

FinQuiz.com

CFA Level I 4th Mock Exam

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FinQuiz.com – 4th Mock Exam 2015 (AM Session)

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Questions 1 through 18 relate to Ethical and Professional Standards

1. Frank Liew is a research analyst who is working with a team of analysts to produce a report on a large, multinational firm. Each member performs an independent analysis of the firm based on comprehensive data about the firm's financials and its competitor strategies. However, after developing his recommendation, Liew discovers that the consensus opinion differs significantly. The report is published with Liew's name included in the list of analysts.

By opting not to dissociate from the report, Liew has *most likely*:

- A. not violated any Standards.
 - B. violated Standard V(A) 'Diligence and reasonable basis'.
 - C. violated Standard V(A) 'Diligence and reasonable basis and Standard II(B) 'Market Manipulation'.
2. To be compliant with the GIPS standards, a firm's total assets must be the aggregate of the:
 - A. market value of all discretionary fee and non-fee paying accounts.
 - B. fair value of all discretionary and non-discretionary fee-paying accounts.
 - C. fair value of all discretionary and non-discretionary accounts including both fee paying and non-fee paying portfolios.

3. Rafael Stuart is a research analyst at Grand Investment Associates (GIA), a U.S. based financial advisory firm that targets private wealth clients. Stuart, along with a group of research analysts at GIA, is preparing a report on Tetragonal Corporation (TETCO), a large-cap technology firm. Based on a comprehensive analysis of the firm's pro forma financial statements, Stuart reached the conclusion that TETCO's next quarter's EPS would be at least 5% lower than consensus. Stuart's research team, however, disagrees, and publishes the report including a 'buy' recommendation.

To be in compliance with CFA Institute Standards of Professional Conduct, Stuart should most likely:

- A. remove his name from the report before it is published.
 - B. report the disagreement to supervisory authorities and ask for corrective action.
 - C. remove his name from the report and report the disagreement to supervisory authorities.
4. If local laws are in conflict with the GIPS standards, a GIPS compliant firm should comply with:
- A. the law that is more stringent.
 - B. GIPS standards and disclose the conflict in the compliant presentation.
 - C. the local laws and make full disclosure of the conflict in the complaint presentation.

5. Jim Chao works for an investment management firm that is developing marketing material to promote its business and attract prospective clients. The firm utilizes the past 15-years return to a composite that includes only the firm's successful client accounts that have generated an average return of at least 10% during the time period. Chao does not prepare the marketing material, but is required to use it during preliminary meetings with prospective clients.

With regards the use of the marketing material, to be in compliance with Standard I-A of the CFA Institute Standards of Professional Conduct, Chao should most likely:

- A. use the marketing material when soliciting business for the firm.
 - B. use the marketing material, and disclose the calculation methodology to the clients.
 - C. not use the marketing material, and bring the situation to the attention of the supervisor.
6. In the absence of regulatory guidance, CFA Institute recommends that firms should maintain records for at least:
- A. 5-years.
 - B. 7-years.
 - C. 10-years.
7. Edward Li is an analyst at an equity management firm in the U.S. During a meeting with one of his clients, Vincent Yan, Li discovered that Yan has a surplus of \$30,000 to invest in a diversified mutual fund. A few days later, Li attended a conference of reputable financial analysts and portfolio managers. There he met Wilbert Ho, the manager of one of the area's best performing mutual funds. In an attempt to help his client, Li told Ho to contact Yan, one of his clients who had \$30,000 cash, and offer him performance details of his mutual fund.

By revealing information about his client, Li has *most likely*:

- A. violated Standard III (E)—Preservation of Confidentiality.
- B. not violated Standard III (E)—Preservation of Confidentiality because the information was not confidential.
- C. not violated Standard III (E)—Preservation of Confidentiality because Li's intent was to help his client as is stipulated by his duty of loyalty to the client.

8. J&J Investment Advisors (J&J) is an investment firm that is in the process of being a GIPS compliant firm. As such, J&J has calculated the portfolio performance of its largest institutional client in accordance with the GIPS standards. During a meeting with the client, J&J refers to the calculation methodology as being consistent with GIPS standards.

In making this statement, J&J is in:

- A. violation of the GIPS standards, because such statements are strictly prohibited.
 - B. violation of the GIPS standards, because such statements can only be made in a firm's prospectus and marketing material.
 - C. compliance with the GIPS standards, because J&J is in the process of being GIPS compliant and as such, has prepared the performance data in accordance with the standards.
9. To be fully compliant with the required and recommended procedures of Standard II(A) 'Material nonpublic information', a firm should:
- A. create a restricted list and a watch list in combination.
 - B. broadly distribute a restricted list when in possession of material nonpublic information.
 - C. Restrict all trading within the firm when in possession of material nonpublic information.
10. Elaine Sen manages a trust fund worth \$50,000. The trust documents transfer effective control of the funds to Sen and prohibit investing in non-U.S. stocks and bonds. Sam Kim, a 15 year old girl, is the primary beneficiary of the fund. Just recently, Kim approached Sen to discuss her educational expenses, stating that an additional cash flow of \$20,000 would be needed each year for her to complete high school. Owing to the heightened need of cash, Sen deems it appropriate to invest in high-yield emerging market stocks to increase the fund returns. Consequently, she invests only 5% of the fund in such stocks.

Sen has *most likely* violated:

- A. no Standards.
- B. Standard III(C) 'Suitability'.
- C. Standard III(A) 'Loyalty, Prudence and Care'.

