. Sulzberg's recommendations typically go through a number of internal reviews before they are published. In developing his recommendations, Sulzberg uses a model developed by a quantitative analyst within the firm. Sulzberg made some minor changes to the model but retained the primary framework. In his reports, Sulzberg attributes the model to both the quantitative analyst and

himself. Before the internal reviews of his reports are completed, Sulzberg buys shares in one of the companies. After the internal review is complete, he fails to recommend the purchase of the stock to his clients and erases all of his research related to this company. Sulzberg *least likely* violated the CFA Institute Code of Ethics and Standards of Professional Conduct related to:

- A. Record Retention.
- B. Misrepresentation.
- C. Priority of Transactions.

18. Chris Rodriguez, CFA, is a portfolio manager at Nisqually Asset Management, which specializes in trading highly illiquid shares. Rodriguez has been using Hon Securities Brokers almost exclusively when making transactions for Nisqually clients, as well as for his own relatively small account. Hon always executes Rodriguez's personal trades at a more preferential price than for Rodriguez's clients' accounts. This occurs regardless of whether or not Rodriguez personally trades before or after clients. Rodriguez should *least likely* do which of the following in order to comply with the CFA Institute Code of Ethics and Standards of Professional Conduct?

- A. Eliminate the exclusive trading arrangement.
- B. Trade client accounts before his own account.
- C. Average trade prices across all trading accounts.

Questions 19 through 32 relate to Quantitative Methods

19. A borrower is considering three competing mortgage loan offers from her bank. The amount borrowed on the mortgage is \$100,000 with monthly compounding.

Mortgage type	Nominal (stated) annual interest rate at initiation of the loan	Year in which rate first adjusts
30-year fixed-rate	5.000%	N/A
15-year fixed-rate	4.385%	N/A
30-year 3/5 adjustable-rate mortgage (ARM)	3.750%	3

The rate on the ARM resets at the end of Year 3. Assuming the ARM is reset at 5.500% (i.e., the remaining balance on the loan will now be repaid with 5.500% nominal annual interest), which of the three loans will have the *smallest* monthly payment after the rate reset at the end of Year 3?

- A. 30-year ARM
- B. 15-year fixed-rate loan
- C. 30-year fixed-rate loan

20. A U.S. Treasury bill (T-bill) has 90 days to maturity and a bank discount yield of 3.25%. The effective annual yield (EAY) for the T-bill is *closest* to:

- A. 3.29%.
- B. 3.32%.
- C. 3.36%.

21. By definition, the probability of any event, E , is a number between:

- A. zero and positive one.
- B. zero and positive infinity.
- C. minus one and positive one.

22. A variable is normally distributed with a mean of 5.00 and a variance of 4.00. Calculate the probability of observing a value of negative 0.40 or less. That is, calculate $P(X_i \leq -0.40)$ given X is distributed as $N(5, 4)$. Use this excerpt from the cumulative distribution function for the standard normal random variable table to calculate your answer.

Cumulative Probabilities for a Standard Normal Distribution

$P(Z \leq x) = N(x)$ for $x \geq 0$ or $P(Z \leq z) = N(z)$ for $z \geq 0$

x or z	0	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
1.10	0.8643	0.8665	0.8686	0.8708	0.8729	0.8749	0.8770	0.8790	0.8810	0.8830
1.20	0.8849	0.8869	0.8888	0.8907	0.8925	0.8944	0.8962	0.8980	0.8997	0.9015
1.30	0.9032	0.9049	0.9066	0.9082	0.9099	0.9115	0.9131	0.9147	0.9162	0.9177
1.40	0.9192	0.9207	0.9222	0.9236	0.9251	0.9265	0.9279	0.9292	0.9306	0.9319
...										
2.50	0.9938	0.9940	0.9941	0.9943	0.9945	0.9946	0.9948	0.9949	0.9951	0.9952
2.60	0.9953	0.9955	0.9956	0.9957	0.9959	0.9960	0.9961	0.9962	0.9963	0.9964
2.70	0.9965	0.9966	0.9967	0.9968	0.9969	0.9970	0.9971	0.9972	0.9973	0.9974
2.80	0.9974	0.9975	0.9976	0.9977	0.9977	0.9978	0.9979	0.9979	0.9980	0.9981
2.90	0.9981	0.9982	0.9982	0.9983	0.9984	0.9984	0.9985	0.9985	0.9986	0.9986
3.00	0.9987	0.9987	0.9987	0.9988	0.9988	0.9989	0.9989	0.9989	0.9990	0.9990
3.10	0.9990	0.9991	0.9991	0.9991	0.9992	0.9992	0.9992	0.9992	0.9993	0.9993

The calculated value is *closest* to:

- A. 0.35%.
- B. 0.62%.
- C. 8.85%.

