1 of 240

After a firm presents a minimum required number of years of GIPS- compliant performance, the firm must present an additional year of performance each year, building up to a minimum of:

	15 years of GIPS-compliant performance.
	10 years of GIPS-compliant performance.
	5 years of GIPS-compliant performance.

Question not answered

After a firm presents a minimum of five years of GIPS-compliant performance, the firm must present an additional year of performance each year, building up to a minimum of 10 years of GIPS-compliant performance.

CFA Level I
"The GIPS Standards," CFA Institute
Section: Historical Performance Record

Question
2 of 240

Justin Blake, CFA, a retired portfolio manager, owns 20,000 shares of a small public company that he would like to sell because he is worried about the company's prospects. He posts messages on several internet bulletin boards. The messages read, "This stock is going up once the pending patents are released, so now is the time to buy. The stock is a buy at anything below $3. I have done some close research on these guys." According to the *Standards of Practice Handbook*, Blake *most likely* violated the Code and Standards associated with:

	Integrity of Capital Markets, but not Conflicts of Interest.
	neither Integrity of Capital Markets nor Conflicts of Interest.
	Integrity of Capital Markets, and Conflicts of Interest.

Question not answered

Blake violated Standard II(B) regarding the Integrity of Capital Markets by engaging in a practice that is likely to artificially inflate trading volume.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard II(B), Standard VI(A)

Question
3 of 240

Ron Dunder, CFA, is the CIO for Bling Trust (BT), an investment adviser. Dunder recently assigned one of his portfolio managers, Doug Chetch, to manage several accounts that primarily invest in thinly traded micro-cap stocks. Dunder soon notices that Chetch places many stock trades for these accounts on the last day of the month, toward the market's close. Dunder finds this trading activity unusual and speaks to Chetch, who explains that the trading activity was completed at the client's request. Dunder does not investigate further. Six months later, regulatory authorities sanction BT for manipulating micro-cap stock prices at month end in order to boost account values. Did Dunder violate any CFA Institute Standards of Professional Conduct?

	Yes, because he failed to reasonably supervise Chetch.

	Yes, because he did not report his findings to regulatory authorities.
	No.

Question not answered

The CFA Institute Code and Standard on Responsibilities of Supervisors, Standard IV (C), requires members/candidates to take steps to detect and prevent violations of laws, rules and regulations. Dunder failed in his supervisory role when he accepted Chetch's explanation of the unusual trading activity. Dunder should have reviewed the client's goals and objectives, as well as records, to see whether the client in fact requested month-end trading. Regardless of the explanation provided by Chetch, Dunder should have investigated further.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard IV(C)

Question
4 of 240

Amanda Covington, CFA, works for McJan Investment Management. McJan employees must receive prior clearance of their personal investments in accordance with McJan's compliance procedures. To obtain prior clearance, McJan employees must provide a written request identifying the security, the quantity of the security to be purchased, and the name of the broker through which the transaction will be made. Precleared transactions are approved only for that trading day. As indicated below, Covington received prior clearance.

Security	Quantity	Broker	Prior Clearance
A	100	Easy Trade	Yes
B	150	Easy Trade	Yes

Two days after she received prior clearance, the price of Stock B decreased, so Covington decided to purchase 250 shares of Stock B only. In her decision to purchase 250 shares of Stock B only, did Covington violate any CFA Institute Standards of Professional Conduct?

	Yes, relating to her employer's compliance procedures
	Yes, relating to diligence and reasonable basis
	No

Question not answered

Prior-clearance processes guard against potential and actual conflicts of interest; members are required to abide by their employer's compliance procedures (Standard VI (B)).

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard V(A), Standard VI(B)

Question
5 of 240

Jefferson Piedmont, CFA, a portfolio manager for Park Investments, plans to manage the portfolios of several family members in exchange for a percentage of each portfolio's profits. Because his family members have extensive portfolios requiring substantial attention, they have requested that Piedmont provide the services outside of his employment with Park. Piedmont notifies his employer in writing of his prospective outside employment. Two weeks later, Piedmont begins managing the family members' portfolios. By managing these portfolios, which of the following CFA Institute Standards of Professional Conduct has Piedmont violated?

	Both Additional Compensation and Conflicts of Interest
	Additional Compensation
	Conflicts of Interest

Question not answered

According to Standard IV(B) and Standard VI(A), members should disclose all potential conflicts of interest, should disclose the substantial time involved in managing family accounts and, when engaging in independent practice for compensation, should not render services until receiving written consent from all parties.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard IV(B), Standard VI(A)

Question
6 of 240

Rebecca Wong is enrolled to take the Level I CFA exam. Her friend William Leung purchased Level I study materials from a well-known CFA review program the previous year. Leung made a photocopy of the previous year's copyrighted materials and sold it to Wong to help her study. Who *most likely* violated the CFA Institute Code of Ethics or any Standards of Professional Conduct?

	Neither violated.
	Only Leung violated.
	Both violated.

Question not answered

Photocopying copyrighted material, regardless of the year of publication, is a violation of Standard I(A) because copyrighted materials are protected by law. Candidates and members must comply with all applicable laws, rules, and regulations and must not knowingly participate or assist in a violation of laws.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard I(A)

Question
7 of 240

In order to provide investors with a more comprehensive view of a firm's performance, the current GIPS standards includes new provisions related to:

	the unique characteristics of each asset class.
	various measures of risk.
	all aspects of performance measurement.

Question not answered

Historically, the GIPS standards focused primarily on returns. In the spirit of fair representation and full disclosure, and in order to provide investors with a more comprehensive view of a firm's performance, the current GIPS standards includes new provisions related to risk.

CFA Level I
"The GIPS Standards," CFA Institute

Section: Overview

Question
8 of 240
For firms to claim compliance with the GIPS standards they *most likely* must:

	increase the consistency and quality of the firm's compliant presentations.
	hire an independent third party to test a sample of their composites.
	take responsibility for their claim of compliance and maintaining that compliance.

Question not answered
Firms claiming compliance with the GIPS standards are responsible for their claim of compliance and for maintaining that compliance. That is, firms self-regulate their claim of compliance.

CFA Level I
"Introduction to the Global Investment Performance Standards (GIPS)," CFA Institute
Section: V. Verification

Question
9 of 240
Umi Grabbo, CFA, is a highly regarded portfolio manager for Atlantic Advisors, a mid-sized mutual fund firm investing in domestic securities. She has watched the hedge fund boom and on numerous occasions suggested her firm creates such a fund. Senior management has refused to commit resources to hedge funds. Attracted by potential higher fees associated with hedge funds, Grabbo and several other employees begin development of their own hedge fund to invest in international securities. Grabbo and her colleagues are careful to work on the fund development only on their own time. Because Atlantic management thinks hedge funds are a fad, she does not inform her supervisor about the hedge fund creation. According to the *Standards of Practice Handbook*, Grabbo should *most likely* address which one of the Codes and Standards immediately?

	Disclosure of Conflicts
	Additional Compensation Arrangements
	Priority of Transactions

Question not answered
According to Standard VI(A) Disclosure of Conflicts, Grabbo should disclose to her employer her hedge fund development because this activity could possibly interfere with her responsibilities at Atlantic. In setting up a hedge fund, Grabbo was not acting for the benefit of her employer. She should have informed Atlantic she wanted to organize the hedge fund and come to some mutual agreement on how this process would occur.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard IV(B), Standard VI(A), Standard VI(B)

Question
10 of 240
According to the GIPS standards a verification report confirms all of the following *except* whether:

	specific composite presentations are accurate.

	processes and procedures are designed to calculate and present compliant performance results.
	a firm has complied with all firm-wide composite construction requirements.

Question not answered
GIPS verification does not ensure the accuracy of any specific composite presentations.

CFA Level I
“Introduction to the Global Investment Performance Standards (GIPS),” CFA Institute
Section V–Verification

Question
11 of 240
Hui Chen, CFA, develops marketing materials for an investment fund he founded three years ago. The materials show the three-year, two-year and one-year returns for the fund. He includes a footnote that states in small print "Past performance does not guarantee future returns." He does not claim compliance with the GIPS standards in the disclosures or footnotes. He also includes a separate sheet showing the fund's most recent semiannual and quarterly returns, which notes that those returns have been neither audited nor verified. Has Chen *most likely* violated any Codes and Standards?

	Yes, because he did not adhere to the Global Investment Performance Standards
	No
	Yes, because he included unaudited and unverified results

Question not answered
The Standards require members to make reasonable efforts to make sure performance information is fair, accurate, and complete. The Standards do not require compliance with the (GIPS) standards, auditing, or verification requirements. See Standard III(D).

CFA Level I
"Guidance for Standards I-VII," CFA Institute

Question
12 of 240
In cases where applicable local laws governing calculation and presentation of investment performance conflict with the GIPS standards, firms are:

	required to calculate and maintain two sets of performance data in order to claim GIPS compliance.
	required to comply with local regulations and make full disclosure of the conflict to claim GIPS compliance.
	unable to claim GIPS compliance in cases where local regulations prohibit accurate calculation.

Question not answered

In cases where applicable local laws governing calculation and presentation of investment performance conflict with the GIPS standards, firms must comply with local regulations and fully disclose the conflict in the compliant presentation.

CFA Level I
"Global Investment Performance Standards (GIPS)," CFA Institute
Section 4.A.22

Question
13 of 240

Kam Bergeron, CFA, is an equity portfolio manager who often takes time off in the afternoon to play golf with important clients. Today, Bergeron is on the golf course when his game is interrupted by a phone call from his office. The call is from Bergeron's assistant, who notifies him of a steep and accelerating market decline. Bergeron, eager to get back to his golf game, tells his assistant to raise cash by selling 15% of all clients' holdings. Bergeron instructs his assistant to first sell the most liquid stocks in each client's portfolio and then do the same for his personal account. Bergeron is *least likely* in violation of which of the CFA Institute Standards of Professional Conduct?

	Suitability
	Diligence and Reasonable Basis
	Priority of Transactions

Question not answered

The manager gives instructions to sell his personal holdings after those of his clients so there is no indication a violation of Standard VI(B)–Priority of Transactions occurred.

CFA Level I
"Guidance for Standards I–VII"
Standard III(C)–Suitability, Standard V(A)–Diligence and Reasonable Basis, Standard VI(B)–Priority of Transactions

Question
14 of 240

Heidi Katz is a CFA candidate and an analyst at a pension consulting firm. Her father is a major shareholder and managing director at Saturn Partners, a large hedge fund. When assisting in an alternative manager search for a pension client, Katz plans to recommend Saturn's market-neutral strategy because she believes it meets all of the pension plan's criteria. Given this situation, the best course of action for Katz is to:

	disclose the potential conflict to her employer and follow their guidance regarding disclosure of her relationship to the client.
	disclose the potential conflict to the pension client when discussing this recommendation.
	not present this strategy to the client and recommend another strategy.

Question not answered

Standard VI (A) requires disclosure of conflicts but does not prohibit members from making recommendations as long at the potential conflicts are appropriately disclosed.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard IV(A)

Question
15 of 240
Bob White is a new CFA charterholder, and he is updating his resume and company biography to reflect this accomplishment. In his bio, he states that he successfully passed all three CFA exams in three consecutive years. On his resume, he adds the following line: "CFA, 2013, CFA Society of Pittsburgh". Are his bio or his resume in violation of the standards regarding referencing the CFA designation and program?

	Yes, both his bio and his resume are in violation of the Standards
	Yes, his resume is incorrect
	No

Question not answered
His resume should read CFA, 2013, CFA Institute. The resume is incorrect because it lists the CFA Society of Pittsburgh instead of CFA Institute as the organization associated with the CFA designation.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard VII(B)

Question
16 of 240
Alexander Newton, CFA, is the chief compliance officer for Mills Investment Limited. Newton institutes a new policy requiring the pro rata distribution of new security issues to all established discretionary accounts for which the new issues are appropriate. The policy also provides for the exclusion of newly established discretionary accounts from the distribution until they have reached their one-month anniversary date. This policy is disclosed to all existing and potential clients. Did Newton *most likely* violate any CFA Institute Standards of Professional Conduct?

	No, because the allocation policy is not inequitable under the standards
	No, because the policy has been adequately disclosed to all existing and potential clients
	Yes

Question not answered
Under Standard III(B)-Fair Dealing, members and candidates should disclose to clients and prospective clients how they select accounts to participate in and how they determine the amount of securities each account will buy or sell. Trade allocation procedures must be fair and equitable, and disclosure of inequitable allocation methods does not relieve the member or candidate of this obligation. All discretionary accounts should be treated in the same manner. Treating newer accounts differently would be considered inequitable regardlessof whether this policy is disclosed.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard III(B)

Question
17 of 240
William Wong, CFA, is an equity analyst with Hayswick Securities. On the basis of his fundamental analysis, Wong concludes that the stock of a company he follows, Nolvec Inc., is substantially undervalued and will experience a large price increase. He delays revising his recommendation on

the stock from "hold" to "buy" to allow his brother to buy shares at the current price. Wong is *least likely* to have violated the CFA Institute Standards of Professional Conduct related to:

	priority of transactions.
	duty to clients.
	reasonable basis.

Question not answered

There is nothing to suggest that Wong does not have a reasonable basis for his conclusion related to Nolvec, as required by Standard V(A).

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard III(A), Standard VI(B), Standard V(A)

Question
18 of 240

Andrew Smith, CFA, works for Granite, a commercial bank that also has a sizable sell-side research division. Smith is presenting financing solutions to a potential business client, Dynamic Materials Corp. As part of his presentation, Smith mentions that Granite will initiate research coverage on Dynamic. Is Smith's arrangement *most likely* appropriate with regard to the Code and Standards?

	No, because Granite cannot provide research coverage on a corporate finance client because it constitutes a violation of research independence
	Yes
	No, because Smith cannot offer to provide research coverage on a company if it becomes a corporate finance client

Question not answered

Under Standard I(B), members and candidates must protect their independence and objectivity. Agreeing to provide objective research coverage of a company does not constitute a violation of this standard, provided the analyst writing the report is free to come up with his own independent conclusion. Smith can agree to provide research coverage but cannot commit Granite's research department to providing a favorable recommendation.

CFA Level I
"Guidance for Standards I-VII," CFA Institute
Standard I(B)

Question
19 of 240

Income Statement	**Millions ($)**
Revenues	9.8
Variable operating costs	7.2
Fixed operating costs	1.5
Operating income	1.1
Interest	0.6
Taxable income	0.5
Tax	0.2
Net income	0.3

The degree of operating leverage (DOL) is *closest* to:

	1.7.
	2.4.
	1.1.

Question not answered

DOL = Revenues – Variable operating costs/Revenues – Variable operating costs – Fixed operating costs

CFA Level I
"Measures of Leverage," Pamela Peterson Drake, Raj Aggarwal, Cynthia Harrington, and Adam Kobor
Section 3.3

Question
20 of 240
A company has an equity beta of 1.4 and is 60% funded with debt. Assuming a tax rate of 35%, the company's asset beta is*closest* to:

	0.98.
	1.01.
	0.71.

Question not answered
Note: 60% debt financing is equivalent to a debt-to-equity ratio of 1.50 = 0.60/(1 – 0.60).
$\beta_{Asset} = \beta_{EQ} \times \{1/[1 + (1 - t)D/E)]\} = 1.4/[1 + (1 - 0.35) \times 1.5] = 0.7089$.

CFA Level I
"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 4.1

Question
21 of 240
The acceptance of which of the following capital budgeting projects is *most likely* to expose a company to the highest level of uncertainty?

	Replacement of worn out equipment
	Expansion projects
	Newly launched product or services

Question not answered
Investments related to new products or services expose the company to even more uncertainties than expansion projects. These decisions are more complex and will involve more people in the decision- making process.

CFA Level I
"Capital Budgeting," John D. Stowe, and Jacques R. Gagne
Section 2

Question
22 of 240
The following information is available for a firm:

Revenue	£800,000

Variable cost	400,000
Fixed cost	200,000
Operating income	200,000
Interest	60,000
Net income	140,000

The firm's degree of total leverage (DTL) is *closest* to:

	1.43.
	2.86.
	2.00.

Question not answered

DTL = Revenue – Variable cost/Net income = £800,000 – £400,000/£140,000 = 2.86.

CFA Level I
"Measures of Leverage," Pamela Peterson Drake, Raj Aggarwal, Cynthia Harrington, and Adam Kobor
Section 3.5

Question
23 of 240
Business risk *most likely* incorporates operating risk and:

	financial risk.
	interest rate risk.
	sales risk.

Question not answered

Business risk is the combination of sales risk and operating risk.

CFA Level I
"Measures of Leverage," Pamela Peterson Drake, Raj Aggarwal, Cynthia Harrington, and Adam Kobor
Sections 3.1, 3.2

Question
24 of 240
Using the debt-rating approach to find the cost of debt is *most* appropriate when market prices for a company's debt are:

	below par value.
	stable.
	unreliable.