11. The CFA Institute Standards of Professional Conduct require that a client's investment policy statement should be reviewed at least:
- A. annually.
 - B. quarterly.
 - C. semiannually.
12. Alex Lama has just been hired as a research analyst by Exo-Tech Limited (ETL) to produce a research report on their company. Lama has been provided with all factual information about the firm that he plans to use to perform a thorough and unbiased analysis of the firm. ETL has granted Lama 500 stock options in return for writing the report.

As an independent analyst, has Lama most likely violated best practice with regards to Standard I-B 'Independence and Objectivity' of the CFA Institute Standards of Professional Conduct?

- A. No.
 - B. Yes, because her compensation arrangement is not what best practice recommends.
 - C. Yes, because she did not disclose the nature of the compensation to investors.
13. Jessica Wright is a marketing specialist at Capital Managers (CAPM) an asset management firm in Houston, Texas. Wright has been asked to develop promotional material for CAPM's Emerging Market Equities Fund created by the firm around ten years ago. Due to a typographical error, the material prepared by Wright states that the fund includes Russian securities when in fact, it does not. Wright presents the material to upper management, who approve it for distribution to clients. After several days, Wright identifies the mistake and corrects it immediately.

With regards to Standard I(C)-Misrepresentation, Wright has most likely:

- A. violated the Standard since he allowed the erroneous material to be distributed and did not prepare the material with caution.
- B. not violated the Standard since he corrected it immediately after identifying it.
- C. not violated the Standard as long as he informs those who have received the erroneous information about the error.

14. Casey Hart is a fixed-income analyst at Golden Gust Investments (GGIN), an asset management firm in Indianapolis, USA. Hart is planning to leave the firm to start her own advisory business with an old friend and an entrepreneur. To ensure that she does not engage in any unethical or controversial practices, Hart refrains from soliciting clients while employed at GGIN. In addition, she does not take documents or other confidential information from the firm. Hart plans to copy and take with her only her own recommended list of securities and her personal marketing presentations containing her performance record.

With regards to Standard IV—Duties to Employers, Hart has *most likely*:

- A. violated her duty of loyalty to the firm.
 - B. not violated her duty of loyalty since she plans to take only personal information with her.
 - C. not violated her duty of loyalty since her work and experience gained at GGIN is her property and not the firm's.
15. Adam Blank directs all trades of one of his clients through a broker specified by the client. Doing so does not help Blank achieve best execution and best price. Blank discloses this fact to the client but continues trading through the same broker.

Blank will *least likely* be in violation of Standard III(A)-Loyalty, Prudence, and Care if he:

- A. continues to trade through the broker.
 - B. finds and selects a broker that offers the best 'price'.
 - C. seeks best execution by selecting a different broker and informs the client about his selection.
16. West & Graham Associates (W&G) is a financial advisory firm that allows its employees to reissue previously released reports by its own employees without providing attribution to these prior W&G analysts.

The firm is *most likely* in violation of:

- A. no standards.
- B. Standard I(C)-Misrepresentation.
- C. Standard I(B)-Independence & Objectivity and Standard I(C)-Misrepresentation.

17. The duty to clients imposed by Standard III(B)—Fair Dealing is *most likely*:
- A. more critical when changing recommendations than when making initial recommendations.
 - B. more critical when making initial recommendations than when changing recommendations.
 - C. equally critical when making initial recommendations as well as when changing recommendations.
18. Money-Etched Investments (MEIN) is a firm that attained considerable popularity last year owing to high returns on its equity funds. The firm earned at least a 20% return on its funds with the highest return being 28%. While developing advertising material for the company, the firm's CEO, Jeremy Chinn, asked to include the following statement in the brochure:

“Investors in MEIN's equity funds can expect the value of their investments to grow by at least 20% over a year, and hopefully, even more.”

Is MEIN's advertising material *most likely* in compliance with the CFA Institute Standards of Professional Conduct?

- A. Yes.
- B. No, because it violates Standard III(D) 'Performance Presentation'.
- C. No, because it violates Standard III(D) 'Performance Presentation' and Standard I(C) 'Misrepresentation'.

Questions 19 through 32 relate to Quantitative Methods

19. According to the central limit theorem, which of the following is *most* accurate?
- A. The variance of the distribution of the sample will decrease as the sample size increases.
 - B. The mean of the distribution of the sample will almost be equal to the mean of the population from which the sample is drawn.
 - C. The variance of the distribution of the sample will be equal to the variance of the population divided by $(n-1)$.

20. A financial statistician made the following comments while addressing a group of internees about the various statistical techniques used in equity analysis.

Statement 1: “Sample variance calculated with a divisor of ‘n’ is a biased estimator of the population variance.”

Statement 2: “An estimator is more efficient and unbiased the larger the sample size.”

He is *most* accurate with respect to:

- A. Statement 1 only.
 - B. Statement 2 only.
 - C. Neither statement 1 nor statement 2.
21. Which of the following is *least likely* a property of binomial distribution?
- A. A binomial distribution has fixed number of trials.
 - B. The trials in a binomial distribution are independent.
 - C. Each trial in a binomial distribution has only one outcome.

22. An equity analyst is using the P/E ratio to rank the component firms of a broad-based equity market index. The exhibit below is an excerpt from the information that the analyst gathered about the 35 companies included in the index.

Exhibit
P/E Data provided in ascending order.