23. In setting the confidence interval for the population mean of a normal or approximately normal distribution and given that the sample size is small, Student's t -distribution is the preferred approach when the variance is:

- A. large.
- B. known.
- C. unknown.

24. A two-tailed test of the null hypothesis that the mean of a distribution is equal to 4.00 has a p-value of 0.0567. Using a 5% level of significance (i.e., $\alpha = 0.05$), the *best* conclusion is to:

- A. reject the null hypothesis.
- B. fail to reject the null hypothesis.
- C. increase the level of significance to 5.67%.

25.

Population	1	2
Sample size	$n_1 = 5$	$n_2 = 5$
Sample variance	$s_1^2 = 4$	$s_2^2 = 28$
The samples are drawn independently, and both populations are assumed to be normally distributed		

Using the above data, an analyst is trying to test the null hypothesis that the population variances are equal ($H_0: s_1^2 = s_2^2$) against the alternative hypothesis that the variances are not equal ($H_A: s_1^2 \neq s_2^2$) at the 5% level of significance. The table of the F-Distribution is provided below.

Table of the F-Distribution

Panel A: Critical values for right-hand tail areas equal to 0.05

	df1 (read across)	1	2	3	4	5
df2 (read down)	1	161	200	216	225	230
	2	18.5	19.0	19.2	19.2	19.3
	3	10.1	9.55	9.28	9.12	9.01
	4	7.71	6.94	6.59	6.39	6.26
	5	6.61	5.79	5.41	5.19	5.05

Panel B: Critical values for right-hand tail areas equal to 0.025

	df1 (read across)	1	2	3	4	5
df2 (read down)	1	648	799	864	900	922
	2	38.51	39.00	39.17	39.25	39.30
	3	17.44	16.04	15.44	15.10	14.88
	4	12.22	10.65	9.98	9.60	9.36
	5	10.01	8.43	7.76	7.39	7.15

Which of the following statements is *most* appropriate? The critical value is:

- A. 6.39 and reject the null.
- B. 7.15 and do not reject the null.
- C. 9.60 and do not reject the null.

26. In Elliott Wave Theory, Wave 2 commonly exhibits a pattern *best* described as a(n):

- A. basing pattern consisting of five smaller waves.
- B. Fibonacci ratio percentage retracement composed of three smaller waves.
- C. uptrend moving above the high of Wave 1 and consisting of five smaller waves.

27. An investor wants to maximize the possibility of earning at least 5% on her investments each year. Using Roy's safety-first criterion, which of the following portfolios is the *most* appropriate choice?

Portfolio	Expected return	Standard deviation	Roy's Safety-First value
1			0.35
2			0.64
3	22%	40%	

- A. Portfolio 1
- B. Portfolio 2
- C. Portfolio 3

28. Which of the following is the *least likely* characteristic of the normal probability distribution?
The normal probability distribution:

- A. has kurtosis of 3.0.
- B. has the same value for mean, median, and mode.
- C. is more suitable as a model for asset prices than for returns.

29. A technical analyst observes a head and shoulders pattern in a stock she has been following. She notes the following information:

Head price	\$83.50
Shoulder price	\$72.00
Neckline price	\$65.75

Based on this information, her estimate of the price target is *closest* to:

- A. \$48.00.
- B. \$59.50.
- C. \$89.75.

30. The following table represents the history of an investment in a company:

Time	Activity	Price per Share	Dividends Paid per Share
Beginning of Year 1	Purchase 10 shares	€160	
End of Year 1	Purchase 5 shares	€168	€3.00
End of Year 2		€175	€4.00
End of Year 3	Sell 15 shares	€165	€0.00

The investor does not reinvest the dividends that he receives. Assuming no taxes on dividends, the time-weighted rate of return on this investment is *closest* to:

- A. 1.93%.
- B. 2.40%.
- C. 2.57%.

31. Which of the following *most* accurately describes a distribution that is more peaked than normal?

- A. Platykurtotic
- B. Mesokurtotic
- C. Leptokurtotic

32. A fund manager would like to estimate the probability of a daily loss higher than 5% on the fund he manages. He decides to employ a method that uses the relative frequency of occurrence based on historical data. The resulting probability is *best* known as:

- A. a priori probability.
- B. empirical probability.
- C. subjective probability.