Question not answered

Question
25 of 240
The optimal capital budget for a firm is *best* described as occurring when the company's marginal cost of capital is:

	less than the investment opportunity schedule.
	greater than the investment opportunity schedule.
	equal to the investment opportunity schedule.

Question not answered

The optimal capital budget occurs when the marginal cost of capital (MCC) intersects with (is equal to) the investment opportunity schedule (IOS).

CFA Level I
"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 2.3

Question
26 of 240
The cost of which source of capital *most likely* requires adjustment for taxes in the calculation of a firm's weighted average cost of capital?

	Bonds
	Preferred stock
	Common Stock

Question not answered
Bonds are a form of debt that must be adjusted for taxes when calculating the weighted average cost of capital.

CFA Level I
"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 2.1

Question
27 of 240
A company has 100 million shares outstanding. The share price of a company's stock is £15 just prior to announcing a £100 million expansionary investment in a new plant and estimates that the present value of future after-tax cash flows will be £150 million. Analysts, however, estimate the new plant's profitability will be lower than the company's expectations. The company's stock price will *most likely*:

	drop below £15 per share due to the cannibalization of revenue from the new plant.
	increase by the new plant's net present value per share.
	increase by less than £0.50 per share.

Question not answered
The value of a company is the value of its existing investments plus the net present values of all of its future investments. The NPV of this new plant is £150 million - £100 million = £50 million. The price per share should increase by NPV per share or £50 million ÷ 100 million shares = £0.50 per share. As the new plant's profitability is less than expectations, the NPV per share (and hence the increase in the stock price) should therefore be slightly below £0.50 per share.

CFA Level I
"Capital Budgeting," John D. Stowe, and Jacques R. Gagné
Section 4.10

Question
28 of 240

The diagram to the right shows the domestic demand and supply curves for a country which imports a commodity, where P_W is its world price and P_T is its domestic price after the imposition of a tariff. The reduction in the net national welfare of this country as a result of the tariff is *best*described by the area(s):	

	F+H.
	E.
	G.

Question not answered
The loss in consumer surplus because of higher prices is represented by area E+F+G+H. This exceeds the gains from producer surplus (E) and government revenues on imports (G). Hence the net welfare effect to the country is a deadweight loss of [E+F+G+H] – [E] – [G] = **F+H.**

CFA Level 1
“Demand and Supply Analysis: Introduction,” Richard V. Eastin and Gary L. Arbogast, CFA
Sections 3.9, 3.10, 3.13

“International Trade and Capital Flows,” Usha Nair-Reichert, PhD, and Daniel Robert Witschi, PhD, CFA
Section 3.1

Question
29 of 240
Which of the following statements with respect to Giffen and Veblen goods is *least* accurate?

	Giffen goods are "inferior," whereas Veblen goods are "high-status" goods.
	Both types of goods demonstrate the possibility of a positively sloping demand curve.
	Both types of goods violate the fundamental axioms of demand theory.

Question not answered
Veblen goods violate the fundamental axioms of demand theory, whereas Giffen goods do not.

CFA Level I

"Demand and Supply Analysis: Consumer Demand," Richard V. Eastin and Gary L. Arbogast

Sections 6.4, 6.5

Question
30 of 240
Holding the working-age population constant, if the labor force participation rate declines while the number of people employed remains unchanged, the unemployment rate will *most likely*:

	remain unchanged.

	decrease.
	increase.

Question not answered

For a given working-age population, a decline in the labor force participation rate (often caused by an increase in discouraged workers) reduces the labor force. If the number of people employed remains the same while the labor force becomes smaller, the number of workers defined to be unemployed must be smaller and thus the unemployment rate lower.

The following example illustrates the direction of change:		
	Initial Case	**After Change**
Working-age population	100	100
Labor force = Employed + Unemployed	60 + 20 = 80	60 + 15 = 75
Labor force participation rate	80%	75%
Unemployment rate	20/80 = 25%	15/75 = 20%
Labor force participation rate = Labor force/Working age population		
Unemployment rate = Unemployed/Labor force		

CFA Level I

“Understanding Business Cycles,” Michele Gambera, Milton Ezrati, and Bolong Cao

Section 4.1

Question
31 of 240

Over a given period, the price of a commodity falls by 5.0%, and the quantity demanded rises by 7.5%. The price elasticity of demand for the commodity is *best* described as:

	perfectly elastic.
	inelastic.
	elastic.

Question not answered

If demand is elastic, a 1% reduction in price increases the quantity sold by more than 1%.

CFA Level I

"Demand and Supply Analysis: Introduction," Richard V. Eastin and Gary L. Arbogast

Section 4.1

Question
32 of 240

Which of the following measures of profit is *most likely* necessary for a firm to stay in business in the long run?

	Normal
	Accounting
	Economic

Question not answered

Normal profit is the level of accounting profit needed to just cover the implicit opportunity costs ignored in accounting costs. This profit is all that a firm needs to earn in the long run to remain in business. Failing to earn normal profits over the long run has a debilitating impact on the firm's ability to access capital and to function properly as a business enterprise. Economic profit (also known as abnormal or supernormal profit) is accounting profits in excess of implicit opportunity costs.

CFA Level I

"Demand and Supply Analysis: The Firm," Gary L. Arbogast and Richard V. Eastin

Section 2.2

Question
33 of 240

A firm in a perfectly competitive environment has its total costs equal to total revenue and marginal costs greater than marginal revenue. Given this, which of the following strategies is *most* appropriate? The firm should:

	increase its level of production to enter profit territory.
	decrease its level of production to enter profit territory.
	shut down in the short run and exit in the long run.

Question not answered

A firm in a perfectly competitive environment with total costs equal to total revenue and marginal costs greater than marginal revenue is operating at the upper breakeven point. Therefore, it should decrease the level of production to enter profit territory.

CFA Level I

"Demand and Supply Analysis: The Firm," Gary L. Arbogast and Richard V. Eastin

Section 3.1.4

Question
34 of 240

The following international trade information is available for a hypothetical economy:

	Exports	**Imports**
Initial Value (DCU)	4,800	6,500
Demand elasticity	0.70	0.55
DCU: domestic currency units		

Following a 12% depreciation in the DCU, the trade balance will be *closest* to:

	–1,648.
	–1,726.
	–1,674.

Question not answered

Impact on Trade Balance	
Total Trade = Exports + Imports = 4,800 + 6,500 = 11,300	
ω_x = share of exports = 4,800 ÷ 11,300 = 0.425	ω_m = share of imports = 6,500 ÷11,300 = 0.575

ϵ_{ML} = Marshall-Lerner trade weighted elasticity	$\epsilon_{ML} = \omega_X \epsilon_X + \omega_m (\epsilon_m - 1)$ $= (0.425 \times 0.70) + 0.575 \times (0.55 - 1)$ = **0.039**

Change in Trade Balance using Marshall-Lerner trade weighted elasticity: ϵ_{ML} × Trade Balance × Depreciation = 0.039 × 11,300 × 0.12 = **52.5**
New trade balance = 4,800 – 6,500 + 52.5 = **-1,647.5 = -1,648**
Since the Marshall-Lerner condition >0, depreciation will reduce the trade deficit.
Alternatively, the change in the trade balance can be calculated from % changes in imports and exports:

Decrease in imports:	- (12% × (1 – 0.55) × 6,500) =	-351.0
Increase in exports:	12% × 0.70 × 4,800 =	403.2
Difference		**52.2**
Change in trade balance	4,800 – 6,500 + 52.2 =	**-1,648** (rounded)

CFA Level I

"Demand and Supply Analysis: Introduction," Richard V. Eastin and Gary L. Arbogast

Section 4.2

"The Firm and Market Structures," Richard G. Fritz and Michele Gambera

Section 3.1.1

"Currency Exchange Rates," William A. Barker, Paul D. McNelis, and Jerry Nickelsburg

Section 5.1

Question
35 of 240

The supply curve for a particular factor of production with total income consisting solely of economic rent is *most likely*:

	vertical.
	perfectly elastic.
	horizontal.

Question not answered

When the total income of a factor of production consists solely of economic rent, it indicates that the factor has perfectly inelastic supply. For perfectly inelastic supply, the supply curve is a vertical line.

CFA Level I

"Demand and Supply Analysis: The Firm," Gary L. Arbogast, and Richard V. Eastin

Section 2.1.3

Question
36 of 240

A household has a total monthly budget of $110 to spend on chicken and lamb. Per kilogram, the price of chicken is $7.50 and the price of lamb is $10. The quantity of chicken consumed is 35% less than that for lamb. The quantity of chicken (in kilograms) consumed by the household in a month is *closest* to:

	4.8 kg.
	2.6 kg.
	5.1 kg.

Question not answered

The formula for the budget constraint is given by:

$P_{chicken} \times Q_{chicken} + P_{lamb} \times Q_{lamb} = \text{Income}$

$7.5 \times 0.65Q_{lamb} + 10 \times Q_{lamb} = 110$

$14.875 \times Q_{lamb} = 110$

$Q_{lamb} = 7.39$ kilograms; $Q_{chicken} = 0.65Q_{lamb} = 4.81$ kilograms.

CFA Level I

"Demand and Supply Analysis: Consumer Demand," Richard V. Eastin and Gary L. Arbogast

Section 4.1

Question
37 of 240

A local laundry and dry cleaner collects the following data on its workforce productivity. Workers always work in teams of two, and the laundry and dry cleaner earns $3.00 of revenue for each shirt laundered.

Quantity of Labor (L) (workers)	**Total Product (TP) (shirts laundered per hour)**
0	0
2	20
4	36
6	50
8	62

The marginal revenue product (MRP, $ per worker) for hiring the fifth and sixth workers is *closest* to:

	$42.
	$21.
	$14.

Question not answered

Marginal Product (MP) is the amount of additional output resulting from using one more unit of input: ΔTP/ΔL, where ΔTP is the change in total product and ΔL is the change in total labor. Marginal revenue product is the marginal product of an input times the price of the product: MP × Price = ΔTP/ΔL × Price. In this problem, the marginal product of hiring the fifth and sixth workers (ΔL = 2) is 14 shirts per hour/2 workers = 7 shirts per hour/worker. With each shirt resulting in $3 of revenue, the MRP is 7 shirts per hour/worker × $3/shirt = $21 per worker.

CFA Level I

"Demand and Supply Analysis: The Firm," Gary L. Arbogast and Richard V. Eastin

Section 3.2.1

Question

38 of 240

According to the Fisher effect, an increase in expected inflation will *most likely* increase:

	both nominal and real interest rates.
	the nominal interest rate.
	the real interest rate.

Question not answered

The Fisher effect states that the nominal interest rate is the sum of the real rate of interest and the expected rate of inflation over a given time horizon. An increase in expected inflation will result in a higher nominal rate.

CFA Level I

“Monetary and Fiscal Policy,” Andrew Clare and Stephen Thomas

Section 2.1.7

Question

39 of 240

A small country has a comparative advantage in the production of pencils. The government establishes an export subsidy for pencils to promote economic growth. Which of the following will be the *most likely* result of this policy?

	The increase in the domestic producer surplus will exceed the sum of the subsidy and the decrease in the domestic consumer surplus.
	Although domestic producers will receive a net benefit, the policy will give rise to inefficiencies that cause a deadweight loss to the national welfare.
	As new domestic producers enter the pencils market, supply will increase and domestic prices will decline.

Question not answered

Export subsidies interfere with the functioning of the free market and result in a deadweight loss to society. The deadweight loss arises on the producer side because the higher subsidized price causes inefficient producers to remain in the market. On the consumer side, the higher price causes those that would have purchased at the lower price to be shut out of the market.

CFA Level I

“International Trade and Capital Flows,” Usha Nair-Reichert and Daniel Robert Witschi

Section 3.3

Question

40 of 240

The convergence of global accounting standards has advanced to a degree that the Securities & Exchange Commission in the United States now mandates that foreign private issuers who use IFRS may report under:

	U.S. GAAP with voluntary supplemental reporting under IFRS.
	U.S. GAAP or under IFRS.

	U.S. GAAP or under IFRS with a reconciliation to U.S. GAAP.

Question not answered

Historically, the Securities & Exchange Commission required reconciliation for foreign private issuers that did not prepare financial statements in accordance with U.S. GAAP. However the reconciliation requirement was eliminated as of 2008 for companies that prepared their financial statements under IFRS.

CFA Level I

"Financial Reporting Standards," Elaine Henry, Jan Hendrik van Greuning and Thomas R. Robinson

Sections 4, 7

Question
41 of 240

In a period of rising prices, when compared with a company that uses weighted average cost for inventory, a company using FIFO will *most likely* report higher values for its:

	debt-to-equity ratio.
	return on sales.
	inventory turnover.

Question not answered

In periods of rising prices, FIFO results in a higher inventory value and a lower cost of goods sold and thus a higher net income. The higher net income increases return on sales. The higher reported net income also increases retained earnings and thus results in a lower debt-to-equity ratio, not a higher one. The combination of higher inventory and lower cost of goods sold (CGS) decreases inventory turnover (CGS/Inventory).

CFA Level I
“Inventories,” Michael A. Broihahn
Sections 3.2, 3.3, 3.5, 3.7

Question
42 of 240

The following data is available on a company:

Metric	**($ millions)**
Total assets	145
Total revenues	282
Total expenses	241
Research & development expenses	12

Under a common-size analysis, the value used for research & development expenses is *closest* to:

	4.2%.
	8.3%.
	5.0%.

Question not answered

The appropriate base for a common-size income statement is revenue. As such, the value used for research & development expenses is $12 million÷$282 million x 100 = 4.25%.

CFA Level I

"Understanding Income Statements," Elaine Henry and Thomas R. Robinson

Section 7.1

Question
43 of 240
Which of the following statements is *most* accurate?

	Accrued revenue arises when a company receives cash prior to earning the revenue.
	Accrued expenses arise when a company incurs expenses that have not yet been paid as of the end of the accounting period.
	A valuation adjustment for an asset converts its historical cost to its depreciated value.

Question not answered
The statement about accrued expenses is correct. A valuation adjustment for an asset converts its historical cost to current market value; accrued revenue arises when revenue has been earned but not yet received.

CFA Level I

"Financial Reporting Mechanics," Thomas R. Robinson, Jan Hendrik van Greuning, Karen O'Connor Rubsam, Elaine Henry, and Michael A. Broihahn

Section 5.1

Question
44 of 240
Notes to financial statements *most likely* include:

	a discussion of significant trends, events and uncertainties that affect the operating results.
	an auditor's opinion as to the fair presentation of the financial statements.
	supplementary information about accounting policies, methods and estimates.

Question not answered
The notes disclose information about the accounting policies, methods, and estimates used to prepare the financial statements.

CFA Level I
"Financial Statement Analysis: An Introduction," Elaine Henry and Thomas R. Robinson
Section 3.1.5

Question
45 of 240
A company that prepares its financial statements in accordance with International Financial Reporting Standards (IFRS) is attempting to produce lighter and longer-lasting batteries for portable electronic devices. The *most* appropriate accounting treatment for the related costs incurred in this project is to:

	capitalize costs directly related to the development.
	expense costs until technical feasibility has been established.
	expense them as incurred.

Question not answered
Under IFRS, research and development costs are expensed until certain criteria are met, including that technical feasibility has been established and the company intends to use the developed product.

CFA Level I
"Long-Lived Assets," Elaine Henry and Elizabeth A. Gordon
Section 2.2.2

Question
46 of 240
An analyst has compiled the following information on a company:

		£ thousands
Beginning of the year values		
	Share capital	2,000
	Retained earnings	8,850
During the year		
	Revenues	12,000
	Total expenses	10,150
	Proceeds from shares issued	500
End of year values		
	Total current assets	9,200
	Total non-current assets	12,750
	Investments	350
	Total liabilities	9,400

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

	300.
	650.
	150.

Question not answered

Total assets = Current assets + Non-current assets = 9,200 + 12,750	Total assets = £21,950 thousand
Assets = Liabilities + Equity 21,950 = 9,400 + Equity	Equity = £12,550 thousand
Equity = Share capital + Retained earnings 12,550 = (2,000 +500) + Retained earnings	Retained earnings = £10,050 thousand
Retained earnings = Beginning retained earnings + Net income – Dividends 10,050 = 8,850 + (12,000 – 10,150) – Dividends	Dividends = £650 thousand

CFA Level I
"Financial Reporting Mechanics," Thomas R. Robinson, Jan Hendrik van Greuning, Karen O'Connor Rubsam, Elaine Henry, and Michael A. Broihahn

Sections 3.2, 4.2

Question
47 of 240
Interim reports *most likely*:

	include a full set of financial statements and notes.
	are audited.
	are issued semi-annually or quarterly.

Question not answered
Interim reports are provided semi-annually or quarterly, depending on applicable regulatory requirements.

CFA Level I

"Financial Statement Analysis: An Introduction," Elaine Henry and Thomas R. Robinson

Section 3.2

Question
48 of 240
The following information is available on a company for the current year.