No.	Company	P/E ratio
1	A	0.55
2	B	0.67
3	C	1.10
4	D	1.47
5	E	2.89

- The estimate for the 10th percentile for the P/E ratio is *closest* to:
- A. 1.322.
 - B. 1.360.
 - C. 1.391.
23. For a random sample of 200 small-cap U.S. stocks, the average dividend yield is 1.56% and the sample has a standard deviation of 0.40.
- The 99% confidence interval for the population mean of all small-cap U.S. stocks based on the standard normal distribution will be *closest* to:
- A. 1.487% to 1.633%.
 - B. 1.504% to 1.615%.
 - C. 1.513% to 1.606%.
24. A stated annual interest rate is the:
- A. quoted interest rate that does not account for compounding within the year.
 - B. amount by which a unit of currency will grow in a year with interest on interest included.
 - C. quoted interest rate per period that equals the periodic rate divided by the number of compounding periods per year.

25. The Chebyshev's inequality will *most likely* hold for:
- A. continuous data that is normally distributed.
 - B. discrete data regardless of the shape of the distribution.
 - C. continuous and discrete data regardless of the shape of the distribution.
26. Ronald Gibson is a statistical expert that works for an equity management firm. Gibson believes that the normal distribution describes most common stock returns, at least in the long-run. Under this assumption, Gibson is estimating the probability that an emerging market equity portfolio's return would exceed 22%. The portfolio mean return is 14% and the standard deviation of returns is 26% per year. Gibson is using the following excerpt from the table of normal probabilities to help him with his calculation.

x or z	0	0.01	0.02
0.20	0.5793	0.5823	0.5871
0.30	0.6179	0.6217	0.6255
0.40	0.6554	0.6591	0.6628

- Gibson's estimated probability should be *closest* to:
- A. 37.83%.
 - B. 38.21%.
 - C. 39.88%.
27. A portfolio manager is concerned about the occurrence of any structural changes in the returns data series that he has gathered for non-U.S. stocks.
- The manager's concern is *most likely* related to the:
- A. look-ahead bias.
 - B. time-period bias.
 - C. sample selection bias.

28. Edward Burger is meeting with his portfolio manager for the regular, annual performance review of his portfolio. The portfolio manager has recommended Burger to cash out of a few investments that he considers are not adding value to his overall wealth. Burger is presented with the following information about these investments:

Investment	Recent Annual Sharpe Ratio
A	-0.23
B	-1.56
C	-2.01

Given that Burger wants to cash out of only one investment for the time being, he selects Investment C.

Burger's decision regarding investment C is *most likely*:

- A. appropriate.
- B. inappropriate, because a shorter evaluation period should be used.
- C. inappropriate, because a different evaluation metric should be used.

29. Peter Brook has shortlisted three investments to add to his \$10,000 equity portfolio. Brook needs to pay the first installment on his house in a year's time and needs the portfolio to generate enough cash to be able to do so. The table below reveals certain performance measures for the portfolio after adding each of the three investments.

Investment	Sharpe Ratio	Target Semi-Deviation
A	2.3	17%
B	4.6	23%
C	3.5	11%

Which of the above investments should Brook *most likely* invest in?

- A. Investment A.
 - B. Investment B.
 - C. Investment C.
30. Jeanette King, a portfolio manager, is constructing the investment policy statement of one of her firm's new clients. Currently, the client has most of his money invested in risk-free T-bills or investment grade corporate bonds. He is considerably averse to volatility in his portfolio's returns. King is considering the following investments for the client.

Company	Kurtosis	Skewness
A	3	0
B	4.5	-0.5693
C	2.1	0.7955

Which of the above investments will be *most* suitable for King's client?

- A. Company A.
- B. Company B.
- C. Company C.

31. In candlestick charts, doji is a pattern where the stock opened:
- A. and closed at the same price.
 - B. at its low and closed near its high.
 - C. at its high and dropped significantly to close near its low.
32. Bob Harper, a hedge fund manager, lists all the major hedge funds operating in the industry and categorizes them into different styles. He then assigns a number to each investment style.

Which of the following measures of central tendency would be *most* appropriate for the data Harper is analyzing?

- A. Mean.
- B. Mode.
- C. Median.

Questions 33 through 44 relate to Economics

33. If the aggregate demand of an economy increases more than increase in the aggregate supply, an investor should *most likely* reduce investments in:
- A. cyclical companies.
 - B. fixed-income securities.
 - C. commodity-oriented equities.
34. When a firm's $TR = TC$ and $MR > MC$, the firm:
- A. is at maximum profit level.
 - B. is operating at upper breakeven point.
 - C. should increase quantity to generate profits.
35. An economist is attempting to display, graphically, the income constraint of a private wealth client with regards to two of his highly consumed products: Petrol and electricity.
- The slope of the income constraint equals the amount of petrol consumption that the client would have to give up if he were to consume more electricity.
- If the price of petrol were to rise, the slope of the income constraint would *most likely*:
- A. increase.
 - B. decrease.
 - C. remain unchanged.
36. As a firm increases the quantity of its product produced, the distance between its ATC and AVC curve:
- A. starts increasing.
 - B. starts decreasing.
 - C. remains constant.

37. Which of the following will *least likely* shift an economy's short-run average supply leftward but will have no effect on the long-run average supply?
- A. A decrease in input prices.
 - B. An increase in human capital.
 - C. A decrease in the expectation of future prices.

38. Alex Gerald is examining his budget constraint given his current income and expenditures. Gerald has a total budget of \$125 per week to spend on milk or juices. The price of milk is \$3.5/litre and the price of juice is 2.5/litre.

If the quantity of milk is measured on the horizontal axis of the budget constraint, the slope of the budget constraint would be *closest* to:

- A. -0.71.
 - B. -0.95.
 - C. -1.40.
39. A research analyst is analyzing a retail chain that offers products with downward sloping demand curves.

Which of the following *best* describes the retail chain's profit maximizing output and break-even point?