Questions 33 through 44 relate to Economics

33. The market demand function for item X is a function of its price, household income, and the price of item Y.

Own-price elasticity of demand for X	-0.8
Income elasticity of demand for X	1.5
Cross-price elasticity of demand for X with respect to the price of Y	0.4

Given the above elasticity coefficients for the two items, which of the following statements is *most* accurate?

- A. X and Y are substitutes.
- B. Demand for X is elastic.
- C. Item X is an inferior good.

34. The monthly demand curve for playing tennis at a particular club is given by the following equation: $P_{\text{Tennis Match}} = 9 - 0.20 \times Q_{\text{Tennis Match}}$. The club currently charges members \$4.00 to play a match but is considering changing to a new flat-rate monthly membership fee for unlimited play. The most that the club will be able to charge for the flat-rate monthly membership is *closest* to:

- A. \$40.00.
- B. \$62.50.
- C. \$162.50.

35. With its existing production facilities, a monopolist firm can produce up to 100 units. It faces the following demand and cost schedules:

Output (units)	Price (\$/unit)	Total Costs (\$)
0	3,000	600
20	2,800	10,600
40	2,600	32,600
60	2,400	66,600
80	2,200	112,600
100	2,000	170,600

The optimal output level for this producer (in units) is *closest* to:

- A. 20.
- B. 60.
- C. 100.

36. The following information applies to an economy:

Total population	1,100
Working age population	975
Labor force	750
Underemployed	120
Unemployed	95
Discouraged workers	80
Frictionally unemployed	25
Voluntarily unemployed	40

The unemployment rate in the economy is *closest* to:

- A. 9.7%.
- B. 12.6%.
- C. 16.0%.

37. In an economy, consumption is 70% of pre-tax income and the average tax rate is 25% of total income. If planned government expenditures are expected to increase by \$1.25 billion, the increase in total incomes and spending (\$ in billions) is *closest* to:
- A. \$1.3.
 - B. \$2.6.
 - C. \$4.2.
38. In early 2011, the British pound (GBP) to New Zealand dollar (NZD) spot exchange rate was 2.0979. LIBOR interest rates, quoted on a 360-day year basis, were 1.6025% for the British pound and 3.2875% for the New Zealand dollar. The 180-day forward points (scaled up by four decimal places) in GBP/NZD would be *closest* to:
- A. -343.
 - B. -173.
 - C. 176.
39. A country implements policies that are expected to increase taxes by €100 million, increase government spending by €50 million, and reduce investments and private sector savings by €25 million each. As a result, the country's current account balance will *most likely*:
- A. increase by €50 million.
 - B. decrease by €50 million.
 - C. increase by €100 million.

40. An Australian firm purchased a patent for USD20,000 and machinery for USD21,500 from a U.S. firm when the exchange rates were as follows:

Ratio	Exchange Rate
USD/EUR	1.29
AUD/EUR	1.24

The impact of these transactions on the capital account of Australia (in AUD) is *closest* to:

- A. 19,225.
 - B. 20,667.
 - C. 20,806.
41. Which of the following statements with respect to Giffen and Veblen goods is *least* accurate?
- A. Both types of goods violate the fundamental axioms of demand theory.
 - B. Giffen goods are "inferior" whereas Veblen goods are "high-status" goods.
 - C. Both types of goods demonstrate the possibility of a positively sloping demand curve.

42. The following data apply to a country in its domestic currency units:

Consumer spending on goods and services	875,060	Government spending on goods and services	305,600
Business gross fixed investment	286,400	Government gross fixed investment	84,120
Change in inventories	-68,500	Capital consumption allowance	8,540
Transfer payments	9,300	Statistical discrepancy	-2,850
Exports	219,800	Imports	250,980

Using the expenditures approach, the country's gross domestic product (GDP) is *closest* to:

- A. 1,448,650.
- B. 1,451,500.
- C. 1,466,490.

43. As a monetary policy tool, quantitative easing (QE) will *most likely* help revive an ailing economy in which of the following environments?

- A. Liquidity trap
- B. Deflationary trap
- C. Declining bank reserves and economic activity

44. A firm in the market environment characterized by monopolistic competition will *most likely*:

- A. continue to experience economic profit in the long run.
- B. have a well-defined supply function reflecting its marginal and average costs.
- C. have many competitors, each of which follows its own product differentiation strategy.

Questions 45 through 68 relate to Financial Statement Analysis

45. A company entered into a three-year construction project with a total contract price (all figures in '000s) of \$5,300 and expected costs of \$4,400. The company recognizes revenue using the percentage of completion method. The data below relate to the contract.