Net income	$1,000,000
Average number of common shares outstanding	100,000
Details of convertible securities outstanding:	
Convertible preferred shares outstanding	2,000
o Dividend/share	$10
o Each preferred share is convertible into five shares of common stock	
Convertible bonds, $100 face value per bond	$80,000
o 8% coupon	
o Each bond is convertible into 25 shares of common stock	
Corporate tax rate	40%

The company's diluted EPS is *closest* to:

	$7.72.
	$7.69.
	$7.57.

Question not answered
Because both the preferred shares and the bonds are dilutive, they should both be converted to calculate the diluted EPS. Diluted EPS is the lowest possible value.

	Basic EPS	**Diluted EPS: Bond Converted**	**Diluted EPS: Preferred Converted**	**Diluted EPS: Both Converted**
Net income	$1,000,000	$1,000,000	$1,000,000	$1,000,000

Preferred dividends	–$20,000	–$20,000	0	0
After-tax cost of interest 8% × $80,000 × (1 – 0.40)		$3,840		$3,840
Numerator	$980,000	$983,840	$1,000,000	$1,003,840
Average common shares outstanding	100,000	100,000	100,000	100,000
Preferred converted			10,000	10,000
Bond converted		20,000		20,000
Denominator	100,000	120,000	110,000	130,000
EPS	$9.80	$8.20	$9.09	$7.72

CFA Level I
"Understanding Income Statements," Elaine Henry and Thomas R. Robinson
Sections 6.2, 6.3

Question
49 of 240
Which of the following statements *best* describes a trial balance? A trial balance is a document or computer file that:

	shows all business transactions by account.
	contains all business transactions recorded in the order in which they occur.
	lists all account balances at a particular point in time.

Question not answered
A trial balance is a document that lists account balances at a particular point in time.

CFA Level I

"Financial Reporting Mechanics," Thomas R. Robinson, Jan Hendrik van Greuning, Karen O'Connor Rubsam, Elaine Henry, and Michael A. Broihahn

Section 6

Question
50 of 240
The *least likely* reason thata security analyst needs to understand the accounting process is to:

	aid in the assessment of management's judgment in accruals and valuations.
	prevent earnings manipulation by management.
	make adjustments to reflect items not reported in the financial statements.

Question not answered
Understanding the accounting process may assist an analyst in identifying earnings manipulation,

but it will not prevent the manipulation of earnings by management. It is important for an analyst to understand the accounting process so that they can make adjustments for items not reported and aid in the assessment of management's judgment of accruals and valuations.

CFA Level I

"Financial Reporting Mechanics," Thomas R. Robinson, Jan Hendrik van Greuning, Karen O'Connor Rubsam, Elaine Henry, and Michael A. Broihahn

Section 7

Question
51 of 240

According to the International Financial Reporting Standards (IFRS), which of the following conditions *should* be satisfied to report revenue from the sale of goods on the income statement?

	Goods have been delivered to the customer.
	Payment has been received.
	Costs can be reliably measured.

Question not answered

The IFRS conditions that should be met to recognize revenue from the sale of goods include that the costs incurred can be reliably measured, that the economic benefits will flow to the entity, and that the significant risks and rewards of ownership have been transferred, which is normally when the goods have been delivered but not always. The actual receipt of any payment is not a condition.

CFA Level I

"Understanding Income Statements," Elaine Henry and Thomas R. Robinson

Section 3.1

Question
52 of 240

The following information is available on a retailer:

Summarized Income Statement	**$ 000s**
Revenues	17,210
Cost of goods sold	9,283
Salary and wage expense	2,981
Rent expense	1,275
Depreciation expense	761
Income tax expense	823
Net income	2,087
Partial Cash Flow Statement	**$ 000s**
Operating cash flows	
Net income	2,087
Add: non-cash items	
Depreciation expense	761
Increase in accounts receivable	(123)
Increase in inventory	511
Decrease in prepaid expenses	(37)
Decrease in accounts payable	(190)
Increase in wages payable	133

Operating cash flows	3,142

An analyst is converting the cash flow statement to the direct method. The amount (in $ 000s) that she calculates for "Cash paid to suppliers" is *closest* to:

	9,984.
	11,222.
	8,582.

Question not answered

Metric	**$ 000s**
Cost of goods sold	$ 9,283
Add: increase in inventory	511
Equals purchases from suppliers	9,794
Add: decrease in accounts payable	190
Cash paid to suppliers	**$9,984**

CFA Level I

"Understanding Cash Flow Statements," Elaine Henry, Thomas R. Robinson, Jan Hendrik van Greuning , and Michael A. Broihahn

Sections 3.2.1.2, 3.3

Question
53 of 240

At the start of the year a company that uses U.S. GAAP entered a contract to design and build a bridge with the following terms:

Contract length	3 years
Fixed contract price	$40 million
Estimated contract cost	$32 million
Costs incurred in first year	$12 million

The company was initially quite certain about its cost estimates and intended to recognize revenue based on them. However, unexpected problems during the first year have caused engineers to suggest that a more expensive design may be required, costing up to $8 million more. If the appropriate design cannot be determined before the company's financial statements are issued, the difference in the amount of revenue the company would recognize is *closest* to:

	$15 million.
	$ 0.
	$ 3 million.

Question not answered

U.S. GAAP requires that long term contracts whose outcomes can be reliably measured should be accounted for using the percentage-of-completion method, based on the stage of completion. Under the original assumptions, the company would have recognized $15 million of revenue.

Calculations Under the Percentage-of-Completion Method	
Costs incurred to date	$12 million
Estimated total costs	$32 million
% total costs incurred to date	37.5%
Total contract revenue	$40 million
% revenue to be recognized	37.5%
Current year revenue	$15 million

Now that the company is unclear on the appropriate design and thus the cost, the outcome cannot be reliably measured. The completed contract method is used. Under this approach, no revenue ($ 0) is recognized until the contract is substantially complete. The difference in reported revenue under the two methods is: $15 million - $0 = $15 million.

CFA Level I

"Understanding Income Statements," Elaine Henry and Thomas R. Robinson

Section 3.2.1

Question
54 of 240

In 2013, a software company recorded unearned revenue related to a software license that it will recognize as revenue during 2014. Ignoring income taxes, the recognition of the software revenue in 2014 will *most likely* result in 2014 cash from operations being:

	higher.
	unchanged.
	lower.

Question not answered

The company received the cash in 2013 when it recorded the unearned revenue, and it increased cash from operations in that year. In 2014, the revenue is earned, but there is no cash exchanged and thus no effect on the cash from operations, ignoring taxes.

CFA Level I

"Financial Reporting Mechanics," Thomas R. Robinson, Jan Hendrik van Greuning, Karen O'Connor Rubsam, Elaine Henry, and Michael A. Broihahn

Section 5.1

"Understanding Cash Flow Statements," Elaine Henry, Thomas R. Robinson, Jan Hendrik van Greuning, and Michael A. Broihahn

Sections 3.1, 3.2.5

Question
55 of 240

The non-controlling or minority interests found in the equity section of the balance sheet are *best* described as the equity interests:

	of minority shareholders of the corporation who have significant influence, but not control.
	held by the corporation in other entities which it does not control, but has significant influence.
	of minority shareholders in subsidiaries that have been consolidated.

Question not answered

Non-controlling interests found in the equity section represent the equity interests of minority shareholders in non-wholly-owned subsidiaries that have been consolidated.

CFA Level I

"Understanding Balance Sheets," Elaine Henry and Thomas R. Robinson

Section 6.1

Question
56 of 240
Which of the following is *least likely* to be a general feature underlying the preparation of financial statements within the International Financial Reporting Standards (IFRS) Conceptual Framework?

	Materiality
	Accrual basis
	Matching

Question not answered
The IFRS Conceptual Framework specifies a number of general features underlying the preparation of financial statements, including materiality and accrual basis. Matching is not one of those general features; it is a general principle of expense recognition.

CFA Level I

"Financial Reporting Standards," Elaine Henry, Jan Hendrik van Greuning, and Thomas R. Robinson

Sections 5.5, 5.5.2

"Understanding Income Statements," Elaine Henry and Thomas R. Robinson

Section 4.1

Question
57 of 240
Which of the following is *best* described as a necessary characteristic for an effective financial reporting framework?

	Consistency in the measurement basis used across the balance sheet
	Uniform treatment of transactions by different entities
	Transparency to the underlying economics

Question not answered
An effective framework should enhance the transparency of the underlying economics through the financial statements; transparency arises through full disclosure and fair presentation.

CFA Level I

"Financial Reporting Standards," Elaine Henry, Jan Hendrik van Greuning and Thomas R. Robinson

Section 6.1

Question
58 of 240
The International Financial Reporting Standards (IFRS) Conceptual Framework identifies fundamental qualitative characteristics that make financial information useful. Which of the following is *least likely* to be one of these characteristics?

	Faithful representation
	Relevance

	Materiality

Question not answered

The two fundamental qualitative characteristics that make financial information useful are relevance and faithful representation. Materiality relates to the level of detail of the information needed to achieve relevance.

CFA Level I

"Financial Reporting Standards," Elaine Henry, Jan Hendrik van Greuning, and Thomas R. Robinson

Section 5.2

Question
59 of 240

At the start of the current year, Company A, which reports using US GAAP, sold a piece of land to Company B for $10 million. The land cost $6 million. Company B made a $2 million down payment with the remaining balance to be paid over the next five years. Over the course of the year, it has been determined that there is significant doubt about the ability and commitment of Company B to complete all payments. In the current year, Company A would *most likely* report a profit related to the sale of the land of:

	$0.8 million using the installment method.
	$2 million using the cost recovery method.
	$4 million using the accrual method.

Question not answered

Because of the uncertainty about collection of the remaining payments, it would not be appropriate to use the accrual method. Under the installment method, the portion of the total profit that is recognized in each period is determined by the percentage of the total sales price for which the seller has received cash. Company A will recognize 2/10 × $4 million = $0.8 million. Although the cost recovery method could have been used in this situation, the reported profit would be $0.

CFA Level I

"Understanding Income Statements," Elaine Henry and Thomas R. Robinson

Section 3.2

Question
60 of 240

For which of the following inventory valuation methods is the gross profit margin *least likely* to be the same under both a perpetual inventory system and a periodic inventory system?

	Specific identification
	LIFO
	FIFO

Question not answered

The periodic and perpetual systems result in the same inventory and cost of goods sold values (and thus gross profit margin) using both FIFO and specific identification valuation methods but not always under LIFO.

CFA Level I
“Inventories,” Michael A. Broihahn
Section 3.6

Question
61 of 240
Under International Financial Reporting Standards (IFRS), which of the following financial statement elements *most* accurately represents inflows of economic resources to a company?

	Revenues
	Assets
	Owners' equity

Question not answered

The financial statement elements under IFRS are assets, liabilities, owners' equity, revenue, and expenses. Revenues are inflows of economic resources. Assets are economic resources but not inflows. Equity is the residual claim on those economic resources.

CFA Level I
"Financial Reporting Mechanics," Thomas R. Robinson, Jan Hendrik van Greuning, Karen O'Connor Rubsam, Elaine Henry, and Michael A. Broihahn
Section 3

Question
62 of 240
During the year, a retailer purchases 1,000 units of inventory at £20.20 per unit. In addition, the following items relate to inventory acquisition and handling during the year.

Item Description	**£ Thousands**
Volume rebate received	404
Import and sales taxes	2,970
Transport and transport insurance costs	325
Storage costs	1,250
Warehouse administrative costs	3,300

The total costs (in thousands) that will be included in inventory are *closest* to:

	£22,766.
	£24,341.
	£23,091.

Question not answered
Inventory costs include all direct costs of acquisition including import taxes, transportation costs, and transportation insurance costs, but not storage costs or warehouse administrative costs. Volume rebates and similar items reduce the price paid and the costs of purchase.

Cost Determination	**£ Thousands**
Purchase price (1,000 × £20.20)	20,200
Volume rebate	–404
Import and sales taxes	2,970
Transport and transport insurance	325
Total costs to be inventoried	23,091

CFA Level I
“Inventories,” Michael A. Broihahn
Section 2

Question
63 of 240

Under IFRS which of the following balance sheet presentation formats is *most* acceptable? Classifying assets and liabilties:

	into operating, investing, and financing categories.
	as monetary vs. non-monetary.
	in liquidity order.

Question not answered

A liquidity-based presentation can be used when it provides information that is reliable and more relevant. Entities that typically choose this format include banks.

CFA Level I

"Understanding Balance Sheets," Elaine Henry and Thomas R. Robinson

Section 2.2, 2.3

Question
64 of 240

Monte Carlo simulation is *best* described as:

	providing a distribution of possible solutions to complex functions.
	a restrictive form of scenario analysis.
	an approach to backtest data.

Question not answered

Monte Carlo simulation provides a distribution of possible solutions to complex functions. The central tendency and the variance of the distribution of solutions give important clues to decision makers regarding expected results and risk.

CFA Level I

"Common Probability Distributions," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 4

Question
65 of 240

The belief that trends and patterns tend to repeat themselves and are, therefore, somewhat predictable *best* describes:

	technical analysis.
	arbitrage pricing theory.
	weak-form efficiency.

Question not answered

Technical analysts believe that trends and patterns tend to repeat themselves and are, therefore, somewhat predictable.

CFA Level I
"Technical Analysis," Barry M. Sine and Robert A. Strong
Section 2.1

Question
66 of 240

Cumulative Probabilities for a Standard Normal Distribution $P(Z \le x) = N(x)$ for $x \ge 0$ or $P(Z \le z) = N(z)$ for $z \ge 0$										
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
…										
1.90	0.9713	0.9719	0.9726	0.9732	0.9738	0.9744	0.9750	0.9756	0.9761	0.9767
2.00	0.9772	0.9778	0.9783	0.9788	0.9793	0.9798	0.9803	0.9808	0.9812	0.9817
2.10	0.9821	0.9826	0.9830	0.9834	0.9838	0.9842	0.9846	0.9850	0.9854	0.9857
…										
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

A variable is normally distributed with a mean of 5.00 and a variance of 4.00. Using the excerpt above from the cumulative distribution function for the standard normal random variable table, the probability of observing a value of –0.40 or less is *closest*to:

	0.35%.
	8.85%.
	2.44%.

Question not answered

First the outcome of interest, –0.40, is standardized for the given normal distribution:

Z = (*X* – μ)/σ = (–0.40 – 5.00)/2 = –2.70.

Then use the table to find the probability of a *Z* value being 2.70 standard deviations *below* the mean (i.e., when *z* ≤ 0). The value is 1 – *P*(*Z* ≤ +2.70). In this problem, the solution is: 1 – 0.9965 = 0.0035 = 0.35%.

CFA Level I

"Common Probability Distributions," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 3.2

Question
67 of 240

The null hypothesis is *most likely* to be rejected when the *p*-value of the test statistic:

	falls below a specified level of significance.
	is negative.
	exceeds a specified level of significance.

Question not answered

If the *p*-value is less than the specified level of significance, the null hypothesis is rejected.

CFA Level I
"Hypothesis Testing," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 2

Question
68 of 240

Over the past four years, a portfolio experienced returns of –8%, 4%, 17%, and –12%. The geometric mean return of the portfolio over the four-year period is *closest* to:

	0.99%.
	–0.37%.
	0.25%.

Question not answered

Add one to each of the given returns, then multiply them together and take the fourth root of the resulting product. 0.92 × 1.04 × 1.17 × 0.88 = 0.985121; 0.985121 raised to the 0.25 power is 0.996259. Subtracting one and multiplying by 100 gives the correct geometric mean return: $[(0.92 \times 1.04 \times 1.17 \times 0.88)^{0.25} - 1] \times 100 = -0.37\%$.

CFA Level I
"Statistical Concepts and Market Returns," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 5.4.2

Question
69 of 240

Based on historical returns, a portfolio has a Sharpe ratio of 2.0. If the mean return to the portfolio is 20%, and the mean return to a risk-free asset is 4%, the standard deviation of return on the portfolio is *closest* to:

	8%.
	12%.
	10%.

Question not answered

CFA Level I

"Statistical Concepts and Market Returns," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 7.8

Question
70 of 240

The minimum rate of return an investor must receive in order to accept an investment is *best* described as the:

	expected return.

	internal rate of return.
	required rate of return.

Question not answered

The required rate of return is the minimum rate of return an investor must receive in order to accept an investment.

CFA Level I

"The Time Value of Money," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 2

Question
71 of 240

In generating an estimate of a population parameter, a larger sample size is *most likely* to improve the estimator's:

	unbiasedness.
	efficiency.
	consistency.

Question not answered

A consistent estimator is one for which the probability of estimates close to the value of the population parameter increases as the sample size increases. Unbiasedness and efficiency are properties of an estimator's sampling distribution that hold for any size sample.

CFA Level I
"Sampling and Estimation," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 4.1

Question
72 of 240

A portfolio provides the following returns over a five-year period.