- A. The breakeven point occurs when TR equals TC, and profit maximization occurs when MR equals MC.
- B. The breakeven point occurs when MC equals MR, and profit maximization occurs when TR is greater than TC.
- C. The breakeven point occurs when TR equals TC, and profit maximization does not necessarily occur when MR equals MC.

40. A consumer buys both ice cream and cake each week for dessert. The price of ice cream is \$1.25 per scoop and the price of cake is \$1.55 per piece. The consumer's marginal rate of substitution, MRS_{IC} , equals 0.66.

To maximize utility, the consumer should *most likely*:

- A. not change her consumption.
 - B. increase her consumption of cake and decrease her consumption of ice-cream.
 - C. decrease her consumption of ice-cream and increase her consumption of cake.
41. Rosy Diaz is a research analyst that follows the Russian automobile industry. As part of the industry's competitive analysis, Diaz determined that at a range of output levels, size does not give a firm a competitive edge. However, over and above those levels, the larger the business, the greater its potential investment value.

Given the structure of the Russian automobile industry, the industry's:

- A. long-run supply curve has either a zero slope or a decreasing slope.
 - B. short-run supply curve is downward sloping over a particular range of output.
 - C. long-run supply curve is U-shaped, with the slope decreasing over a range of output.
42. Which of the following asset categories price will *most likely* exhibit substantial price increases when the economy is in boom phase?
- A. Riskiest assets.
 - B. Government Bonds.
 - C. Shares of exporting companies.

43. Helen Oswald, a portfolio manager, is assessing the effect of a recent increase in one of her client's salary on her consumption patterns. Oswald had constructed a production opportunity frontier with spending on designer dress shirts on the vertical axis and t-shirts on the horizontal axis.

Given the change in circumstances, the client's production opportunity frontier would *most likely*:

- A. shift upward, and the optimal indifference curve would shift rightward.
 - B. shift upward, and the optimal indifference curve would remain unchanged.
 - C. remain unchanged, and the optimal indifference curve would shift leftward.
44. During his research Ross Katz, an economist, reviews the GDP data for the European economy for the year ended 2005. The following exhibit is an excerpt from the table provided by the Department of Finance in Europe.

Exhibit
GDP Release for the European economy
(in millions of euros)

Consumer spending	550,000
Government spending	190,678
Government gross fixed investment	30,000
Business gross fixed investment	145,300
Exports	320,666
Imports	312,865
Change in inventories	15,500
Statistical discrepancy	500
Interest income	77,500

Using the expenditure approach, nominal GDP for the European economy is *closest to*:

- A. €939,779 billion.
- B. €1,001,779 billion.
- C. €1,101,779 billion.

Questions 45 through 68 relate to Financial Reporting and Analysis

45. Which of the following statements is *least likely* correct regarding gross profit margin?

Gross profit margin:

- A. is inversely related to the competition in the industry.
 - B. provides a liquidity measure that is independent of the financing of the firm's assets.
 - C. reflects the percentage of revenue available to pay operating and other expenses and to generate profit.
46. Which of the following would *least likely* affect a firm's cash flow from financing activities?
- A. A firm's employee exercising stock options.
 - B. A firm increasing its dividend payout ratio effective immediately.
 - C. An increase in the market interest rates on debt similar to a firm's outstanding loans.
47. If a firm's leverage ratio increases, its return on equity will:
- A. increase.
 - B. decrease.
 - C. either increase or decrease.
48. Holding everything else constant, assuming a firm does not sell on credit at all, which of the following ratios for the firm would *most likely* be equivalent?
- A. Cash ratio and quick ratio.
 - B. Current ratio and cash ratio.
 - C. Current ratio and quick ratio.
49. Under U.S. GAAP, which of the following items will *most likely* be reported as extraordinary in the income statement?
- A. Restructuring charges.
 - B. Losses from a major legal case.
 - C. A significant gain on the sale of a rare piece of machinery.

50. Sasha Audrey, a financial analyst, is preparing a report on Vault Managers (VMA), a financial management firm in Chicago, USA. Audrey has accumulated information about the firm to estimate key financial ratios. The following exhibit displays this information.

Exhibit
Selective Financial Information of Vault Managers
(in thousands of US dollars)

	December 31, 2011
Revenues	\$405,000
Cost of services	\$85,200
Interest	\$135,500
Selling, general, and administrative expenses	75,000
Depreciation	45,500
Tax Rate	35%

VMA's operating profit margin is *closest* to:

- A. 10.24%.
 - B. 15.75%.
 - C. 49.21%.
51. All Star Products (ASP) reported net income of \$2,750,000 for the year ended December 31, 2010. During the same year the company had an average of 1,050,000 shares of common stock outstanding. In addition to common stock, ASP also had 50,000 of convertible preferred stock, with each convertible into ten shares of the firm's common stock. The firm pays a preferred dividend of \$15/share and a common dividend of \$20.

ASP's diluted EPS is *closest* to:

- A. \$1.77.
- B. \$1.29.
- C. \$1.90.

52. An analyst is performing a comparative analysis of two firms operating in the U.S. fashion industry. Firm A has assets of \$15.796 million and Firm B has assets of \$22.90 million. The equity of Firm A and Firm B equal \$9.876 million and \$15.66 million respectively.

With regards to solvency:

- A. Both firms A and B are strong.
 - B. Firm A is strong but Firm B is weak.
 - C. Firm B is strong but Firm A is weak.
53. An analyst has been asked to perform a comparative analysis of the financial statements of Pin Enterprises (PIEN) for the most recent years. She initiated the analysis with the firm's profitability ratios and compiled the following data:

	2010	2011
Leverage	1.80	2.50
Total asset turnover	2.0	2.3
Tax burden	0.50	0.70
Interest burden	0.60	0.90
EBIT Margin	5.13%	7.29%

Which of the following *least* describes one of the conclusions given her compiled data?