(All figures in '000s)	Year 1	Year 2	Year 3
Costs incurred and paid	\$1,200	\$2,000	\$1,200
Amounts billed and payments received	\$800	\$3,000	\$1,500

The amount of revenue (in \$'000s) the company will recognize in Year 2 is *closest* to:

- A. 1,766.
- B. 2,409.
- C. 3,000.

46. In the audit report, an additional paragraph that explains an exception to an accounting standard is *best* described as a(n):

- A. adverse opinion.
- B. qualified opinion.
- C. disclaimer of opinion.

47. Which of the following is *least likely* a characteristic of an effective financial reporting framework?

- A. Transparency
- B. Comparability
- C. Comprehensiveness

48. The following relates to a company's common equity over the course of the year:

Outstanding shares, at start of the year	2,000,000	
Stock options outstanding, at start and end of the year	100,000	Exercise price: \$5.00
Shares issued on April 1	300,000	
Shares repurchased (treasury shares) on July 1	100,000	
Average market price of common shares for the year		\$20/share

If the company's net income for the year is \$5,000,000, its diluted EPS is *closest* to:

- A. \$2.17.
- B. \$2.20.
- C. \$2.22.

49. An analyst has compiled the following information on a company:

	£ '000s
Revenues for the year	12,000
Total expenses for the year	10,150
Total current assets at year-end	9,200
Total non-current assets at year-end	12,750
Investments	350
Share capital at the beginning of the year	2,000
Proceeds from shares issued during the year	500
Retained earnings at the beginning of the year	8,850
Total liabilities at year-end	9,400

The amount of dividends declared (£ '000s) during the year is *closest* to:

- A. 150.
- B. 300.
- C. 650.

50. A cell phone manufacturer has switched to high margin premium-priced products with the most innovative features as part of its product differentiation strategy. Which of the following other changes is *most* consistent with this strategy?

- A. An increase in inventory levels
- B. A decrease in R&D expenditures
- C. An increase in advertising expenditures

51. Which of the following is the *most likely* reason for an analyst to choose the direct method rather than the indirect method for analyzing a firm's operating cash flows?

- A. To avoid making adjustments for non-cash items
- B. To identify operating cash flows by source and by use
- C. To understand the relationship between net income and operating cash flows

52. In the current year, a company increased its deferred tax asset by \$500,000. During the year, the company *most likely*:

- A. became entitled to a \$500,000 tax refund.
- B. reported a lower accounting profit than taxable income.
- C. had permanent differences between accounting profit and taxable income.

53. The following selected balance sheet and ratio data are available for a company:

Metric	2012	2011
Cash and cash equivalents	98.0	
Marketable securities	389.2	
Accounts receivables	12.0	
Other current assets	<u>120.</u> <u>1</u>	
Total current assets	619.3	
Deferred revenues	85.0	
Other current liabilities	<u>92.3</u>	
Total current liabilities	177.3	
Cash ratio		2.37
Quick ratio		2.97
Current ratio		3.27

Which of the following ratios decreased between 2011 and 2012?

- A. Cash
- B. Quick
- C. Current

54. The following annual financial data are available for a company:

	£ millions
Beginning interest payable	90.4
Cash paid for interest	103.3
Ending interest payable	84.5

Interest expense for the year is *closest* to:

- A. 71.6.
- B. 97.4.
- C. 109.2.

55. Financial ratios alone are *least likely* helpful to determine a company's:

- A. creditworthiness.
- B. past performance.
- C. current financial condition.

56. A company manufactures aluminum cans for the beverage industry and prepares its financial statements in accordance with IFRS. During its latest full fiscal year, the company recorded the following data:

Inventory Item	Amount €
Raw material aluminum costs	150,000
Storage of finished cans	15,000
Wasted aluminum materials from abnormal production errors during the year	500
Transportation-in costs	640
Tax-related duties	340
Administrative overhead	7,500
Trade discounts due to volume purchases throughout the year	520

The total costs included in inventory (in €) for the year are *closest* to:

- A. 149,820.
- B. 150,460.
- C. 150,980.

57. An accounting document that records transactions in the order in which they occur is *best* described as a:

- A. trial balance.
- B. general ledger.
- C. general journal.

58. Which of the following statements is *most* accurate with respect to financial reporting requirements?

- A. Regulatory authorities are typically private sector, self-regulated organizations.
- B. Standard-setting bodies have authority because they are recognized by regulatory authorities.
- C. The requirement to prepare financial reports in accordance with specified accounting standards is the responsibility of standard-setting bodies.