Year	1	2	3	4	5
Return	10%	–25%	8%	5%	7%

The compound rate of return of the portfolio across the five-year period is *closest* to:

	0.02%.
	1.00%.
	–9.31%.

Question not answered

The geometric mean return is the correct approach to calculate portfolio average returns across a period of time:

CFA Level I

"Statistical Concepts and Market Returns," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 5.4.2

Question
73 of 240

The probability of Event A is 40%. The probability of Event B is 60%. The joint probability of AB is 40%. The probability (P) that A or B occurs, or both occur, is *closest* to:

	60%.
	84%.
	40%.

Question not answered

P(A or B) = P(A) + P(B) – P(AB) = 0.40 + 0.60 – 0.40 = 0.60 or 60%.

CFA Level I
"Probability Concepts," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 2

Question
74 of 240

A discrete uniform distribution consists of the following 12 values:

–2.5	5.3	6.7	8.8	–4.6	9.2
3.3	8.2	1.4	0.8	–5.3	6.9

On a single draw from the distribution, the probability of drawing a value between –2.0 and 2.0 from the distribution is *closest* to:

	33.33%.
	27.59%.
	16.67%.

Question not answered

First order the values from smallest to largest.

–5.3	–4.6	–2.5	0.8	1.4	3.3
5.3	6.7	6.9	8.2	8.8	9.2

Then note that 2 of the 12 values (i.e., 0.8 and 1.4) are between –2.0 and 2.0. Thus, the probability of a draw from the distribution being between –2.0 and 2.0 is 2/12 = 0.16667.

CFA Level I
"Common Probability Distributions," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 2.1

Question
75 of 240

The following information applies to a portfolio composed of Fund A and Fund B:

	Fund A	Fund B
Portfolio weights (%)	70	30
Expected returns (%)	10	16
Standard deviations (%)	7	13
Correlation between the returns of Fund A and Fund B	0.80	

The portfolio's standard deviation of return is *closest* to:

	7.38%.
	8.80%.
	8.35%.

Question not answered

CFA Level I

"Probability Concepts," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 3

Question
76 of 240
An individual wants to be able to spend €80,000 per year for an anticipated 25 years in retirement. To fund this retirement account, he will make annual deposits of €6,608 at the end of each of his working years. He can earn 6% compounded annually on all investments. The minimum number of deposits that are needed to reach his retirement goal is *closest* to:

	40.
	51.
	28.

Question not answered
The following figure represents the timeline for the problem:

Using a financial calculator, the funds needed at retirement (R on the timeline) are calculated: N = 25, I/Y = 6%, PMT = €80,000, Future value (FV) = €0; Mode = End. The calculated present value (PV) is €1,022,668.

Then, €1,022,668 is used as the FV (at R on the timeline) for the accumulation phase annuity as per: I/Y = 6%, PV = €0, PMT = –€6,608, FV = €1,022,668; Mode = End. The computed N is **40.**

Alternatively, 40 could be calculated with the formula:

CFA Level I

“The Time Value of Money,” Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Sections 4.1, 6.1

Question
77 of 240
Assuming no short selling, a diversification benefit is *most likely* to occur when the correlations among the securities contained in the portfolio are:

	greater than +1.

	equal to +1.
	less than +1.

Question not answered

As long as security returns are not perfectly positively correlated, diversification benefits are possible.

CFA Level I
"Probability Concepts," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 3

Question
78 of 240

The *most likely* impact of adding commodities to a portfolio of equities and bonds is to:

	provide higher current income.
	increase risk.
	reduce exposure to inflation.

Question not answered

Over the long term, commodity prices are closely related to inflation and thus including commodities in a portfolio of equities and bonds will reduce its exposure to inflation.

CFA Level I

"Introduction to Alternative Investments," Terri Duhon, George Spentzos, and Scott D. Stewart

Section 6.3

Question
79 of 240

In the context of venture capital financing, seed-stage financing *most likely* supports:

	initial commercial production and sales.
	product development and/or marketing efforts.
	transformation of an idea into a business plan.

Question not answered

Support of product development and/or marketing efforts takes place during seed-stage financing.

2014 CFA Level I
"Introduction to Alternative Investments," by Terri Duhon, George Spentzos, and Scott D. Stewart
Section 4.2.2

Question
80 of 240

Which of the following investments *most likely* provides an investor with indirect equity exposure to real estate?

	Commercial mortgage-backed securities
	Real estate limited partnerships
	Real estate investment trusts

Question not answered

Real estate investment trusts (REITs) provide investors with indirect equity real estate exposure.

Real estate investment partnerships are a form of direct real estate equity investment. Commercial mortgage-backed securities (CMBSs) provide investors with indirect debt investment opportunities in real estate.

CFA Level I

"Introduction to Alternative Investments," Terri Duhon, George Spentzos, and Scott D. Stewart

Sections 5.1, 5.2

Question
81 of 240

Convenience yield is *best* described as a nonmonetary benefit of holding a(n):

	forward contract.
	asset.
	option contract.

Question not answered

Convenience yield represents the nonmonetary advantage of holding the asset.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 2.2.5

Question
82 of 240

For a forward contract with a value of zero, a situation where the spot price is above the forward price is *best* explained by high:

	storage costs.
	convenience yield.
	interest rates.

Question not answered

If the convenience yield is high, holding the underlying confers large benefits, thus the spot price can exceed the forward price for a forward contract with a value of zero. Based on the formula and an initial value $V_t(0)$ of zero, large benefits explain why the spot price can exceed the forward price.

2015 CFA Level 1
“Basics of Derivative Pricing and Valuation,” Don M. Chance, CFA
Section 2.2.5

Question
83 of 240

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:

	€400.
	€900.
	€600.

Question not answered
Because the share price (S_T) is greater than the strike price (X), the investor collects the premium plus the difference between the strike price and purchase price: $X – S_0 + c_0$. In this case, 100 × (€55 – €50 + €1) = €600.

CFA Level I

"Risk Management Applications of Option Strategies," Don M. Chance

Section 2.2.1

Question
84 of 240
If the implied volatility for options on a broad-based equity market index goes up, then it is *most likely* that:

	the broad-based equity market index has gone up in value.
	the general level of market uncertainty has gone up.
	market interest rates have gone up.

Question not answered
One benefit of derivatives markets is information discovery. Implied volatility reveals information about the risk of the underlying. Increases in implied volatility are an implication of increased market uncertainty.

CFA Level I

“Derivative Markets and Instruments,” Don M. Chance

Section 5.2

Question
85 of 240
A high convenience yield is *most likely* associated with holding:

	equities.
	commodities.
	bonds.

Question not answered
Convenience yield is primarily associated with commodities and generally exists as a result of difficulty in shorting the commodity or unusually tight supplies.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 2.2.5

Question
86 of 240
Using put-call parity, a long call can *best* be replicated by going:

	long the put, long the asset and short the bond.
	short the put, long the asset and short the bond.
	long the put, short the asset and long the bond.

Question not answered

According to put-call parity, a long call is equal to long put, long asset, short bond.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 4.1.9

Question
87 of 240
A trader who owns shares of a stock currently trading at $100 per share places a “GTC, stop $90, limit $85 sell” order (GTC means good till cancelled). Assuming the specified stop condition is satisfied and the order becomes executed, which of the following statements is *most* accurate?

	The order becomes a market order when the price falls below $85 and remains valid for execution.
	The order will be executed at either $90 or $85.
	The trader faces a maximum realized loss of $15.

Question not answered
The order becomes valid when the price falls to, or below, $90. The “limit $85 sell” indicates that the trader is unwilling to sell below $85. Thus, the trader faces a maximum loss of $15 ($100 – $85).

CFA Level I
“Market Organization and Structure,” Larry Harris
Section 6.2

Question
88 of 240
Accounting standards and reporting requirements that produce meaningful and timely financial disclosures are *most* critical for achieving which of the following efficiencies associated with a well-functioning financial system?

	Informational
	Operational
	Allocational

Question not answered
Accounting standards and reporting requirements that allow meaningful and timely financial disclosures reduce the costs of obtaining fundamental information and thereby allow analysts to form more accurate estimates of fundamental values. They support informationally efficient markets.

CFA Level I
“Market Organization and Structure,” Larry Harris

Section 9

Question
89 of 240
Returns from a depository receipt are *least likely* affected by which of the following factors?

	Analysts' recommendations
	Number of depository receipts
	Exchange rate movements

Question not answered
The price of each depository receipt (and, in turn, returns) will be affected by factors that affect the price of the underlying shares—such as company fundamentals, market conditions, analysts' recommendations, and exchange rate movements. The number of depository receipts issued affects their price but does not affect the returns.

CFA Level I

"Overview of Equity Securities," Ryan C. Fuhrmann and Asjeet S. Lamba

Section 5.2

Question
90 of 240
The advantages to an investor owning convertible preference shares of a company *most likely* include:

	an opportunity to receive additional dividends if the company's profits exceed a pre-specified level.
	less price volatility than the underlying common shares.
	preference dividends that are fixed contractual obligations of the company.

Question not answered
Convertible preference shares tend to exhibit less price volatility than the underlying common shares because the dividend payments are known and more stable.

CFA Level I

"Overview of Equity Securities," Ryan C. Fuhrmann and Asjeet S. Lamba

Section 3.2

Question
91 of 240
A market has the following limit orders standing on its book for a particular stock:

Buyer	**Bid Size**	**Limit Price**	**Seller**	**Offer Size**	**Limit Price**
	(# of shares)	**($)**		**(# of shares)**	**($)**
1	500	18.5	1	200	20.2
2	300	18.9	2	300	20.35
3	400	19.2	3	400	20.5

4	200	20.1	4	100	20.65
5	100	20.15	5	200	20.7

If a trader submits an immediate-or-cancel limit buy order for 700 shares at a price of $20.50, the average price the trader would pay is *closest* to:

	$20.58.
	$20.50.
	$20.35.

Question not answered
The limit buy order will be filled first with the most aggressively priced limit sell order and will be followed by filling with the higher priced limit sell orders that are needed up to and including the limit buy price until the order is filled.
Average price = [(200 × $20.20) + (300 × $20.35) + (200 ×$20.50)]/700 = $20.35.

CFA Level I

"Market Organization and Structure," Larry Harris

Sections 6.1, 8.2.2.1

Question
92 of 240
A pension fund has decided to invest in alternative investments. Which of the following assets is the fund *most likely* to include in this strategy?

	Securitized debt
	Equity exchange-traded funds
	Convertible bonds

Question not answered
Securitized debt is an alternative investment so it could be included in this strategy.

CFA Level I

"Market Organization and Structure," Larry Harris

Section 3.1

Question
93 of 240
Which of the following is *least likely* to be directly reflected in the returns on a commodity index?

	Changes in the spot prices of underlying commodities
	Changes in the futures prices of commodities in the index
	Roll yield

Question not answered
Commodity index returns reflect the changes in future prices and the roll yield. Changes in the underlying commodity spot prices are not reflected in a commodity index.

CFA Level I
"Security Market Indices," Paul D. Kaplan and Dorothy C. Kelly
Section 7.1

Question
94 of 240
An investor gathers the following information for an index:

Value of the index as of 31 December 2013	1,000
Interest income over the year 2013	\$23.50
Dividend income over the year 2013	\$21.50
Total return of the index over the year 2013	–4.50%

The value of the index as of 1 January 2013 is *closest* to:

	1,094.
	1,047.
	1,070.

Question not answered
The total return of an index is the price appreciation, or change in the value of the price return index, plus income (dividends and/or interest) over the period, expressed as a percentage of the beginning value of the price return index.
$TR_I = (V_{PRI1} - V_{PRI0} + Inc_I)/V_{PRI0}$
where
TR_I = the total return of the index portfolio (as a decimal number)
V_{PRI1}= the value of the price return index at the end of the period
V_{PRI0} = the value of the price return index at the beginning of the period
Inc_I = the total income (dividends and/or interest) from all securities in the index held over the period
$–4.5\% = (1000 – V_{PRI0} + 23.5 + 21.5)/V_{PRI0}$;
$V_{PRI0} = (1000 + 23.5 + 21.5)/(1 – 0.045) = 1{,}094$.

CFA Level I
“Security Market Indices,” Paul D. Kaplan and Dorothy C. Kelly
Section 2.1

Question
95 of 240
A market index contains only the following three securities:

Security	**Beginning of Period Price per Share (\$)**	**Market Cap (\$ millions)**
X	100	100
Y	200	150
Z	110	300

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

	Equal
	Market capitalization
	Price

Question not answered

As the following computations show, the market-capitalization approach to indexing will give Security X the lowest weight in the index.

Index Weighting Method	**Method of Computation**	**Weight of Security X in the Index**
Price	100/(100 + 200 + 110) =	0.244, or 24.4%

Equal	1/3 =	0.333, or 33.3%
Market cap	100/(100 + 150 + 300) =	0.182, or 18.2%

CFA Level I
“Security Market Indices,” Paul D. Kaplan and Dorothy C. Kelly
Section 3.2

Question
96 of 240
A trader places a limit order to buy shares at a price of $49.94 with the stock trading at a market bid price of $49.49 and the bid–ask spread of 0.7%. The order will *most likely* be filled at:

	$49.49.
	$49.94.
	$49.84.

Question not answered

An order is filled at the best available price, as long as this price is lower than the limit price. In this case, the best available price is the market ask price = $49.49 × (1+ 0.7%) = $49.84. Because this price is lower than the limit price of $49.94, the order will be filled at this price.

CFA Level I
“Market Organization and Structure,” Larry Harris
Section 6.1

Question
97 of 240
An investor buys a stock on margin. Assume that the interest on the loan and the dividend are both paid at the end of the holding period. The data related to the transaction are as follows:

Number of shares	500
Purchase price per share	$28
Leverage ratio	3.33
Commission	$0.05/share
Position holding period	Six months
Sale price per share	$30
Call money rate	5% per year
Dividend	$0.40 / share

The investor’s total return on this investment over the margin holding period is *closest* to:

	21.4%.
	16.7%.
	15.6%.

Question not answered

Initial investment	[($28 × 500) × (1/3.33)] + ($0.05 × 500)	$4,229
– Purchase commission	$0.05 × 500	– 25
+ Trading gain	($30 – $28) × 500	1,000
– Margin interest paid	$9,800 × 0.05 × 6 months	– 245
+ Dividends received	$0.40 × 500	200
– Sales commission paid	$0.05 × 500	– 25
= Remaining equity		$5,134
Return on investment	($5,134 – $4,229)/$4,229	21.4%

CFA Level I

“Market Organization and Structure,” Larry Harris
Section 5.2

Question
98 of 240
The type of efficiency that exists in an economy that distributes capital in the most productive way is *best* described as:

	informational.
	operational.
	allocational.

Question not answered

Economies are said to be allocationally efficient when their financial systems allocate capital (funds) to those uses that are most productive.

CFA Level I
“Market Organization and Structure,” Larry Harris
Section 2.3

Question
99 of 240
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 likel*y be selling at:

	a discount.
	a premium.
	par.

Question not answered
The coupon rate on the bonds is lower than the yield to maturity, implying that the bonds should be selling at a price lower than their par value—that is, at a discount.

CFA Level 1

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 2.1

Question
100 of 240
An analyst uses a valuation model to estimate the value of an option-free bond at 92.733 to yield 11%. If the value is 94.474 for a 60 bp decrease in yield and 91.041 for a 60 bp increase in yield, the approximate modified duration of the bond is *closest* to:

	6.17.
	3.09.
	1.85.

Question not answered
The approximate modified duration of a bond is, where PV_{-}, PV_0, and PV_+ are the values of the bond when the yield falls, under the current yield, and when the yield rises, respectively, and ∆Yield is the size of the yield change. Therefore,

CFA Level 1
"Understanding FixedIncome Risk and Return," James F. Adams and Donald J. Smith Section 3.2

Question
101 of 240
The market value of an 18-year zero-coupon bond with a maturity value of $1,000 discounted at a 12% annual interest rate with semi-annual compounding is *closest* to:

	$192.86.
	$130.04.
	$122.74.

Question not answered
The value of a zero-coupon bond is,

where *r* is the market discount rate per period and *N* is the number of evenly spaced periods to maturity. The value of the zero-coupon bond is,

CFA Level I

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 2.1

Question
102 of 240
A two-year spot rate of 5% is *most likely* the:

	yield to maturity on a zero-coupon bond maturing at the end of Year 2.
	coupon rate in Year 2 on a coupon-paying bond maturing at the end of Year 4.
	yield to maturity on a coupon-paying bond maturing at the end of Year 2.

Question not answered
A spot rate is defined as the yield to maturity on a zero-coupon bond maturing at the date of that cash flow.

CFA Level I

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 2.4

Question
103 of 240
Given two otherwise identical bonds, when interest rates rise, the price of Bond A declines more than the price of Bond B. Compared with Bond B, Bond A *most likely*:

	has a lower coupon.
	has a shorter maturity.
	is callable.