- A. The major contributor to the increase in the firm's return on assets was the rise in net profit margin.
- B. The firm's return on equity increased by 20.87% in 2011, mostly because of an increase in leverage.
- C. The firm's interest costs decreased more than the decrease in its tax costs during the 2010-2011 financial period.

54. An overview of specific business lines and the segmentation of income are *most likely* found in the:
- A. statement of operations.
 - B. supplementary schedule.
 - C. management commentary .
55. A portfolio manager is assessing the following information as part of a comprehensive analysis of a firm's financial health and investment attractiveness using cash flow ratios.

Cash flow from operating activities	\$89,250
Interest paid	\$45,000
Taxes paid	\$22,000
Lease payments	\$15,500
Dividends paid	\$12,000

Using the information above, the interest coverage ratio is *closest* to:

- A. 2.47.
- B. 2.62.
- C. 3.47.

56. A portfolio manager has accumulated the following data to carry out a comparative analysis of firms within the U.S. automobile industry.

Exhibit
SOP Auto Manufacturers Financial Information

Net Income	\$25,000,000
Weighted average common shares	150,000,000
Beginning of year stock options outstanding	75,000
Exercise price of stock options	\$45
Market price of company's stock	\$65
Stock option price	\$11.55

- Using the treasury stock method, the diluted EPS for SOP Auto Manufacturers is *closest* to:
- A. \$0.167.
 - B. \$0.159.
 - C. \$1.220.
57. A company engages in the dealing and trading of financial assets that are highly liquid. Such purchase and sale is not part of the company's primary business activity.
- In the cash flow statement the above activities would appear as:
- A. Investing activities.
 - B. Operating activities.
 - C. Financing activities.
58. If a firm's price to book value ratio is one, the equity investors in the firm will *most likely* earn:
- A. a normal profit only.
 - B. excess profits since the ratio is positive.
 - C. zero profits as return would not exceed risk.

59. The head of a firm's sales and marketing department is attempting to determine the appropriate method of reporting revenue under a long-term contractual sale. Due to the nature of the counterparty involved, the outcome of the contract cannot be measured reliably and a 30% loss on the contract is expected.

Given the above information, under U.S. GAAP, the:

- A. percentage of completion method will be used to recognize the loss immediately.
 - B. completed contract method will be used but the loss will be recognized immediately.
 - C. loss will be recognized upon completion when revenue is recognized, unlike IFRS, which will require the loss to be recognized immediately.
60. When the income tax expense in the income statement is greater than current income tax liability, the difference will *most likely* increase a firm's:
- A. taxable income.
 - B. deferred tax assets.
 - C. deferred tax liabilities.
61. If a firm purchases services on credit, in effect borrowing from the provider, it would *most likely* appear on the cash flow statement as an:
- A. operating activity.
 - B. investing activity.
 - C. financing activity.
62. For a particular firm, holding everything constant and assuming rising prices, the inventory turnover will be *lowest* under the:
- A. FIFO method of inventory accounting.
 - B. LIFO method of inventory accounting.
 - C. average method of inventory accounting.

63. Superior Tech Limited (S-Tech) has a contract to develop a marketing campaign for a newly established firm. The agreed upon sales price is \$15 million and S-Tech estimates that it would take 4 years to get the job done. Total costs are estimated to be \$9 million. Details about the expenditures incurred in years 1 and 2 are given below:

- At the end of year 1, S-Tech spends \$4 million.
- At the end of year 2, the company spends an additional \$3.5 million.

Under the percentage-of-completion method, how much revenue will S-Tech recognize in year 2?

- A. \$5,833,333.
 - B. \$6,666,667.
 - C. \$12,500,000.
64. Unlike under U.S. GAAP, under IFRS interest received or paid can be reported either as an:
- A. investing activity or operating activity.
 - B. financing activity or investing activity.
 - C. operating, investing or financing activity.
65. For an issuing company, interest expense reported for the bonds in its financial statements is based on the:
- A. coupon rate.
 - B. effective interest rate.
 - C. market rate of interest.

66. The following data relates to a manufacturing concern's financial performance and efficiency.

Beginning inventory 2012	\$70,000
Ending inventory 2012	\$50,000
Cost of goods sold 2012	\$180,000
Cost of goods sold 1 st quarter 2013	\$45,000
Average inventory 1 st quarter 2013	\$66,000

Relative to 2012, the firm's inventory turnover ratio in 2013:

- A. improved.
 - B. deteriorated.
 - C. remained unchanged.
67. Relative to expensing, which of the following *least* describes the effect of capitalizing borrowing costs on a firm's reported financials?
- A. Leverage would appear higher for the firm.
 - B. Operating income would be lower in the future.
 - C. Operating cash flow would be higher but investing cash flow would be lower.

68. Wicker Textiles (WTEX) is a well-established firm in central Minneapolis, Minnesota. WTEX has increased inventory to meet the seasonal demand of its products. Some information about WTEX's inventory value is given below:
- The cost of the inventory is \$60,000.
 - The estimated selling price less costs of completion and costs to make the sale equals \$80,000.
 - The market value of the inventory is \$55,000.
 - A normal profit margin equals 15%.

Under U.S. GAAP, the inventory value on WTEX's financial statements should be *closest* to:

- A. \$55,000.
- B. \$60,000.
- C. \$80,000.