59. Income statements for two companies (A and B) and the common-sized income statement for the industry are provided below:

All \$ figures in '000s	Company A	Company B	Industry
Sales	\$ 10,500	\$ 8,250	100.0%
Cost of goods sold	6,353	5,239	62.8%
Selling, general, and administrative expenses	2,625	2,021	24.8%
Interest expense	840	536	7.0%
Pretax earnings	683	454	5.4%
Taxes	205	145	1.7%
Net earnings	\$ 478	\$ 309	3.7%

The *best* conclusion an analyst can make is that:

- A. Company B's interest rate is lower than the industry average.
- B. both companies' tax rates are higher than the industry average.
- C. Company A earns a higher gross margin than both Company B and the industry.

60. The following information is from a company's accounting records:

	€ millions
Revenues for the year	12,500
Total expenses for the year	10,000
Gains from available-for-sale securities	1,475
Loss on foreign currency translation adjustments on a foreign subsidiary	325
Dividends paid	500

The company's total comprehensive income (in € millions) is *closest* to:

- A. 1,150.
- B. 3,150.
- C. 3,650.

61.

£ millions	2012	2011
Accounts receivables, gross	6,620	4,840
Allowance for doubtful accounts	92	56
Write-offs during the year	84	42

Based on the above information about a company's trade receivables, the bad debt expense (in millions) for 2012 is *closest* to:

- A. £36.
- B. £84.
- C. £120.

62. An analyst has gathered the following information about a company:

	C\$ millions
Cash flow from operating activities	105.9
Cash flow from investing activities	(11.8)
Cash flow from financing activities	46.5
Net change in cash for the year	140.6
Interest paid (included in CFO)	22.4
Taxes paid (tax rate of 30%)	18.0
Total debt, end of year	512.8

The cash flow debt coverage ratio for the year is *closest* to:

- A. 20.6%.
- B. 23.7%.
- C. 27.4%.

63. Which inventory method *best* matches the actual historical cost of the inventory sold with their physical flow if a company is using a perpetual inventory system?

- A. FIFO
- B. LIFO
- C. Specific identification

64. On 1 January, a company, which prepares its financial statements according to IFRS, arranged financing for the construction of a new plant. The company:

- borrowed NZ\$5,000,000 at an interest rate of 8%,
- issued NZ\$5,000,000 of preferred shares with a cumulative dividend rate of 6%, and

- temporarily invested NZ\$2,000,000 of the loan proceeds for the first six months of construction and earned 7% on that amount.

The amount of financing costs to be capitalized (NZ\$) to the cost of the plant in the first year is *closest* to:

- A. 330,000.
- B. 400,000.
- C. 630,000.

65. A company purchased equipment in 2010 for £25,000. The year-end values of the equipment for accounting purposes and tax purposes are as follows:

	2011	2010
Carrying amount for accounting purposes	£20,000	£22,500
Tax base for tax purposes	£16,000	£20,000
Tax rate	25%	30%

Which of the following statements *best* describes the effect of the change in the tax rate on the company's 2011 financial statements? The deferred tax liability:

- A. increases by £250.
- B. decreases by £200.
- C. decreases by £800.

66. A company took the following actions related to \$5 million of 10-year bonds with a coupon rate of 8% payable semi-annually on 30 June and 31 December:

- A. Issued on 1 January 2006, when the market rate of interest was 6%.
- B. Bought back in an open market transaction on 1 January 2012, when the market rate of interest was 8%.

Which of the following statements *best* describes the effect of the bond repurchase on the financial statements for 2012? If the company uses the indirect method of calculating the cash from operations, there will be a:

- A. \$346,511 gain on the income statement.
- B. \$743,873 gain on the income statement.
- C. \$350,984 decrease in the cash from operations.

67. On a cash flow statement prepared using the indirect method, which of the following would *most likely* increase the cash from investing activities?

- A. Sale of a long-term receivable
- B. Sale of held-for-trading securities
- C. Securitization of accounts receivable

68. An analyst has gathered the following information about a company's capital assets:

Year ending	2012	2011
Property, plant, and equipment	€2,500	€2,500
Accumulated depreciation	375	250
Net book value	2,125	2,250

As of the end of 2012, the expected remaining life of the assets, in years, is *closest* to:

- A. 6.
- B. 17.
- C. 20.

Questions 69 through 78 relate to Corporate Finance

69. Given the following information about a firm:

- debt-to-equity ratio of 50%
- tax rate of 40%
- cost of debt of 8%
- cost of equity of 13%,

the firm's weighted average cost of capital (WACC) is *closest* to:

- A. 7.5%.
- B. 8.9%.
- C. 10.3%.

70. The unit contribution margin for a product is \$20. A firm's fixed costs of production of up to 300,000 units is \$500,000. The degree of operating leverage (DOL) is *most likely* the lowest at which of the following production levels (in units)?