Question not answered
The lower the coupon rate, the more sensitive the bond's price is to changes in interest rates.

CFA Level 1

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 2.3

Question
104 of 240
Credit spreads are *most likely* to narrow during:

	a period of flight to quality.
	economic expansions.
	economic contractions.

Question not answered
Credit spreads narrow during economic expansions and widen during economic contractions. During an economic expansion, corporate revenues and cash flows rise, making it easier for corporations to service their debt, and investors purchase corporates instead of Treasuries, thus causing spreads to narrow.

CFA Level I

"Fundamentals of Credit Analysis," Christopher L. Gootkind

Section 6

Question
105 of 240
Which of the following bonds is *most likely* to trade at a lower price relative to an otherwise identical option-free bond?

	Putable bond
	Convertible bond
	Callable bond

Question not answered
A callable bond benefits the issuer because it gives the issuer the right to redeem all (or part) of the bonds before the maturity date. Thus, the price of a callable bond will typically be lower than the price of an otherwise identical non-callable bond.

CFA Level I

"Fixed-Income Securities: Defining Elements," Moorad Choudhry and Stephen E. Wilcox

Section 5.1

Question
106 of 240
Consider two bonds that are identical except for their coupon rates. The bond that will have the highest interest rate risk *most likely*has the:

	lowest coupon rate.
	coupon rate closest to its market yield.
	highest coupon rate.

Question not answered

A lower coupon rate means that more of the bond's value comes from repayment of face value, which occurs at the end of the bond's life.

CFA Level I

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 2.3

Question
107 of 240

The option-free bonds issued by ALS Corp. are currently priced at 108.50. Based on a portfolio manager's valuation model, a 1bp increase in interest rates will result in the bond price falling to 108.40, whereas a 1bp decrease in interest rates will result in the bond price rising to 108.59. The price value of a basis point (PVBP) for the bonds is *closest* to:

	0.190.
	0.088.
	0.095.

Question not answered

The bond's PVBP is computed using

so,

CFA Level 1

"Understanding FixedIncome Risk and Return," James F. Adams and Donald J. Smith

Section 3.5

Question
108 of 240

In a securitization structure, credit tranching allows investors to choose between:

	partially amortizing loans and fully amortizing loans.
	subordinated bonds and senior bonds.
	extension risk and contraction risk.

Question not answered

Credit tranching allows investors to choose between subordinate and senior bond classes as a means of credit enhancement. The purpose of this structure is to redistribute the credit risk associated with the collateral.

CFA Level I
“Introduction to Asset-Backed Securities,” Frank J. Fabozzi
Section 3.3

Question
109 of 240

Holding all other characteristics the same, the bond exposed to the greatest level of reinvestment risk is *most likely* the one selling at:

	par.
	a premium.
	a discount.

Question not answered

A bond selling at a premium has a higher coupon rate and, all else being equal, bonds with higher coupon rates face higher reinvestment risk. The reason is that the higher the coupon rate, the more dependent the bond's total dollar return will be on the reinvestment of the coupon payments in order to produce the yield to maturity at the time of purchase.

CFA Level I

"Understanding Fixed-Income Risk and Return," James F. Adams and Donald J. Smith

Section 2

Question
110 of 240

The process of securitization is *least likely* to allow banks to:

	reduce the layers between borrowers and ultimate investors.
	originate loans.
	repackage loans into simpler structures.

Question not answered

Securitization allows banks to originate (or create) loans and the process results in a reduction in the layers between borrowers and ultimate investors. The loans are repackaged into more complex, not simpler, structures.

CFA Level I

"Introduction to Asset-Backed Securities", Frank J. Fabozzi

Section 2

Question
111 of 240

Using the following US Treasury spot rates, the arbitrage-free value of a two-year $100 par value Treasury bond with a 6% coupon rate is *closest* to:

Period	**Years**	**Spot Rate**
1	0.5	1.60%
2	1.0	2.20%
3	1.5	2.70%
4	2.0	3.10%

	$107.03.
	$99.75.
	$105.65.

Question not answered

The value of the bond is

CFA Level I

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 4

Question
112 of 240
Which of the following *most likely* exhibits negative convexity?

	A callable bond
	An option-free bond
	A putable bond

Question not answered
A callable bond exhibits negative convexity at low yield levels and positive convexity at high yield levels.

CFA Level 1

"Understanding Fixed-Income Risk and Return," James F. Adams and Donald J. Smith

Section 3.6

Question
113 of 240
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:

	3.9%.
	10.8%.
	6.9%.

Question not answered

CFA Level I

"Portfolio Risk and Return: Part II," Vijay Singal

Section 3.2.6

Question
114 of 240
The execution step of the portfolio management process includes:

	preparing the investment policy statement.
	monitoring the portfolio performance.
	finalizing the asset allocation.

Question not answered
Asset allocation occurs in the execution step.

CFA Level I

"Portfolio Management: An Overview," Robert M. Conroy and Alistair Byrne

Section 4

Question
115 of 240
A return-generating model that provides an estimate of the expected return of a security based on such factors as earnings growth and cash flow generation is *best* described as a:

	fundamental factor model.
	macroeconomic factor model.
	market factor model.

Question not answered
A return-generating model based on such factors as earnings growth and cash flow generation is a fundamental factor model.

CFA Level I

"Portfolio Risk and Return: Part II," Vijay Singal

Section 3.2.1

Question
116 of 240
A portfolio manager decides to temporarily invest more of a portfolio in equities than the investment policy statement prescribes because he expects equities will generate a higher return than other asset classes. This decision is *most likely* an example of:

	tactical asset allocation.
	strategic asset allocation.
	rebalancing.

Question not answered
Tactical asset allocation is the decision to deliberately deviate from the policy exposures to systematic risk factors with the intent to add value based on forecasts of the near-term returns of those asset classes.

CFA Level I

Basics of Portfolio Planning and Construction," Alistair Byrne and Frank E. Smudde

Section 3.3

Question
117 of 240
Consider a portfolio with two assets. Asset A comprises 25% of the portfolio and has a standard deviation of 17.9%. Asset B comprises 75% of the portfolio and has a standard deviation of 6.2%. If the correlation of these two investments is 0.5, the portfolio standard deviation is *closest* to:

	9.13%.
	7.90%.
	6.45%.

Question not answered

The standard deviation of a two-asset portfolio is given by the square root of the portfolio's variance:

Using this formula, the existing standard deviation is calculated as follows:

CFA Level I

"Portfolio Risk and Return: Part I," Vijay Singal

Section 2.3.3

Question
118 of 240
Which of the following institutional investors is *most likely* to have a low tolerance for investment risk and relatively high liquidity needs?

	Defined benefit pension plan
	Charitable foundation
	Insurance company

Question not answered
Insurance companies need to be relatively conservative and liquid, given the necessity of paying claims when due.

CFA Level I

"Portfolio Management: An Overview," Robert M. Conroy and Alistair Byrne

Section 3

Question
119 of 240
Carolina Ochoa, CFA, is the chief financial officer at Pantagonia Computing. Ochoa is currently the subject of an inquiry by Pantagonia's corporate investigations department. The inquiry is the result of an anonymous complaint accusing Ochoa of falsifying travel expenses for senior management related to a government contract. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, it is most appropriate for Ochoa to disclose the allegations:

	on her Professional Conduct Statement.
	to CFA Institute if the allegations are proven correct.
	to CFA Institute when the investigation concludes.

Question not answered
Members and candidates must self-disclose on the annual Professional Conduct Statement all matters that question their professional conduct, such as involvement in civil litigation or criminal investigations or being the subject of a written complaint.

CFA Level I
"Code of Ethics and Standards of Professional Conduct"

Question

120 of 240

Prudence Charmaine, CFA, was recently accused in writing of cheating on a professional accounting exam. She denied cheating and successfully defended herself against the allegation. As part of her defense and as evidence of her character, Charmaine stated she is a CFA charterholder and upholds the CFA Institute Code of Ethics and Standards of Professional Conduct. On her next annual Professional Conduct Statement, Charmaine does not report this allegation to CFA Institute. Did Charmaine *most likely*violate the CFA Institute Code of Ethics or Standards of Professional Conduct (Code and Standards)?

	Yes, she did not report the allegation on her annual Professional Conduct Statement.
	No
	Yes, she improperly used the CFA Institute Code and Standards to defend herself.

Question not answered

Charmaine should have reported the cheating allegation when making her annual Professional Conduct Statement. Even though she successfully defended herself against the charges and the charges were dropped, she has a responsibility to report the written complaint involving her integrity. The Code of Ethics requires CFA charterholders to practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.

CFA Level I
"Code of Ethics and Standards of Professional Conduct"

Question
121 of 240

Ileana Inkster, CFA, was recently offered a senior management position within the trust department at a regional bank. The department is new, but the bank has plans to expand it significantly over the next few months. Inkster has been told she will be expected to help grow the client base of the trust department. She is informed that the trust department plans to conduct educational seminars and pursue the attendees as new clients. Inkster notices that recent seminar advertisements prepared by the bank's marketing department do not mention investment products will be for sale at the seminar. The ads indicate attendees can "learn how to immediately add $100,000 to their net worth." What should Inkster *most likely* do to avoid violating any CFA Institute Standards of Professional Conduct?

	Accept the position and inform senior management of inadequate compliance procedures
	Decline to accept the new position
	Accept the position and revise the marketing material

Question not answered

The prospective supervisor's first step should be to not take the position. Accepting the position with inadequate procedures in place or improper marketing material would leave Inkster at risk of incurring a violation of Standard IV(C)–Responsibilities of Supervisors. She could agree to be hired as an interim consultant with the bank in order to implement adequate procedures before taking on any supervisory role.

CFA Level I
"Guidance for Standards I–VII"
Standard IV(C)–Responsibilities of Supervisors

Question
122 of 240

While at a bar in the financial district after work, Ellen Miffitt, CFA, overhears several employees of a competitor discuss how they will manipulate down the price of a thinly traded micro-cap stock's price over the next few days. Miffitt's clients have large positions of this stock, so when she arrives at work the next day, she immediately sells all of these holdings. Because she had determined the micro-cap stock was suitable for all of her accounts at its previously higher price, Miffitt buys back her client's original exposure at the end of the week at the new, lower price. Which CFA Institute Standards of Professional Conduct did Miffitt *least likely*violate?

	Market Manipulation
	Material Nonpublic Information
	Preservation of Confidentiality

Question not answered

Miffitt has not violated Standard III (E)–Preservation of Confidentiality, which involves information about former, current, and prospective clients.

CFA Level I
"Guidance for Standards I–VII"
Standard II(A)–Material Nonpublic Information, Standard II(B)–Market Manipulation, Standard III(E)–Preservation of Confidentiality

Question
123 of 240

Mariam Musa, CFA, head of compliance at Dunfield Brokers, questions her colleague Omar Kassim, a CFA candidate and a research analyst, about his purchase of shares in a company for his own account immediately before he publishes a "buy" recommendation. He defends his actions by stating he has done nothing wrong because Dunfield does not have any personal trading policies in place. The CFA Institute Standards of Professional Conduct were most likely violated by:

	only Musa.
	both Musa and Kassim.
	only Kassim.

Question not answered

Both Musa and Kassim violated the Standards of Professional Conduct. Musa violated Standard IV(C)–Responsibilities of Supervisors by not ensuring policies were in place to prevent violations of the Standards of Professional Conduct (in this case, Standard VI(B)–Priority of Transactions) by someone subject to her supervision. As the head of compliance, Musa supervised Kassim and must meet her supervisory responsibilities outlined in the Standards of Professional Conduct. Kassim violated Standard VI(B)–Priority of Transactions because he did not give sufficient priority to Dunfield's clients before trading on his recommendation.

CFA Level I
"Guidance for Standards I–VII"
Standard IV(C)–Responsibilities of Supervisors, Standard VI(B)–Priority of Transactions

Question
124 of 240

Which of the following statements does *not* accurately represent the objectives of Global Investment Performance Standards (GIPS)? The GIPS standards:

	management firms in all markets by requiring common fee structures.
	obtain global acceptance of calculation and presentation standards in a fair, comparable format with full disclosure.
	ensure consistent, accurate investment performance data in the areas of reporting, records, marketing, and presentations.

Question not answered

One of the objectives of the GIPS standards is to promote fair competition among investment management firms in all markets; thisobjective does not require unnecessary entry barriers or hurdles for new firms, such as common fee structures.

CFA Level I
"The GIPS Standards," CFA Institute
Fundamentals of Compliance

Question
125 of 240

Margie Germainne, CFA, is a risk management consultant who has been asked by a small investment bank to recommend policies to prevent bank employees from front running client orders. These clients generally invest in one or more of the bank's large cap equity unit trusts. To ensure compliance with the CFA Institute Standards of Professional Conduct, Germainne should *least likely*recommend which of the following? Employees should be restricted from trading:

	without prior permission.
	during established time periods.
	equity-related securities.

Question not answered

Although Standard VI(B)–Priority of Transactions is designed to prevent any potential conflict of interest or the appearance of a conflict of interest with respect to personal transactions, it does not ban employees from trading securities. A ban on all equity-related securities could be excessively restrictive to employees and unnecessary if appropriate personal transaction policies and procedures are in place.

CFA Level I
"Guidance for Standards I–VII"
Standard VI(B)–Priority of Transactions

Question
126 of 240

Which of the following statements does *not* accurately represent the Global Investment Performance Standards (GIPS) concerning the fundamentals of compliance? The GIPS standards:

	ensure consistent, accurate investment performance data in the areas of reporting, records, marketing, and presentations.
	obtain global acceptance of calculation and presentation standards in a fair, comparable format with full disclosure.

	promote fair competition among investment management firms in all markets by requiring a common fee structure.

Question not answered
The GIPS standards do not promote fair competition among investment management firms in all markets by requiring a common fee structure.

CFA Level I
“The GIPS Standards,” CFA Institute
Fundamentals of Compliance

Question
127 of 240
Chan Liu, CFA, is the new research manager at the Pacific MicroCap Fund. Liu observed the following activities after she published a research report on a thinly traded micro-cap stock that included a "buy" recommendation:

• Pacific traders purchased the stock for Pacific's proprietary account and then purchased the same stock for all client accounts; and

• Pacific marketing department employees disseminated positive, but false, information about the stock in widely read internet forums.

Liu notes the stock's price increased more than 50% within a period of two days and was then sold for Pacific's account. Which of the following steps is most appropriate for Liu to take to avoid violating the CFA Institute Standards of Professional Conduct?

	Publicly refute the false information posted on internet forums.
	Remove her name from the micro-cap stock research report.
	Report the observed activities to her employer.

Question not answered
Certain staff at Liu's employer appear to be engaged in front running, a violation of Standard VI(B)–Priority of Transactions, and market manipulation, a violation of Standard II(B)–Market Manipulation. If Liu observes these violations without taking steps to notify her employer, she will be in violation of Standard I(A)–Knowledge of the Law. Liu should know that the conduct observed is likely a violation of applicable laws, rules, and regulations as well as a violation of the CFA Institute Standards of Professional Conduct. Her first step, therefore, should be to attempt to stop the behavior by bringing it to the attention of the employer through a supervisor or the firm's compliance department. Inaction may be construed as participation or assistance in the illegal or unethical conduct.

CFA Level I
"Guidance for Standards I–VII"
Standard I (A)–Knowledge of the Law, Standard II(B)–Market Manipulation, Standard VI(B)–Priority of Transactions

Question
128 of 240
Colin Gifford, CFA, is finalizing a monthly newsletter to his clients, who are primarily individual investors. Many of the clients' accounts hold the common stock of Capricorn Technologies. In the newsletter, Gifford writes, "Based on the next six month's earnings of $1.50 per share and a 10% increase in the dividend, the price of Capricorn's stock will be $22 per share by the end of the

year." Regarding his stock analysis, the *least* appropriate action Gifford should take to avoid violating any CFA Institute Standards of Professional Conduct would be to:

	separate fact from opinion.
	identify limitations of the analysis.
	include earnings estimates.

Question not answered

Although pro forma analysis may be standard industry practice, it is not required by the Standards of Professional Conduct. Earnings estimates are opinions and must be clearly identified as such. It is also important for investors to be able to identify limitations of analysis when making investment decisions.

CFA Level I
"Guidance for Standards I–VII"
Standard V(B) Communication with Clients and Prospective Clients

Question
129 of 240

Which of the following statements concerning the Global Investment Performance Standards (GIPS) is *most likely* correct?

	Clients or prospective clients benefit from the Standards because the historical track record of compliant firms is accurate and precise.
	Compliance with the Standards enhances the credibility of investment management firms.
	The Standards eliminate the need for in-depth due diligence by investors.

Question not answered
Compliance with the GIPS standards enhances the credibility of investment management firms.

CFA Level I
“Introduction to the Global Investment Performance Standards (GIPS),” CFA Institute
Who Benefits from Compliance?