Questions 69 through 76 relate to Corporate Finance

69. Which of the following about financial leverage and unit sales is *most* accurate?

The farther unit sales are from the break-even points for high leverage companies, the:

- A. magnifying effect becomes unpredictable.
- B. lower the magnifying effect of this leverage.
- C. greater the magnifying effect of this leverage.

70. Ryan Myers, a financial analyst, has been appointed the task of developing a valuation estimate for Colors Fashion Label (CFL), a private, U.S. based firm operating in the fashion industry of the country. Myers gathered the following information to aid his analysis:

- The long-term yield on U.S. government bonds is 3.5%.
- The historical equity risk premium in the U.S. is 5.6%.
- A comparable firm has a beta of 1.35, a debt-to-equity ratio of 1.20, and a tax rate of 40%.
- CFL's tax rate is 33%.
- CFL's Debt/Equity ratio is 0.75.

Given the aforementioned information, Myers estimate of CFL's cost of equity should be *closest* to:

- A. 7.896%.
- B. 9.874%.
- C. 10.105%.

71. Breakeven point analysis will be *least* important for a company with a high ratio of:

- A. debt to total assets and low business cycle sensitivity.
- B. intangible assets to total assets and high operating income.
- C. tangible assets to total assets and low business cycle sensitivity.

72. Xerox Technologies (XETECH) is a well-established firm in the gaming industry of the United States. Just recently, XETECH upgraded its gaming device and increased its price to \$250. The production of this device cost the firm \$65/unit in variable costs. The total fixed operating costs equaled \$10,000,000.

If the firm changes its output from 200,000 units to 220,000 units, operating income will change by:

- A. 1.37%
 - B. 10.00%.
 - C. 13.70%.
73. Major drags on liquidity for a firm *most likely* includes:
- A. obsolete inventory.
 - B. reduced credit limits.
 - C. making payments early.
74. Which of the following can be *least* managed or controlled by a firm's management?
- A. Sales risk.
 - B. Financial risk.
 - C. Operating risk.
75. In the face of bankruptcy, the companies *least likely* to emerge as ongoing concerns are the ones with high degree of:
- A. financial leverage.
 - B. operating leverage.
 - C. financial leverage and a low degree of operating leverage.
76. Which of the following is *least likely* correct regarding staggered boards?
- A. Staggered board facilitates better continuity of board expertise.
 - B. Management uses staggered board as an anti-takeover instrument.
 - C. A staggered board provides more flexibility to nominate new board members to meet changes in the marketplace.

Questions 77 through 88 relate to Equity Investments

77. A fixed-income analyst is considering investing in a pooled investment vehicle. His friend recommends a closed-ended mutual fund, an open –ended mutual fund and an exchange-traded fund. The analyst expects to hold the investment for a year or so and has determined that all options are trading at a discount.

The largest discount will *most likely* be for the:

- A. ETF.
 - B. Open-ended mutual fund.
 - C. Close-ended mutual fund.
78. A price-weighted index has an initial value of 45. The prices of the constituent securities before a stock split on security B are given in Exhibit 1.

Exhibit 1
Before a 2 for 1 Split in Security B

Security	Price (\$)
A	65.12
B	84.00
C	8.50
D	11.99

To ensure that the value of the index does not change after the split, the new divisor will be *closest* to:

- A. 1.329.
 - B. 2.836.
 - C. 3.769.
79. According to statistical approaches, companies are grouped based on their:
- A. principal business activities.
 - B. relative sensitivities to the business cycle.
 - C. historical correlations of securities' returns.

80. Cary Lee just received a performance-based bonus from her employer and desires to invest that in real estate. Her current portfolio is invested in stocks and bonds only.

If Lee wants to achieve maximum diversification, she should *most likely* invest in:

- A. Direct real estate.
 - B. Real estate investment trusts (REITs).
 - C. Shares of companies that own and operate real estate.
81. Anthony Francisco just received \$10,000 as inheritance from his uncle who passed away last month. Consequently, Francisco advises his portfolio manager to increase his portfolio's allocation to domestic stocks from 15% to 25%. The manager determines that the most appropriate holding period for Francisco is ten years. He thus invests in non-dividend paying stocks that would yield the required return over ten years.

Given the information above, Francisco is *most likely* an:

- A. Investor.
 - B. Speculator.
 - C. Information-motivated trader.
82. In most financial models, the assumption is that the investors are:
- A. risk averse.
 - B. loss averse.
 - C. risk takers.

83. A firm has just paid a dividend of \$2.5 per share. The required rate of return is 15% per year and dividends are expected to grow at a constant rate of 9.4%. If an analyst uses Gordon Growth model to calculate the firm's intrinsic value, how much does the dividend growth assumption add to the intrinsic value estimate?

- A. \$22.24
- B. \$26.59
- C. \$48.84

84. Bobby Anderson, a portfolio manager, is considering investing in commodities to diversify the risks held in his personal portfolio. Since he has had minimal prior exposure to the commodities market and does not have the facilities to hold most commodities, he is trying to determine the most appropriate way to invest in the sector.

Which of the following markets will be *most* suitable for Anderson to achieve his diversification objective?

- A. The spot market.
- B. The futures market.
- C. The forwards market.

85. Matt Elaine has developed software that enables him to determine the correlation between economic variables and stock returns. Elaine believes that abnormal returns could be generated using his investing approach.

Which of the following characteristics of the financial system would *least likely* aid Elaine in achieving his objective?

- A. Market liquidity.
- B. Low cost trading.
- C. Transparent financial and economic disclosures.