- A. 100,000
- B. 200,000
- C. 300,000

71. Which of the following share repurchase methods will *most likely* take the longest amount of time to execute?

- A. Dutch auction
- B. fixed price tender offer
- C. open market repurchase

72. Assume a 365-day year and the following information for a company:

	Current year	Previous year
Sales	\$12,000	\$10,000
Cost of goods sold	\$9,000	\$7,500
Inventory	\$1,200	\$1,000
Accounts payable	\$600	\$600

The firm's days in payables for the current year is *closest to*:

- A. 18.3.
- B. 23.8.
- C. 24.9.

73. A project has the following cash flows (£):

Year 0	Year 1	Year 2	Year 3	Year 4
-1,525	215	345	475	1,215

Assuming a discount rate of 11% annually, the discounted payback period (in years) is *closest to*:

- A. 3.4.
- B. 3.9.
- C. 4.0.

74. Based on best practices in corporate governance procedures, it is *most* appropriate for a company's compensation committee to:

- A. include some non-independent members.
- B. be aware of any final payments to which executives might be entitled.
- C. rely on management to communicate compensation philosophy to shareholders.

75. Which action is *most likely* considered a secondary source of liquidity?

- A. Increasing the availability of bank lines of credit
- B. Increasing the efficiency of cash flow management
- C. Renegotiating current debt contracts to lower interest payments

76. A company has a fixed \$1,100 capital budget and has the opportunity to invest in the four independent projects below.

Project	Investment outlay	NPV
1	\$600	\$100
2	\$500	\$100
3	\$300	\$50
4	\$200	\$50

The combination of projects that provides the *best* choice is:

- A. 1 and 2.
- B. 1, 3, and 4.
- C. 2, 3, and 4.

77. Which of the following statements is the *most* appropriate treatment of floatation costs for capital budgeting purposes? Floatation costs should be:

- A. expensed in the current period.
- B. incorporated into the estimated cost of capital.
- C. deducted as one of the project's initial-period cash flows.

78. A firm is uncertain about both the number of units the market will demand and the price it will receive for them. This type of risk is *best* described as:

- A. sales risk.
- B. business risk.
- C. operating risk.

Questions 79 through 90 relate to Equity Investments

79. Which of the following statements is *most* accurate?

- A. Investors prefer to invest in callable common shares rather than puttable common shares.
- B. The issuing company is obligated to buy callable common shares at a predetermined price.
- C. Puttable common shares facilitate raising capital because of their appeal to investors over callable common shares.

80. An investor who wants to estimate the enterprise value multiple (EV/EBITDA) of a company has gathered the following data:

Market value of debt	\$10 million
Market capitalization	\$45 million
Cash and short-term investments	\$2.5 million
EBITDA	\$15 million
Firm's marginal tax rate	40%

The company's EV/EBITDA multiple is *closest* to:

- A. 2.5.
- B. 3.5.
- C. 5.8.

81. An investor gathers the following data to estimate the intrinsic value of a company's stock using the justified forward P/E approach.

Next year's earnings per share	\$3.00
Return on equity	12.5%
Dividend payout ratio	60%
Required return on shares	10%

The intrinsic value per share is *closest* to:

- A. \$36.
- B. \$48.
- C. \$72.

82. A company's series B, 8% preferred stock has the following features:

- A par value of \$50 and pays quarterly dividends.
- Its current market value is \$35.
- The shares are retractable (at par) with the retraction date set for three years from today.
- Similarly rated preferred issues have an estimated nominal required rate of return of 12%.
- Analysts expect a sustainable growth rate of 4% for the company's earnings.

The intrinsic value estimate of a share of this preferred issue is *closest* to:

- A. \$33.33.
- B. \$45.02.
- C. \$52.00.

83. Which of the following inferences concerning market efficiency is *most* accurate?

- A. Exploitable over- and under-reactions often occur in efficient markets.
- B. Market pricing anomalies and behavioral biases are contrary to the existence of market efficiency.
- C. If a market is semi-strong-form efficient, neither technicians nor fundamental analysts can expect to consistently earn abnormal returns.

84. Which of the following multiples is *most* useful when comparing companies with significant differences in capital structure?

- A. EV/EBITDA
- B. Price-to-book ratio
- C. Price-to-cash flow ratio

85. An investor buys stock on margin and holds the position for exactly one year.

Shares purchased	700
Purchase price	\$22/share
Call money rate	4%
Dividend	\$0.60/share
Leverage ratio	1.6
Total return on the investment	12%

Assuming that the interest on the loan and the dividend are both paid at the end of the year, the price at which the investor sold the stock is *closest* to:

- A. \$23.05.
- B. \$23.38.
- C. \$23.98.