Question
130 of 240

According the GIPS standards, for periods beginning on or after 1 January 2011, the aggregate fair value of total firm assets *most likely* includes all:

	fee- and non-fee-paying discretionary and non-discretionary accounts.
	fee- and non-fee-paying discretionary accounts.
	fee-paying discretionary accounts.

Question not answered

For periods beginning on or after 1 January 2011, total firm assets must include the aggregate fair value of all discretionary and non-discretionary assets managed by the firm. This includes both fee-paying and non-fee-paying portfolios.

CFA Level I
"Global Investment Performance Standards (GIPS)"

GIPS Requirement 0.A.13

Question
131 of 240
Which of the following statements concerning why the Global Investment Performance Standards (GIPS) were created is *least likely* correct? The GIPS standards were created to:

	establish a standardized, industry wide approach for investment firms to follow.
	identify a set of ethical principles for firms to follow in calculating and presenting historical investment results.
	provide clients certainty in what is presented and allow them to make reasonable comparisons.

Question not answered
The GIPS standards were created to ensure fair representation and full disclosure of investment performance, not to providecertainty in what is presented.

CFA Level I
"Introduction to the Global Investment Performance Standards (GIPS)," CFA Institute
Why Were the GIPS Standards Created?

Question
132 of 240
Bryan Barrett, CFA, runs an investment advisory service providing advice on gold and other commodities to several large retail banks. Barrett advertises his services in widely read publications to broaden his business to include retail clients. Because the client base for the institutions that Barrett serves is large, he is comfortable stating in the ads that thousands of his clients have benefited from his advice. Does Barrett's advertisement *most likely* violate any CFA Institute Standards of Professional Conduct?

	Yes, related to Misrepresentation
	Yes, related to Communication with Clients and Prospective Clients
	No

Question not answered
Barrett's client base is only several large institutions, indicating his client base is small, so stating in the advertisement that his client base is a larger number (i.e., thousands) is a misrepresentation and a violation of Standard I(C). In addition, because the advertisement focuses only on the benefits and does not mention the potential risks of these investments, it is also potentially misleading to clients.

CFA Level I
"Guidance for Standards I–VII"
Standard I(C)–Misrepresentation, Standard V(B)–Communication with Clients and Prospective Clients

Question
133 of 240
Joyce La Valle, CFA, is a portfolio manager at a global bank. La Valle has been told she should use a specific vendor for equity investment research that has been approved by the bank's headquarters. Because La Valle is located in a different country than the bank's headquarters, she

is uncomfortable with the validity of the research provided by the vendor when it applies to her country and would like to use a local vendor on whom she has already conducted due diligence. Which research vendor(s) should La Valle *most likely* use to avoid violating the CFA Institute Standards of Professional Conduct?

	Both the local and the bank-approved research vendors
	The local research vendor
	The bank-approved research vendor

Question not answered

When a member has reason to suspect that either secondary- or third-party research or information comes from a source that lacks a sound basis, the member must not rely on that information, as indicated by Standard V(A)–Diligence and Reasonable Basis.

CFA Level I
"Guidance for Standards I–VII"
Standard V(A) Diligence and Reasonable Basis

Question
134 of 240

Sergio Morales, CFA, believes he has found evidence that his supervisor is engaged in fraudulent activity involving a client's account. When Morales confronts his supervisor, he is told the client is fully aware of the issue. Later that day, Morales contacts the client and after disclosing the fraudulent activity, he is told by the client to mind his own business. Following the requirements of local law, Morales provides all of his evidence, along with copies of the client's most recent account statements, to a government whistleblower program. Has Morales *most likely* violated the CFA Institute Standards of Professional Conduct?

	Yes, concerning Preservation of Confidentiality
	Yes, concerning Duties to Employers
	No

Question not answered

Because Morales believes his supervisor and potentially the client are engaged in fraudulent activity and following the requirements of local law, he has not violated Standard III(E)–Preservation of Confidentiality or Standard (V)–Duties to Employers.

CFA Level I
"Guidance for Standards I–VII"
Standard III(E) Preservation of Confidentiality, Standard (IV) Duties to Employers, Standard (V) Duties to Employers

Question
135 of 240

In countries where new local laws relating to calculation and presentation of investment performance conflict with the GIPS standards, firms who have claimed GIPS compliance should *most likely*:

	stop claiming GIPS compliance.
	continue to claim GIPS compliance, disclosing non-compliance with new laws.
	follow local laws, continue to claim GIPS compliance, and disclose conflicts.

Question not answered

Where local laws and regulations regarding calculation and presentation conflict with the GIPS standards, firms must abide by the local laws and regulations. They are still allowed to claim GIPS compliance but must disclose areas for which the local requirements conflict with those of the GIPS standards.

CFA Level I
"Global Investment Performance Standards (GIPS)"

Question
136 of 240

Benefits of compliance with the CFA Institute Global Investment Performance Standards (GIPS) *least likely* include:

	strengthening of internal controls.
	elimination of in-depth due diligence for investors.
	participation in competitive bidding.

Question not answered

Compliance with the GIPS standards does not eliminate the need for in-depth due diligence on the part of the investor.

CFA Level I
"Introduction to the Global Investment Performance Standards (GIPS)"

Question
137 of 240

The consumer price index (CPI) this year is 252. The CPI last year was 246. The inflation rate this year is *closest* to:

	6.00%.
	2.38%.
	2.44%.

Question not answered
The inflation rate is measured as [(CPI this year – CPI last year) / CPI last year] × 100.
In this case, [(252 – 246) / 246] × 100 = **2.439%**.

CFA Level I
“Understanding Business Cycles,” Michele Gambera, Milton Ezrati, and Bolong Cao
Section 4.2

Question
138 of 240

With regard to the aggregate demand (AD) curve and an increase in one of its associated factors, which of the following relationships is *least* accurate?

Relationship	Increase in Factor	Shifts the AD curve	Reason
1	Stock prices	Rightward	Lower investment
2	Consumer confidence	Rightward	Higher consumption
3	Exchange rate*	Leftward	Lower exports and higher imports
		*Exchange rate is foreign currency per unit of domestic currency	

	Relationship 2
	Relationship 3
	Relationship 1

Question not answered
If stock prices rise, the aggregate demand curve will shift to the right (increase in AD) due to higher consumption (wealth effect), not lower investments.

CFA Level I
"Aggregate Output, Prices, and Economic Growth," Paul R. Kutasovic and Richard G. Fritz
Section 3.3.1

Question
139 of 240
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 GDP is *closest* to:

	1,448,650.
	1,466,490.
	1,451,500.

Question not answered
Using the expenditures approach:
GDP = Consumer spending on goods and services + Business gross fixed investment + Change in inventories + Government spending on goods and services + Government gross fixed investment + Exports – Imports + Statistical discrepancy

Consumer spending on goods and services	875,060
Business gross fixed investment	286,400
Change in inventories	(68,500)
Government spending on goods and services	305,600
Government gross fixed investment	84,120
Exports	219,800
Imports	(250,980)
Statistical discrepancy	(2,850)
= Gross domestic product (GDP)	**1,448,650**

CFA Level I
“Aggregate Output, Prices, and Economic Growth,” Paul R. Kutasovic and Richard G. Fritz
Sections 2.2, 2.3

Question
140 of 240
The following data apply to a firm operating in perfect competition.

Quantity	Total Revenue	Total Cost
21	$210	$138
22	$220	$145
23	$230	$154
24	$240	$165

The firm's profit maximizing output (in units) is *most likely*:

	in excess of 24.
	23.
	21.

Question not answered

Under perfect competition, economic profits are maximized when marginal revenue equals marginal cost—in this case, marginal cost crosses $10 per unit. Profits are maximized at 23 units of production because marginal cost is in excess of marginal revenue at 24 units.

CFA Level I
"The Firm and Market Structures," Richard G. Fritz and Michele Gambera
Section 3.3

Question
141 of 240

An electricy producer charges lower rates to its high volume customers and higher rates to its low volume coustomers. The degree of price discrimination being used is best described as:

	third.
	second.
	first

Question not answered

Second degree price discrimination involves using the quantity purchased as the basis for the pricing of a particular good.

CFA Level I
“The Firm and Market Structures,” Richard G. Fritz and Michele Gambera
Section 6.4

Question
142 of 240

Which characteristic is a firm *least likely* to exhibit when it operates in a market with a downward sloping demand curve, many competitors, and zero economic profits in the long run?

	Low barriers to entry
	Differentiated product
	No pricing power

Question not answered

The characteristics of monopolistic competition include a large number of competitors, low pricing power, and the production of differentiated products (through advertising and other non-price strategies), but these still result in some pricing power. The ease of entry results in zero economic profits in the long run.

CFA Level I

"The Firm and Market Structures," Richard G. Fritz and Michele Gambera

Sections 2.1, 2.2, 4

Question
143 of 240

An expansionary fiscal policy is *least likely* to include an increase in:

	government expenditures.
	tax rates.
	budget deficit.

Question not answered

An expansionary fiscal policy means that the government increases its purchases of goods and services and/or cuts tax rates to increase aggregate demand. Furthermore, an increase in the budget deficit would be associated with an expansionary fiscal policy.

2014 CFA Level I
“Monetary and Fiscal Policy,” by Andrew Clare and Stephen Thomas
Sections 3.1.1–3.1.2

Question
144 of 240

An increase in current prices will *most likely:*

	decrease real GDP.
	increase the GDP deflator.
	increase real GDP.

Question not answered
Nominal GDP is defined as the value of goods and services measured at current prices. Real GDP is not affected by price increases while nominal GDP and the GDP deflator increase with price increases:

Real $GDP_{current\ year}$ = Nominal $GDP_{current\ year} \times 100 \boxtimes$ GDP deflator

Real $GDP_{current\ year} = P^{X}_{base\ year} \times Q^{X}_{current\ year}$

CFA Level I
“Aggregate Output, Prices, and Economic Growth,**”** Paul R. Kutasovic, and Richard G. Fritz
Section 2.1.2

Question
145 of 240

The statement that is *most* consistent with real business cycle (RBC) models is that:

	monetary variables have a major impact on GDP growth.
	governments should intervene when the economy is in contraction.
	persons are unemployed because their asking wages are too high.

Question not answered
As suggested particularly by the earliest RBC models, a person is unemployed because he or she is asking for wages that are too high

CFA Level I

“Understanding Business Cycles,” Michele Gambera, Milton Ezrati, and Bolong Cao
Section 3.3.1

Question
146 of 240
In an effort to influence the economy, a central bank conducted open market activities by selling government bonds. This action implies that the central bank is *most likely* attempting to:

	expand the economy through a lower policy interest rate.
	contract the economy through a lower policy interest rate.
	contract the economy by reducing bank reserves.

Question not answered
Selling government bonds results in a reduction of bank reserves and reduces their ability to lend, causing a decline in money growth through the multiplier mechanism and hence a contraction in the economy.

CFA Level I

“Monetary and Fiscal Policy,” Andrew Clare and Stephen Thomas

Sections 2.3.2.1, 2.3.2.2

Question
147 of 240
An electricity producer charges lower rates to its high-volume customers and higher rates to its low-volume customers. The degree of price discrimination is *best* described as:

	third.
	first.
	second.

Question not answered
Second-degree price discrimination involves using the quantity purchased as the basis for the pricing of a particular good.

CFA Level I

"The Firm and Market Structures," Richard G. Fritz and Michele Gambera

Section 6.4

Question
148 of 240
The two dominant supermarket chains in the area are attempting to increase their market share by moving to 24-hour service instead of closing at 9 p.m. every night. The strategic outcomes and payoff matrix that arise from their actions are depicted in the diagram (with the shaded sections representing payoffs for Chain 2).

According to Nash equilibrium, the *best* strategy is for:

	both chains to open for 24 hours.

	only Chain 2 to open for 24 hours.
	both chains to close at 9 p.m.

Question not answered

Each company will consider the other's reaction in selecting its strategy. Using the following summary, it is best for both chains to provide 24-hour service.

Chain		Consideration		Best Decision
1		**If it opens for 24 hours**, it will see a higher payoff regardless of what Chain 2 does.		Open for 24 hours
	Chain 2 Closes at 9 p.m.	**Chain 2 Opens for 24 hours**		
	Chain 1 earns 540 instead of 180	Chain 1 earns 108 instead of 55		
2		**If it opens for 24 hours**, it will see a higher payoff regardless of what Chain 1 does.		Open for 24 hours
	Chain 1 Closes at 9 p.m.	**Chain 1 Opens for 24 hours**		
	Chain 2 earns 592 instead of 290	Chain 2 earns 140 instead of 75		

CFA Level I

"The Firm and Market Structures," Richard G. Fritz and Michele Gambera

Section 5.1

Question
149 of 240
The unit contribution margin for a product is \$20. A firm's fixed costs of production 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):

	100,000.
	300,000.
	200,000.

Question not answered

The DOL is lowest at the 300,000 unit production level.

CFA Level I
"Measures of Leverage," Pamela Peterson Drake, Raj Aggarwal, Cynthia Harrington, and Adam Kobor
Section 3.3

Question
150 of 240
A firm's price-to-earnings ratio (P/E) is 12.5. The firm has decided to repurchase shares using external funds that have an after-tax cost of 9%. After the repurchase, the earnings per share (EPS) will *most likely*:

	remain unchanged.
	decrease.

	increase.

Question not answered

Convert the P/E to the earnings yield, which is the earnings-to-price ratio (E/P): 1/12.5 = 8%. Because the after-tax cost of the external funds is higher than the earnings yield (i.e., 9% > 8%), the EPS will decrease after the repurchase.

CFA Level I
“Dividends and Share Repurchases: Basics,” George H. Troughton and Gregory Noronha
Section 4.2.1

Question
151 of 240

Which of the following dates in the dividend chronology can fall on a weekend? The

	record date.
	payment date.
	ex-date.

Question not answered

The payment date can occur on a weekend or holiday unlike other pertinent dates, such as the ex-date and record date which occur only on business days.

CFA Level I
"Dividends and Share Repurchases: Basics," George H. Troughton, and Gregory Noronha
Section 3

Question
152 of 240

A company decides to repurchase 5 million of its outstanding 20 million shares with debt funding. After the repurchase, the company’s after-tax earnings decline by 20%. The new earnings per share (EPS) is *most likely*:

	equal to the pre-repurchase EPS.
	greater than the pre-repurchase EPS.
	less than the pre-repurchase EPS.

Question not answered

The pre-repurchase EPS is Net income (NI)/20 million. The EPS after the repurchase is [NI × (1 – 20%)/15 million]. To connect the two values algebraically:
(NI/20 million) × X = [NI × (1 – 20%)/15 million]
X = (1 – 20%) × (20 million/15 million) = 1.067
Because X is greater than 1, the EPS has increased after the repurchase.

CFA Level I
“Dividends and Share Repurchases: Basics,” George H. Troughton and Gregory Noronha
Section 4.2.1

Question
153 of 240

Which method of calculating the firm’s cost of equity is most likely to incorporate the long-run return relationship between the firm's stock and the market portfolio?

	Bond yield plus risk premium approach
	Capital asset pricing model

	Dividend discount model

Question not answered

The capital asset pricing model uses the firm's equity beta, which is computed from a market model regression of the company's stock returns against market returns.

CFA Level I
"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 3.3

Question
154 of 240
Which of the following is the *least* appropriate method for an external analyst to use to estimate a company's target capital structure for determining the weighted average cost of capital (WACC)?

	Using statements made by the company's management regarding capital structure policy
	Using averages of comparable companies' capital structure
	Using the company's current capital structure at book value weights

Question not answered
An external analyst does not know a company's actual target capital structure. Consequently, the analyst should rely on market value (not book value) weights for the components of the company's current capital structure.

CFA Level I
"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 2.2

Question
155 of 240
The following information is available for a firm:

Number of shares outstanding	4 million
Tax rate	40%
Cost of debt (pre-tax)	10%
Current stock price	$20.00
Net income	$6 million

A plan to repurchase $10 million worth of shares using debt will *most likely* cause the earnings per share to:

	decrease.
	remain unchanged.
	increase.

Question not answered
Long way:
Current earnings per share = $6,000,000/4,000,000 = $1.50
Number of shares repurchased = $10,000,000/$20.00 = 500,000 shares
Adjusted net income = Current net income – (Debt × After-tax cost of debt)
= $6,000,000 – [$10,000,000 × 10% × (1 – 40%)] = $5,400,000
New earnings per share = $5,400,000/(4,000,000 – 500,000) = $1.54.

Short way:
Current earnings per share = $6,000,000/4,000,000 = $1.50
Earnings yield = $1.50/$20.00 = 7.5%
If the after-tax cost of debt [10% × (1 – 40%) = 6%] is below the earnings yield, the earnings per share will increase.

CFA Level I
"Dividends and Share Repurchases: Basics," George Troughton and Gregory Noronha
Section 4.2.1

"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 2.1

Question
156 of 240
The following information is available for a firm in a developing country:

Risk-free rate	2.0%
Firm's equity beta	1.5
Equity risk premium in a developed country	3.0%
Developing country risk premium	4.0%
Sovereign yield spread	2.5%

The firm's cost of equity using the CAPM approach is *closest* to:

	12.5%.
	10.5%.
	10.3%.