86. For which of the following indices is rebalancing a major concern?

- A. Equal-weighted indices.
- B. Equal-weighted and market-capitalization weighted indices.
- C. Equal-weighted, market-capitalization weighted and price-weighted indices.

87. Which of the following is not a time series anomaly?

- A. Momentum
- B. Holiday effect
- C. Earnings surprise

88. Ethan Hawk is analyzing the return to his leveraged stock position that he invested in last year. The stock's price at the time of purchase was \$50/share. Hawk purchased 100 shares paying a commission of \$0.05/share. The leverage ratio was 2.0 and the call money rate was 6.0%. At the end of the year, the stock paid a dividend of \$0.50/share and the share price rose to \$70/share.

The total return on Hawk's investment is *closest* to:

- A. 75.45%.
- B. 75.64%.
- C. 75.80%.

Questions 89 through 94 relate to Derivative Investments

89. Which of the following *least* represents the rationale of a traditional insurance product?
- A. Credit-linked note.
 - B. Credit default swap.
 - C. Credit spread option.
90. Off-market forward is a forward transaction that:
- A. starts with a non-zero value.
 - B. is not made within normal business timings .
 - C. is used to offset the current forward transaction.
91. Compared to underlying spot markets, derivatives markets offer which of the following operational advantages?
- A. Lower transaction costs.
 - B. Greater liquidity and easy short selling opportunities.
 - C. Lower transaction costs, greater liquidity, and easy short selling opportunities.
92. Steve Hammond is the CEO of a U.S. based company in the oil exploration business. Hammond is concerned with falling oil prices in the near future. Specifically, he wants to hedge the risk of the company's oil production of a million liters expected in 234 days from now. He wants to ensure near perfect hedging with minimal investment.
- The *most* appropriate way to hedge the company's exposure is to use:
- A. Futures.
 - B. Options.
 - C. Forwards.

93. With regards to equivalence, a swap is *closest* to a series of:
- A. futures expiring at a set of dates coinciding with the swap payment dates.
 - B. forwards expiring at a set of dates coinciding with the swap payment dates.
 - C. options expiring at a set of dates with the options' exercise prices equal to the price inherent in the swap.
94. The higher the exercise price of a call option, the greater the:
- A. price of an option.
 - B. opportunity to gain on the upside.
 - C. premium received by the seller of the call.

Questions 95 through 106 relate to Fixed Income

95. Which of the following statements about the fixed-income market is *least* accurate?
- A. Since, globally, the fixed-income market is not as popular as the equity market, equity securities are far more diverse than debt securities.
 - B. Institutional investors dominate the fixed-income markets because of informational barriers to entry and invest directly in such securities.
 - C. Index weighting in the fixed-income market is based on price or value, and is rarely ever equally-weighted.
96. A fixed-income analyst is analyzing the following bonds' performance given future market conditions.

Exhibit 1

	Coupon Rate	Maturity
Bond A	5.5%	4 years
Bond B	6.5%	3 years
Bond C	5.0%	3 years

Which of the above bonds will have lowest interest rate risk?

- A. Bond A.
- B. Bond B.
- C. Bond C.

97. An analyst is trying to estimate the implied forward rates as inputs to his bond valuation process. For this purpose, she gathers the data provided in the following exhibit.

Exhibit
Zero Coupon Government Bonds

Maturity	Price	Yield to Maturity
2 year	98.77	3.556%
3 year	96.87	3.786%
4 year	93.11	3.980%

*The yields to maturity are stated on a semiannual bond basis

- The '2y1y' implied forward rate would be *closest* to:
- A. 4.25%.
 - B. 4.56%.
 - C. 4.16%.
98. For bonds with the same time-to-maturity and yield-to-maturity, Macaulay duration is the lowest for a:
- A. zero coupon bond.
 - B. low coupon bond trading at a discount.
 - C. high coupon bond trading at a premium.
- Similarly a low-coupon bond trading at a discount has a higher duration than a high coupon bond trading at a premium.
99. A portfolio manager is confused about whether to invest in a bond issue with a serial maturity structure, or one with a term maturity structure, given everything else is similar.
- Which of the following, if introduced, will make the manager largely indifferent between the two structures?
- A. High credit quality.
 - B. Moderate liquidity needs.
 - C. A sinking fund provision.

100. For a fully amortized bond, the annual payment, which includes both the coupon payment and the principal repayment:

- A. remains constant.
- B. decreases at constant rate.
- C. decreases at decreasing rate.

101. A 7% annual coupon bond is trading at a price of 105.67 and has three years to maturity. A 5.5% annual payment, 3-year T-note is trading at a price of 107.89. A 5-year 7% annual coupon T-note is trading at a price of 109.77.

Given the above information, the G-spread will be *closest* to:

- A. 0.16%.
- B. 1.32%.
- C. 2.19%.

102. A dealer believes that the bonds issued by Super-Tee Enterprises (SUTEE) are considerably overvalued and wants to benefit from the mispricing. For achieving this objective, the dealer borrows 100 par value bonds of SUTEE from an institutional investor and lends cash in return. The bonds have a stated coupon rate of 7.5%.

The above transaction will best be known as a:

- A. repurchase agreement, and the coupon will belong to the seller of the security.
- B. reverse repurchase agreement, and the coupon will belong to the borrower of the security.
- C. reverse repurchase agreement, and the coupon will belong to the borrower of cash.

103. Tony Sam has invested in a floating rate bond based on Libor. Due to changing market conditions, Sam is particularly concerned with his investment value deviating from par value.