86. A market index only contains the following three securities:

Security	Beginning of period price per share (\$)	Market cap (\$ in millions)
X	100	100
Y	200	150
Z	110	300

Which approach to indexing will *most likely* give Security X a weight of 18%?

- A. Price
- B. Equal
- C. Market-capitalization

87. Which of the following is *most* accurate concerning key characteristics of different types of preference shares?

- A. Preference shares have characteristics of both debt and equity securities.
- B. Preference shareholders rank above subordinated bondholders with respect to claims on the company's net assets upon liquidation.
- C. The price of convertible preference shares tends to be more volatile than their underlying common shares because they do not allow investors to share in profits of the company.

88. An equity portfolio manager is evaluating her sector allocation strategy for the upcoming year. She expects global economic slowdown for the next two years. Further, she believes that companies will be facing diminishing growth rates with respect to revenues and profits. Owing to these beliefs, the portfolio manager will *most likely*:

- A. overweight materials.
- B. overweight consumer staples.
- C. underweight telecommunications.

89. A company has issued non-callable, non-convertible preferred stock with the following features:

- Par value per share \$10
- Annual dividend per share \$2
- Maturity 15 years

If an investor's required rate of return is 8% and the current market price per share of the preferred stock is \$25, the *most likely* conclusion is that the preferred stock is:

- A. overvalued by \$4.73.
- B. fairly valued at \$25.00.
- C. undervalued by \$15.00.

90. Which of the following statements is *least* accurate? A firm's free-cash-flow-to-equity (FCFE):

- A. is a measure of the firm's dividend-paying capacity.
- B. increases with an increase in the firm's net borrowing.
- C. is significantly affected by the amount of dividends paid by the firm.

Questions 91 through 96 relate to Derivative Investments

91. Which of the following statements *best* describes an advantage of a forward contract over a futures contract? A forward contract:

- A. is essentially free of default risk.
- B. can easily be offset prior to expiration.
- C. allows parties to enter into a customized transaction.

92. A forward rate agreement (FRA) that expires in 180 days and is based on 90-day LIBOR is quoted at 2.2%. At expiration of the FRA, 90-day LIBOR is 2.8%. For a notional principal of USD1,000,000, the payoff of this FRA is *closest* to:

- A. USD1,469.31.
- B. USD1,489.57.
- C. USD1,500.00.

93. Consider a U.S. Treasury bond futures contract where the hypothetical deliverable bond has a coupon of 3.0%. At expiration of the futures contract, the short chooses to deliver a bond with a coupon of 3.8%. The conversion factor of this bond is *most likely*:

- A. equal to 1.
- B. less than 1.
- C. greater than 1.

94. An investor purchases a put option on AAA shares that has a strike price of €50 and expires in three months. One month later, AAA shares are trading at €54. At that time, the put *most likely* has:
- A. positive intrinsic value but no time value.
 - B. positive time value but no intrinsic value.
 - C. positive time value and positive intrinsic value.
95. The tenor of a swap is *best* described as the:
- A. size of the contract.
 - B. original time to maturity.
 - C. net amount owed by one party to the other.
96. An investor purchases 100 shares of common stock at €50 each and simultaneously sells call options on 100 shares of the stock with a strike price of €55 at a premium of €1 per option. At the expiration date of the options, the share price is €58. The investor's profit is *closest* to:
- A. €400.
 - B. €600.
 - C. €900.

Questions 97 through 108 relate to Fixed Income Investments

97. An investor purchases the bonds of JLD Corp., which pay an annual coupon of 10% and mature in 10 years, at an annual yield to maturity of 12%. The bonds will *most likely* be selling at:
- A. par.
 - B. a discount.
 - C. a premium.
98. A portfolio manager holds the following three bonds, which are option free and have the indicated durations.

Bond	Par value owned	Market value owned	Duration
A	\$8,000,000	\$12,000,000	3.0
B	\$8,000,000	\$6,000,000	7.0
C	\$4,000,000	\$6,000,000	6.0

The portfolio's duration is *closest* to:

- A. 4.75.
- B. 5.20.
- C. 5.33.

99. For a collateralized mortgage obligation (CMO), the first tranche of bonds *most likely* has the:

- A. highest level of prepayment risk and interest rate risk.
- B. lowest level of prepayment risk and highest level of interest rate risk.
- C. highest level of prepayment risk and lowest level of interest rate risk.