Question not answered
Cost of equity = risk-free rate + equity beta × (equity risk premium + country risk premium) = 0.02 + 1.5 × (0.03 + 0.04) = 12.5%

CFA Level I
"Cost of Capital," Yves Courtois, Gene C. Lai, and Pamela Peterson Drake
Section 4.2 and 3.3

Question
157 of 240
The following information is available for a firm:

Sales price per unit	€85
Variable cost per unit	€65
Fixed operating costs	€50 million
Fixed financial costs	€30 million

The firm's breakeven quantity of sales (in million units) is *closest* to:

	2.5.
	1.0.
	4.0.

Question not answered
Breakeven quantity of sales,

= (€50 million + €30 million) ÷ (€85 - €65) = **4.0** million units.

CFA Level I
“Measures of Leverage,” Pamela Peterson Drake, Raj Aggarwal, Cynthia Harrington, and Adam Kobor
Section 3.6

Question
158 of 240
Financial risk is *least likely* affected by:

	dividends.
	long-term leases.
	debentures.

Question not answered
By taking on fixed obligations, such as debt (including debentures) and long-term leases, a company increases its financial risk. Dividends will not increase financial risk.

CFA Level I
“Measures of Leverage,” Pamela Peterson Drake, Raj Aggarwal, Cynthia Harrington, and Adam Kobor
Section 3.4

Question
159 of 240
Information about the coupon rates on the various long-term fixed-rate debt issues of a company can *most likely* be found in the:

	non-current liabilities section of the balance sheet.
	Management Discussion & Analysis (MD&A).
	notes to the financial statements.

Question not answered
Information about the coupon rates on the various long-term fixed-rate debt issues can usually be found in the notes to the financial statements. The MD&A is more likely to discuss interest rate trends and/or current financing costs but not specific information on individual debt issues.

2015 CFA Level I

"Non-Current (Long-Term) Liabilities," Elizabeth A. Gordon and Elaine Henry

Sections 2.6

Question
160 of 240
A company is purchasing a customer list that it expects will provide economic benefits for the next 5 years. The company chooses to use an accelerated amortization method. The choice will *most likely* result in:

	an equal amortization expense in all 5 years.
	the highest amortization expense in the first year.
	the highest amortization expense in the fifth year.

Question not answered

With accelerated amortization, first year amortization expense should be the highest.

CFA Level I

"Long-lived Assets," Elaine Henry and Elizabeth A. Gordon

Sections 3.1, 3.2

Question
161 of 240

One of the notable differences between IFRS and US GAAP when dealing with income tax is *best* illustrated by the fundamental treatment of:

	non-deductible goodwill.
	temporary differences between the carrying amount and tax base of assets and liabilities.
	the revaluation of property, plant and equipment.

Question not answered

US GAAP prohibits the revaluation of PPE. Therefore, this is a source of an important difference between US GAAP and IFRS with respect to reporting of income taxes.

CFA Level I

"Income Taxes," Elbie Antonites and Michael A. Broihahn

Section 8

Question
162 of 240

A company has recently revalued one of its depreciable properties and estimates that its remaining useful life will be another 20 years. The applicable tax rate for all years is 30%, and the revaluation of the property is not recognized for tax purposes. Details related to this asset are provided in the following table:

(millions)	**Accounting Purposes**	**Tax Purposes**
Original Values and Estimates		
Acquisition cost in 2011	£8,000	£8,000
Depreciation, straight line	20 years	8 years
Accumulated depreciation, end of 2013	£1,200	£3,000
Net balance, end of 2013	£6,800	£5,000
Re-estimated Values and Estimates, Start of 2014		
Revaluation balance, start of 2014	£10,000	Not applicable
New estimated life	20 years	

The deferred tax liability related to this asset (in millions) as at the end of 2014 is *closest* to:

	£690.
	£1,650.

	£960.

Question not answered

(millions)	**Accounting Purposes**	**Tax Purposes**
Revaluation surplus	(£10,000 – £6,800) = £3,200	No revaluation allowed
Depreciation, straight line	20 years	5 years remaining
Start of year balance after revaluation, 2013	£10,000	£5,000
Depreciation, 2013	(£10,000/20 years) = £500	£1,000
Net balance, end of 2013	£9,500	£4,000
Minus revaluation surplus	– £ 3,200	
Carrying value for purposes of deferred taxes	£6,300	£4,000
Deferred tax liability = 0.30 × (£6,300 – £4,000) = £690		
Only the portion of the difference between the tax base and the carrying amount that is not the result of the revaluation is recognized as giving rise to a deferred tax liability. The portion arising from the revaluation surplus is used to reduce the revaluation surplus in equity.		

CFA Level I
"Income Taxes," Elbie Antonites and Michael A. Broihahn
Sections 2.2, 6.2

Question
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The following data are available for a company and its industry:

Company Common-Size Balance Sheet As of 31 December 2013	
Assets	**Percent**
Cash and short-term investments	43.2
Accounts receivable	9.4
Inventory	0.6
Total current assets	53.2
Net property, plant, and equipment (PP&E)	3.9
Goodwill	40.0
Other long-term assets	2.9
Total assets	100.0
Liabilities and Shareholders' Equity	
Short-term debt	1.6
Accrued liabilities and accounts payable	17.8
Total current liabilities	19.4
Long-term debt	20.1
Other long-term liabilities	6.5
Total liabilities	46.0
Total stockholders' equity	54.0
Total liabilities and shareholders' equity	100.0

Data for Comparison	**Industry**
Debt to equity	50.0%
Long-term debt to equity	40.0%

Which of the following statements about the company is *most* appropriate? The company:

	has more financial leverage than the industry.
	is an electric utility.
	has made significant acquisitions in the past.

Question not answered

Goodwill makes up 40% of total assets and therefore indicates that the company has made significant acquisitions at some point, because goodwill is only recognized during acquisitions. Leverage is below the industry average for both the debt-to-equity ratio of 40% [(20.1 + 1.6)/54] versus the industry average of 50% and long-term debt to equity, 37% (20.1/54), versus the industry average of 40%. The low PP&E levels also indicates that the company is not likely an electric utility.

CFA Level I

"Understanding Balance Sheets,"Elaine Henry and Thomas R. Robinson

Sections 4.4, 7.1, 7.2

Question
164 of 240

For a company that prepares its financial statements under International Financial Reporting Standards (IFRS), for which of the following assets is it *mostlikely* that the company could report using the fair value model?

	A building the company owns and uses to house its administrative activities
	A building owned by the company and leased out to tenants
	Houses built by the company for sale to customers

Question not answered

Under IFRS, a building owned for the purpose of earning rentals or capital appreciation—in this case, the one owned by the company and leased out to tenants—is an investment property and can be reported under either the cost model or fair value model.

CFA Level I
“Inventories,” Michael A. Broihahn
Section 4

“Long-Lived Assets,” Elaine Henry and Elizabeth A. Gordon
Section 8

Question
165 of 240

The method a high end custom-built motorcycle manufacturer uses to value its inventory results in the matching of the physical flow of the particular items sold, and the items remaining in inventory, to their actual cost. Which of the following inventory valuation methods is the manufacturer *most likely* using?

	FIFO
	Weighted average cost
	Specific identification

Question not answered

Specific identification is the inventory method that results in the matching of the physical flow of the particular items sold and would be most suitable for high-end custom-built motorcycles that are not ordinarily considered interchangeable.

CFA Level I

"Inventories," Michael A. Broihahn

Section 3.1

Question
166 of 240

An analyst is reviewing the property, plant, and equipment disclosure related to a company's warehouse. The company uses the International Financial Reporting Standards (IFRS) revaluation model. The analyst would *least likely* be able to determine:

	the original date of acquisition.
	how the fair value was obtained.
	the carrying amount under the cost model.

Question not answered
IFRS does not require disclosure of the original date of acquisition.

CFA Level I
"Long-Lived Assets," Elaine Henry and Elizabeth A. Gordon
Section 7

Question
167 of 240

Selected information from a company's comparative income statement and balance sheet is presented below:

Selected Income Statement Data for the Year Ended 31 August ($ thousands)		
	2013	**2012**
Sales revenue	100,000	95,000
Cost of goods sold	47,000	47,500
Depreciation expense	4,000	3,500
Net Income	11,122	4,556

Selected Balance Sheet Data as of 31 August ($ thousands)		
	2013	**2012**
Current Assets		
Cash and investments	21,122	25,000
Accounts receivable	25,000	13,500
Inventories	13,000	8,500
Total current assets	59,122	47,000
Current liabilities		
Accounts payable	15,000	15,000
Other current liabilities	7,000	9,000

Total current liabilities	22,000	24,000

The cash collected from customers in 2013 is *closest* to:

	$111,500.
	$96,100.
	$88,500.

Question not answered

Cash collected from customers = Revenues – Increase in accounts receivable = $100 – (25 – 13.5) = $88.5 thousand.

CFA Level I

"Understanding Cash Flow Statements," Elaine Henry, Thomas R. Robinson, Jan Hendrik van Greuning, and Michael A. Broihahn

Section 3.2.1.1

Question
168 of 240
The following information applies to a capital asset of a company:

Year ending	**2014**	**2013**	**2012**
Capital asset	€2,500	€2,500	€2,500
Accumulated depreciation	375	250	125
Net book value	2,125	2,250	2,375

This company uses the straight line depreciation method for this capital asset.

At the end of 2014, the expected remaining life of the capital asset, in years, is *closest* to:

	17.
	20.
	6.

Question not answered
Based on the annual increase in accumulated depreciation, annual depreciation expense is $125 and the asset was acquired in 2012.
Total useful life of the capital asset = 2,500/125 = 20 years.
Remaining useful life three years later = 20 years – 3 years = 17 years.

CFA Level I
"Long-Lived Assets," Elaine Henry and Elizabeth A. Gordon
Section 3.1

"Financial Statement Analysis: Applications," Thomas R. Robinson, Jan Hendrik van Greuning, Elaine Henry, and Michael A. Broihahn
Section 6.4

Question
169 of 240
A company that uses International Financial Reporting Standards (IFRS) entered into a three-year construction project with a total contract price (all figures in thousands) of $5,300 and expected costs of $4,400. At inception, the outcome of the contract could not be reliably measured, but the company did expect to recover its costs. Actual results are shown in the following table:

($ thousands)	**Year 1**	**Year 2**	**Year 3**	**Total**

Costs incurred and paid	$1,200	$2,000	$1,200	$4,400
Amounts billed and payments received	$800	$3,000	$1,500	$5,300

The amount of revenue (in thousands) the company recognized in Year 2 was *closest* to:

	$2,409.
	$0.
	$2,000.

Question not answered

Under IFRS, if the outcome of the contract cannot be reliably measured, but the company expects to recover its costs, then revenue may be recognized to the extent of the contract costs incurred. In Year 2, the costs incurred were $2,000 thousand, thus, the revenue would also be $2,000 thousand and the gross profit would be $0.

CFA Level I

"Understanding Income Statements," Elaine Henry and Thomas R. Robinson

Section 3.2.1

Question
170 of 240
Under IFRS, the costs incurred in the issuance of bonds are *most likely*:

	included in the measurement of the bond liability.
	expensed when incurred.
	deferred as an asset and amortized on a straight-line basis.

Question not answered

Under IFRS, debt issuance costs are included in the measurement of the bond liability.

CFA Level I
"Non-Current (Long-Term) Liabilities," by Elizabeth A. Gordon and Elaine Henry
Section 2.1

Question
171 of 240
A company has a building with a net carrying amount of $100,000 and a tax base of $120,000 The tax rate was 20% when the asset was purchased, but it is scheduled to be reduced to 17% this year. Which of the following will the company *most likely* report related to this building?

	Deferred tax liability: $600
	Deferred tax asset: $4,000
	Deferred tax asset: $3,400

Question not answered

The Deferred tax asset is based on the temporary difference arising from the difference in the carrying value for taxes vs. the financial statements = (120,000 – 100,000) × 17%= 3,400. The rate that should be used is the rate expected when the reversal will occur which is now the lower rate of 17%.

CFA Level I

"Income Taxes," Elbie Antonites and Michael A. Broihahn

Section 3.3

Question
172 of 240

Income statements for two companies (A and B) and the common-size income statement for the industry are provided in the following table:

($ thousands)	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:

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

Question not answered

Common-sized analysis of the income statements shows that Company A has a lower percentage cost of goods sold and thus a higher gross margin than the industry and Company B.

	Company A	Company B	Industry	Company A	Company B
Sales	$10,500	$8,250	100.0%	100%	100%
Cost of goods sold	6,353	5,239	62.8%	60.5%	63.5%
Gross margin			37.2%	39.5%	36.5%
Company A earns a higher gross margin than both Company B and the industry.					
Pretax earnings	$683	$454	5.4%	6.5%	5.5%
Taxes	205	145	1.7%	2.0%	1.8%
Tax rate = Taxes/Pretax earnings			32%	30%	32%
The tax rates for the companies are not higher than the industry.					

The tax rates for the companies are not higher than the industry. The interest rate is not a function of sales and cannot be analyzed on a common-size income statement. Tax rates are determined based on Taxes/Pretax earnings, not as a percentage of sales (as shown in common-size analysis).

CFA Level I

“Understanding Income Statements,” Elaine Henry and Thomas R. Robinson
Section 7

“Financial Analysis Techniques,” Elaine Henry, Thomas R. Robinson, and Jan Hendrik van Greuning
Sections 3.1, 3.2.2

Question
173 of 240

Data for a firm are presented in the following table:

As of 31 December	**£ thousands**
Cash	200
Accounts receivable	350
Inventory	1,250
Accounts payable	300
Taxes payable	200
Installment loan payable, due in three equal annual payments on 30 June.	600

The current ratio for the firm's industry is 3.2. Based on the current ratio, the firm's liquidity compared with the industry is *best*described as being:

	higher.
	equivalent.
	lower.

Question not answered
The higher the current ratio, the more liquid the company. Thus, with a current ratio of 2.6 (1,800/700), the company is less liquid than the industry, which has a current ratio of 3.2.

Current ratio = Current assets/Current liabilities.

Current Assets	**£ thousands**		**Current Liabilities**	**£ thousands**
Cash	200		Accounts payable	300
Accounts receivable	350		Taxes payable	200
Inventory	1,250		Loan payable, first installment	200
Total	1,800		Total	700

CFA Level I
“Understanding Balance Sheets,” Elaine Henry and Thomas R. Robinson
Section 7.2

“Financial Analysis Techniques,” Elaine Henry, Thomas R. Robinson, and Jan Hendrik van Greuning
Section 4.3

“Working Capital Management,” Edgar A. Norton, Jr., Kenneth L. Parkinson, and Pamela Peterson Drake
Sections 2.2

Question
174 of 240

If a company has a deferred tax asset reported on its statement of financial position and the tax authorities reduce the tax rate, which of the following statements is *most* accurate concerning the effect of the change? The existing deferred tax asset will:

	not be affected.
	increase in value.
	decrease in value.

Question not answered

A decrease in the tax rate will result in a decrease in the previously reported amounts of deferred tax assets. That is, the value of the future tax assets, based on the new lower rate, is reduced for offsetting future tax payments.

CFA Level I
"Income Taxes," Elbie Antonites and Michael A. Broihahn
Section 3.3

Question
175 of 240

The following data are available on a company:

Metric	
Working capital	\$60 million
Non-current assets	\$235 million
Equity	\$170 million
Current ratio	1.75

The company's financial leverage is *closest* to:

	1.7.
	1.2.
	2.2.

Question not answered

First determine current assets:

where CA = Current assets, CL = Current liabilities, WC = Working capital, and CR = Current ratio.	
CR = CA/CL = 1.75; CL = CA/1.75	
WC = CA – CL; 60 = CA – CA/1.75	60 = 0.75/1.75 × CA
	CA = 140

Then solve for total assets and determine financial leverage:

Metric	
Current assets	\$140 million
Non-current assets	+ \$235 million
Total assets	\$375 million
Equity	\$170 million
Financial leverage = Total assets/Equity	2.2

CFA Level I
"Understanding Balance Sheets," Elaine Henry and Thomas R. Robinson
Section 7.2

Question

176 of 240
The following data are available for a company's first year of operations:

Metric	£ Thousands
Earnings before tax reported on the income statement	2,640
Depreciation expense included in earnings before tax	4,500
Accounting expenses that are not deductible for tax purposes	2,130
Depreciation expense deductible for tax purposes in first year of operations	6,340
Corporate tax rate	25%

The company's end-of-year balance sheet will *most likely* include (in thousands) a deferred tax

	liability of £733.
	asset of £73.
	liability of £460.