Sam's concern is *most likely*:

- A. justified.
 - B. exaggerated, since floating rate securities have little market risk.
 - C. exaggerated, since floating rate securities have little interest rate risk.
104. Mega Derivative Dealers (MDD) is a financial management firm that specializes in derivatives and alternative investments. An analyst at MDD is evaluating three securities with similar characteristics. The table below displays data about them.

	ABC	DEF	GHI
Z-spread	13%	11%	15%
OAS	9%	8.5%	9.5%

Which of the above securities is *most likely* undervalued relative to the others?

- A. ABC.
 - B. DEF.
 - C. GHI.
105. An investor's fixed-income portfolio includes two 180-day money market instruments. Exhibit 1 displays some key information about the securities.

Exhibit

Money Market Instrument	Quotation Basis	Quoted Rate
A	Discount Rate	6.78%
B	Add-on Rate	7.02%

Assuming that the credit risks of the instruments are comparable, the instrument that offers a higher expected rate of return is:

- A. A.
- B. B.
- C. neither, since they both offer almost equivalent returns.

106. Sean Lee has just started work at D&L Dealers Association (DLD), a U.S. based firm that specializes in dealing in stocks and bonds. During a meeting with one of the firm's colleagues, Lee posed the following question:

“I am not sure how the lender of cash in a repurchase agreement would account for the credit risk of the counterparty and make sure it has a margin of safety?”

The *best* response to Lee's question is that the:

- A. repo rate will account for this concern.
- B. repo margin will account for this concern.
- C. collateral's value will account for this concern.

Questions 107 through 112 relate to Alternative Investments

107. Xoro Investors is a private equity firm that is nearing its exit stage for two of its profitable investments. The fund plans to achieve the following objectives through the use of appropriate exit strategies for the investments:

Investment A: “Fast execution, no lock-up period and a higher level of confidentiality.”

Investment B: “The potential for the highest price.”

Which of the following describes the *most* appropriate exit strategies for the investments?

- A. A trade sale for investment A and an IPO for investment B.
 - B. A secondary sale for investment A and a trade sale for investment B.
 - C. A trade sale for investment A and a secondary sale for investment B.
108. Which of the following hedge fund strategies is *least likely* to have a zero beta position?
- A. Market Neutral.
 - B. Quantitative Directional.
 - C. Fixed Income Convertible Arbitrage.
109. XYZ hedge fund is a U.S. based fund with \$200 million of initial investment capital. The fund specifies a ‘2 and 20’ fee structure with fees calculated using end-of-period calculation. A 7% hurdle rate is also specified and performance fees are calculated net of management fees.
- If, in its first year, XYZ hedge fund earns a return of 25%, the investor’s net return will be *closest* to:
- A. 18.4%.
 - B. 18.7%.
 - C. 19.1%.

110. During a seminar on the attractiveness of alternative investments, the guest speaker made the following comment:

“The hedge fund strategy that is closest to the strategy followed by a private equity fund is the activist hedge fund.”

The distinction between the two that sets them apart is that the hedge fund:

- A. does not have a lock-up period.
- B. operates in the public equity market only.
- C. does not influence the target company as much as private equity.

112. Activist is an event driven strategy that focuses on the:

- A. purchase of sufficient equity to influence a company’s policies or direction.
- B. securities of the companies either in bankruptcy or perceived to be near to bankruptcy.
- C. opportunities in the equity of companies that are currently engaged in restructuring activities.

Questions 113 through 120 relate to Portfolio Management

113. The execution step of portfolio management process *most likely* includes:
- A. portfolio monitoring.
 - B. portfolio construction.
 - C. performance measurement.
114. An equity analyst is using the market model to analyze the returns to a stock. During the recent year, the market rose by 5% and the stock rose by 8%. The beta for the stock is 0.66 and alpha is 0.02. The company-specific return to the stock during the recent year is *closest* to:
- A. 2.7%.
 - B. 4.5%.
 - C. 4.7%.
115. According to the CAL, an investor should choose the portfolio that lies at the point where the:
- A. efficient frontier is tangent to the capital allocation line.
 - B. investor's indifference curve cuts the capital allocation line.
 - C. highest indifference curve is tangent to the capital allocation line.
116. A portfolio manager has constructed an investment portfolio for one of his firm's largest institutional clients. Exhibit 1 displays the composition of the portfolio.

Exhibit

Type	Percentage Invested
Stocks	60%
Fixed Income	25%
Alternative Investments	15%

The above portfolio is *least* suitable for:

- A. A foundation.
- B. An insurance company.
- C. A newly offered defined benefit pension plan.

117. If an investor is concerned about the tax effects on dividends he or she should *most likely* invest in:

- A. an ETF.
- B. an index mutual fund.
- C. either an ETF or an index mutual fund.

118. Which of the following investments is likely to have a negative beta?

- A. A risk-free asset.
- B. An insurance policy.
- C. An asset with returns that have insignificant sensitivity to the market return.

119. Carlos Long, a financial analyst, is having a meeting with Tony John, one of his private wealth clients. During the meeting John stated that he wanted to achieve an expected return of 15% from his portfolio. Long estimated that the market portfolio has an expected return of 25% and a standard deviation of 37%. The risk-free rate is 5.0%.

If Long uses the capital allocation line as a benchmark, John's portfolio will have a standard deviation *closest* to:

- A. 18.5%.
- B. 27.0%.
- C. 37.0%.

120. An investor with a risk aversion coefficient of 4 is analyzing an investment with an expected return of 12% and a risk of 15%.

If the risk-free asset has a return of 5.0%, the investor will *most likely* prefer:

- A. the risk-free asset.
- B. the risky investment.
- C. either the risk-free asset or the risky investment.