100. A bond with a par value of \$100 matures in 10 years with a coupon of 4.5%, paid semiannually; is priced to yield 5.83%; and has a modified duration of 7.81. If the yield of the bond declines by 0.25%, the approximate percentage price change for the bond is *closest to*:

- A. 0.98%.
- B. 1.95%.
- C. 3.91%.

101. When are credit spreads *most likely* to narrow? During:

- A. economic expansions.
- B. economic contractions.
- C. a period of flight to quality.

102. If the yield to maturity on an annual-pay bond is 7.75%, the bond-equivalent yield is *closest to*:

- A. 7.61%.
- B. 7.90%.
- C. 8.05%.

103. The duration and convexity of an option-free bond priced at \$90.25 are 10.34 and 75.80, respectively. If yields increase by 200 basis points, the percentage change of the price is *closest to*:

- A. -23.71%.
- B. -20.68%.
- C. -17.65%.

104. Which of the following is *most likely* a limitation of the yield-to-maturity measure?

- A. It does not reflect the timing of the cash flows.
- B. It assumes coupon payments can be invested at the yield to maturity.
- C. It does not consider the capital gain or loss the investor will realize by holding the bond to maturity.

105. Which of the following *most likely* exhibits negative convexity?

- A. A puttable bond
- B. A callable bond
- C. An option-free bond

106. An investor is *least likely* exposed to reinvestment risk from owning a(n):

- A. callable bond.
- B. zero-coupon bond.
- C. amortizing security.

107. All other things being equal, a decrease in expected yield volatility *most likely* increases the price of:

- A. a puttable bond.
- B. a callable bond.
- C. an option-free bond.

108. Which of the following is *least likely* an interest rate policy tool available to the U.S. Federal Reserve?

- A. A change in capital gains tax rates
- B. Conducting open market operations
- C. A change in bank reserve requirements

Questions 109 through 114 relate to Alternative Investments

109. U.S. farmers have become concerned that the future supply of wheat production will exceed demand. Any hedging activity to sell forward would *most likely* protect against which market condition?

- A. Contango
- B. Full carry
- C. Backwardation

110. Relative to traditional investments, alternative investments are *best* characterized as having:

- A. greater liquidity.
- B. higher correlations.
- C. more unique legal and tax considerations.

111. Adding alternative investments to a portfolio of traditional investments will *most likely* result in a new combined portfolio with returns and standard deviation that are, respectively:

	<u>Returns</u>	<u>Standard Deviation</u>
A.	lower	lower
B.	higher	lower
C.	higher	higher

112. For a hedge fund investor, a benefit of investing in a fund of funds is *least likely* the:

- A. multilayered fee structure.
- B. higher level of due diligence expertise.
- C. ability to negotiate better redemption terms.

113. Which attributes would a private equity firm *most likely* consider when deciding if a company is particularly attractive as a leveraged buyout target?

- A. Sustainable cash flow
- B. Efficiently managed companies
- C. Market value exceeds intrinsic value

114. High-water marks are typically used when calculating the incentive fee on hedge funds. They are *most likely* used by clients to:

- A. avoid prime brokerage fees.
- B. claw back the management fees.
- C. prevent paying twice for the same performance.

Questions 115 through 120 relate to Portfolio Management

115. Which of the following is *least likely* a part of the execution step of the portfolio management process?

- A. Security analysis
- B. Portfolio construction
- C. Performance measurement

116. The correlation between the historical returns of Stock A and Stock B is 0.75. If the variance of Stock A is 0.16 and the variance of Stock B is 0.09, the covariance of returns of Stock A and Stock B is *closest* to:

- A. 0.01.
- B. 0.09.
- C. 0.16.

117. The point of tangency between the capital allocation line (CAL) and the efficient frontier of risky assets *most likely* identifies the:

- A. optimal risky portfolio.
- B. optimal investor portfolio.
- C. global minimum-variance portfolio.

118. The stock of GBK Corporation has a beta of 0.65. If the risk-free rate of return is 3% and the expected market return is 9%, the expected return for GBK is *closest* to:

- A. 3.9%.
- B. 6.9%.
- C. 10.8%.

119. A return-generating model that provides an estimate of the expected return of a security based on factors such as earnings growth and cash flow generation is *best* described as a:

- A. market factor model.
- B. fundamental factor model.
- C. macroeconomic factor model.

120. A portfolio manager generated a rate of return of 15.5% on a portfolio with beta of 1.2. If the risk-free rate of return is 2.5% and the market return is 11.8%, Jensen's alpha for the portfolio is *closest* to:

- A. 1.84%.
- B. 3.70%.
- C. 4.34%.