Question not answered
Deferred tax balances result from temporary differences between a company's income as reported for tax purposes and income reported for financial statement purposes. The temporary difference in this case arises from the difference between the depreciation for accounting purposes and the depreciation for tax purposes. Because of this difference, the company would report more income tax expense than would actually be paid in taxes. The difference is a deferred tax liability.

Temporary difference balance = Depreciation expense for accounting purposes – Depreciation for tax purposes	£6,340 – £4,500	£1,840
Deferred tax balance = Temporary difference balance × Corporate tax rate	£1,840 × 25%	£460

CFA Level I
"Understanding Balance Sheets," Elaine Henry and Thomas R. Robinson
Section 5.2

"Income Taxes," Elbie Antonites and Michael A. Broihahn
Sections 2.2, 4

Question
177 of 240
The following selected balance sheet and ratio data are available for a company:

Metric	Current Year	Previous Year
Cash and cash equivalents	98.0	
Marketable securities	389.2	
Accounts receivables	12.0	
Other current assets	120.1	
Total current assets	619.3	
Deferred revenues	85.0	

Other current liabilities	92.3	
Total current liabilities	177.3	
Cash ratio		2.37
Quick ratio		2.97
Current ratio		3.27

Which of the following ratios *most likely* decreased this year?

	Current
	Cash
	Quick

Question not answered

Metric	Current Year	Previous Year	Conclusion
Cash ratio = (Cash + Marketable securities)/Current liabilities	(98 + 389.2)/177.3 = 2.75	2.37	Increase
Quick ratio = (Cash + Marketable securities + Receivables)/ Current liabilities	(98 + 389.2 + 12)/ 177.3 = 2.82	2.97	Decrease
Current ratio = Current assets/ Current liabilities	619.3/177.3 = 3.49	3.27	Increase

CFA Level I
“Understanding Balance Sheets,” Elaine Henry and Thomas R. Robinson
Section 7.2

“Financial Analysis Techniques,” Elaine Henry, Thomas R. Robinson, and Jan Hendrik van Greuning
Section 4.3

Question
178 of 240
Under IFRS it is *most* appropriate to include which of the following pension costs of a defined benefit plan in other comprehensive income?

	Actuarial gains or losses
	Net interest expense accrued on the beginning net pension liability
	Employees service cost

Question not answered
Under IFRS only actuarial gains or losses can be recognized in other comprehensive income.

CFA Level I

"Non-Current (Long-Term) Liabilities," Elizabeth A. Gordon and Elaine Henry

Sections 4

Question
179 of 240

A company is selling a long-lived asset with a carrying amount of $70,000 for $80,000. The original cost of this asset was $120,000. In the year of sale, this event is *most likely* to be reported on the income statement as:

	a gain of $10,000.
	a loss of $40,000.
	revenues of $80,000.

Question not answered

When a long lived asset is sold only the net gain or loss is reported on the income statement. The gain or loss on a sale = sales proceeds – carrying amount = $80,000 – $70,000 = $10,000 gain.

CFA Level I

"Long-lived Assets," Elaine Henry and Elizabeth A. Gordon

Section 6.1

Question
180 of 240
A company acquired a customer list for $300,000 and a trademark for $5,000,000. Management expects the customer list to be useful for three years, and it expects to use the trademark for the foreseeable future. The trademark must be renewed every 10 years with the Patent and Trademark office for a nominal amount; otherwise it expires. If the company uses straight-line depreciation for all its intangible assets, the annual amortization expense for these two assets will be *closest* to:

	$600,000.
	$0.
	$100,000.

Question not answered

The trademark can be renewed at a minimal cost; therefore, it is considered to have an indefinite life, and amortization expense is not required.

Annual amortization expense on the customer list = $300,000 / 3 = $100,000.

CFA Level 1
"Long-Lived Assets," by Elaine Henry and Elizabeth A. Gordon
Section 3.2

Question
181 of 240

The analytical tool that would be *most* appropriate for an analyst to use to identify the percentage of a company's assets that are liquid is the:

	common-size balance sheet.
	cash ratio.
	current ratio.

Question not answered
A common-size balance sheet expresses all balance sheet accounts as a percentage of total assets and would provide insight into what portion of a company’s assets is liquid. On the other hand, cash and current ratios measure liquidity relative to current liabilities, not relative to total assets.

CFA Level I

“Understanding Balance Sheets,” Elaine Henry and Thomas R. Robinson

Sections 7.1, 7.2

“Financial Analysis Techniques,” Elaine Henry, Thomas R. Robinson, and Jan Hendrik van Greuning

Section 3.2.1

Question
182 of 240
The following data are available on a company:

Metric	**Company**
Stock price per share	$60.75
Comprehensive income (millions)	$193.0
Other comprehensive income (millions)	$87.6
Common shares outstanding (millions)	$46.5

On a net income basis, the company's P/E is *closest* to:

	14.6.
	26.8.
	10.1.

Question not answered

Net income = Comprehensive income – Other comprehensive income	$193.0 – $87.6	$105.4 million
Net income per share (EPS) = Net income/Common shares outstanding	$105.4/46.5	$2.27 million
P/E = Stock price/EPS	$60.75/$2.27	26.76

CFA Level I
“Understanding Income Statements,” Elaine Henry and Thomas R. Robinson
Section 8

“Financial Analysis Techniques,” Elaine Henry, Thomas R. Robinson, and Jan Hendrik van Greuning
Section 5.1

Question
183 of 240
The central limit theorem is *best* described as stating that the sampling distribution of the sample mean will be approximately normal for large-size samples:

	for populations described by any probability distribution.
	if the population distribution is symmetrical.
	if the population distribution is normal.

Question not answered
The central limit theorem holds without regard for the distribution of the underlying population.

CFA Level I

"Sampling and Estimation," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 3.1

Question
184 of 240
The following sample of 10 items is selected from a population. The population variance is unknown.

The standard error of the sample mean is *closest* to:

	10.84.
	3.60.
	3.43.

Question not answered
When the population variance is unknown, the standard error of the sample mean is calculated as:

Deviation from Mean	**Squared Deviation**
(10 – 3.6) = 6.4	$6.4^2 = 40.96$
(20 – 3.6) = 16.4	$16.4^2 = 268.96$
(–8 – 3.6) = –11.6	$–11.6^2 = 134.56$
(2 – 3.6) = –1.6	$–1.6^2 = 2.56$
(–9 – 3.6) = –12.6	$–12.6^2 = 158.76$
(5 – 3.6) = 1.4	$1.4^2 = 1.96$
(0 – 3.6) = –3.6	$–3.6^2 = 12.96$
(–8 – 3.6) = –11.6	$–11.6^2 = 134.56$
(3 – 3.6) = –0.6	$–0.6^2 = 0.36$
(21 – 3.6) = 17.4	$\underline{17.4^2 = 302.76}$
Total	1058.4
Variance	1058.4/9 = 117.6
Standard deviation (*s*):	√117.6 = 10.844

The standard error of the sample mean is therefore $10.844/10^{0.5} = 3.429 \sim 3.43$.

CFA Level I

"Sampling and Estimation," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 3.1

Question
185 of 240
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 *most* appropriate approach when the variance is:

	known.
	unknown.
	large.

Question not answered

When the sample size is small (and the population is normally or approximately normally distributed), the Student's *t*-distribution is preferred if the variance is unknown.

CFA Level I

"Sampling and Estimation," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 4.2

Question
186 of 240

A sample of 100 observations drawn from a normally distributed population has a sample mean of 12 and a sample standard deviation of 4.

Cumulative Probabilities for a Standard Normal Distribution $P(Z \le x) = N(x)$ for $x \ge 0$ or $P(Z \le z) = N(z)$ for $z \ge 0$										
x or *z*	0	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
1.5	0.9332	0.9345	0.9357	0.9370	0.9382	0.9394	0.9406	0.9418	0.9429	0.9441
1.6	0.9452	0.9463	0.9474	0.9484	0.9495	0.9505	0.9515	0.9525	0.9535	0.9545
1.7	0.9554	0.9564	0.9573	0.9582	0.9591	0.9599	0.9608	0.9616	0.9625	0.9633
1.8	0.9641	0.9649	0.9656	0.9664	0.9671	0.9678	0.9686	0.9693	0.9699	0.9706
1.9	0.9713	0.9719	0.9726	0.9732	0.9738	0.9744	0.9750	0.9756	0.9761	0.9767
2.0	0.9772	0.9778	0.9783	0.9788	0.9793	0.9798	0.9803	0.9808	0.9812	0.9817

Using the excerpt from the *z*-distribution given above, the 95% confidence interval for the population mean is *closest* to:

	11.216 to 12.784.
	11.340 to 12.660.
	4.160 to 19.840.

Question not answered

The 95% confidence interval uses $z_{0.025}$ as the reliability factor. The cumulative probability value closest to 0.975 provides the appropriate value of $z_{0.025}$, which is $z_{0.025}$ = 1.96. The confidence interval is written as:

In this problem, 12 ± 1.96 × (4/√100) = 12 ± 1.96 × 0.4 (i.e., 11.216 to 12.784).

CFA Level I

"Sampling and Estimation," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David

E. Runkle

Section 4.2

Question
187 of 240
If a stock's continuously compounded return is normally distributed, then the distribution of the future stock price is *best* described as being:

	a Student's *t*.
	lognormal.
	normal.

Question not answered
If a stock's continuously compounded return is normally distributed, then the future stock price is necessarily lognormally distributed.

CFA Level I

"Common Probability Distributions," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 3.4

Question
188 of 240
Independent samples drawn from normally distributed populations exhibit the following characteristics:

Sample	Size	Sample Mean	Sample Standard Deviation
A	25	200	45
B	18	185	60

Assuming that the variances of the underlying populations are equal, the pooled estimate of the common variance is 2,678.05. The*t*-test statistic appropriate to test the hypothesis that the two population means are equal is *closest* to:

	0.29.
	1.90.
	0.94.

Question not answered
The *t*-statistic for the given information (normally distributed populations, population variances assumed equal) is calculated as:

In this case, we have:

s^2_p = 2678.05.

CFA Level I
“Hypothesis Testing,” Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 3.2

Question
189 of 240
A portfolio manager would like to calculate the compound rate of return on an investment. Which of the following mean returns will he *most likely* use?

	Geometric
	Arithmetic
	Harmonic

Question not answered
The geometric mean return represents the growth rate or compound rate of return on an investment.

CFA Level I

"Statistical Concepts and Market Returns," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 5.4.2

Question
190 of 240
The following information is available for a portfolio:

	Asset Allocation Weight (%)	**Asset Class Return (%)**	**Correlation with Equities Class (%)**
Asset Class			
Equities	45	16	100
Mortgages	25	12	30
Cash and equivalents	30	2	10

The return on the portfolio is *closest* to:

	10.8%.
	8.2%.
	10.0%.

Question not answered
The portfolio return is the weighted mean return and is calculated as follows:

CFA Level I

“Statistical Concepts and Market Returns,” Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 5.4.1

Question
191 of 240
A two-tailed *t*-test of the hypothesis that the population mean differs from zero has a *p*-value of 0.0275. Using a significance level of 5%, the *most* appropriate conclusion is:

	that the chosen significance level is too high.
	to reject the null hypothesis.

	to accept the null hypothesis.

Question not answered

The *p*-value is the smallest level of significance at which the null hypothesis can be rejected. In this case, the given *p*-value (0.0275) is less than the given level of significance (0.05); therefore, the null hypothesis is rejected.

CFA Level I

"Hypothesis Testing," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 2

Question
192 of 240

A tree diagram is *most likely* used when dealing with investment problems that involve outcomes that are:

	mutually exclusive.
	unconditional at each node.
	independent at each node.

Question not answered

The following figure depicts an example of a tree diagram:

A tree diagram is a diagram with branches emanating from nodes representing either mutually exclusive outcomes or mutually exclusive decisions. Mutually exclusive outcomes are dependent (the occurrence of one outcome does affect the probability of occurrence of the other outcome). In addition, outcomes at each node are conditional (the probability of an outcome is conditioned on another outcome).

CFA Level I
"Probability Concepts," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle
Section 2

Question
193 of 240

When considering two mutually exclusive capital budgeting projects with conflicting rankings—one has a higher positive net present value (NPV), the other has a higher internal rate of return (IRR)—the *most* appropriate conclusion is to choose the project with the:

	shorter payback.
	higher NPV.
	higher IRR.

Question not answered

The project with the higher NPV should be undertaken because NPV measures the increase in wealth as a result of taking the project. For mutually exclusive projects, IRR may give incorrect decisions as a result of scale and/or cash flow timing effects. Payback is not an economically sound method for evaluation of capital projects.

CFA Level I

"Discounted Cash Flow Applications," Richard A. Defusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 2.3

"Capital Budgeting," John D. Stowe and Jacques R. Gagné

Sections 4.3, 4.8

Question
194 of 240

Use of a nonparametric test is *most* appropriate when the:

	population variance is unknown.
	distribution is symmetrical.
	data are given in ranks.

Question not answered

Nonparametric procedures are primarily used in three situations: when the data are given in ranks, when the data do not meet distributional assumptions, or when the hypothesis being addressed does not concern a parameter.

CFA Level I

"Hypothesis Testing," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 5

Question
195 of 240

Which of the following, holding all else constant, will *most likely* increase the width of the confidence interval for a parameter estimate?

	Reduction in the degree of confidence
	Use of the *t*-distribution rather than the normal distribution to establish the confidence interval
	Increase in the sample size

Question not answered

Reflecting the uncertainty of the unknown variance, confidence intervals based on the *t*-distribution will be larger than those using the normal distribution because $t > z$ for any sample size, n, with the exception of $n = \infty$. Larger sample sizes and reduced confidence levels, holding all else constant, both reduce the width of a confidence interval.

CFA Level I

"Sampling and Estimation," Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Sections 4.2, 4.3

Question
196 of 240

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

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

Question not answered

Wave 2 is a correction, retracing much of the gain from Wave 1, but not all of it. The lost proportion is usually a percentage equal to a Fibonacci ratio, and it consists of three smaller waves.

CFA Level I

"Technical Analysis," Barry M. Sine and Robert A. Strong

Section 4

Question
197 of 240

An analyst wants to estimate the return on the S&P 500 Index for the current year using the following data and assumptions:

- Sample size = 50 stocks from the index.
- Mean return for those stocks in the sample for the previous year = 0.114.
- Variance = 0.0529.
- The reliability factor for a 95% confidence interval with unknown population variance and sample size greater than 30 is $z_{.025}$ = 1.96.

If he assumes that the S&P 500 return this year will be the same as it was last year, which of the following is the *best* estimate of the 95% confidence interval for this year's S&P 500 return?

	0.09934 to 0.12866
	–0.33680 to 0.56480
	0.05025 to 0.17775

Question not answered

The reliability factor for a 95% confidence interval with unknown population variance and sample size greater than 30 is $z_{.025}$ = 1.96. The confidence interval estimate is;

With sample variance of 0.0529, *s* = √0.0529 = 0.23. The estimated interval is: 0.114 ± 1.96 × (0.23/√50) = 0.114 ± 1.96 × (0.03253) = 0.114 ± 0.06375= **+0.05025 to +0.17775**.

CFA Level I

“Sampling and Estimation,” Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle

Section 4.2

Question
198 of 240

Compared with other investment asset classes, an investment in real estate is *least likely* to be characterized by:

	fixed location.
	basic indivisibility.
	homogeneity.

Question not answered

Because no two properties are identical, homogeneity is not a feature of an investment in real estate.

CFA Level I

"Introduction to Alternative Investments," Terri Duhon, George Spentzos, and Scott D. Stewart

Section 5

Question
199 of 240

A hedge fund begins the year with $120 million and earns a 25% return for the year. The fund charges a 1.5% management fee on end-of-year fund value and a 15% incentive fee on the return, net of the management fees, that is in excess of a 6% fixed hurdle rate. The fund's investors' return for the year, net of fees, is *closest* to:

	20.56%.
	21.25%.
	19.66%.

Question not answered

The $120 million grows by 25% to $150 million [= $120 million × (1 + 0.25)]. The management fee is $2.25 million (= $150 million × 0.015), leaving $147.75 million, net of the management fee, or an increase of $27.75 million over the beginning value of $120 million. The 6% hurdle rate requires an increase of $7.2 million (= $120 million × 0.06), so the fund has earned $20.55 million (= $27.75 million – $7.2 million) over the hurdle rate, net of the management fee.

The incentive fee is 15% of this, or $3.0825 million (= $20.55 million × 0.015), leaving an increase in fund assets, net of management and incentive fees, of $24.6675 million (= $27.75 million – $3.0825 million). The investor's return, net of fees, is $24.6675/$120 million = 20.56%.

CFA Level I

"Introduction to Alternative Investments," Terri Duhon, George Spentzos, and Scott D. Stewart

Section 3.3.1

Question
200 of 240

Which of the following is *most likely* a private equity strategy?

	Quantitative directional
	Merger arbitrage
	Venture capital

Question not answered

Venture capital is a private equity strategy in which private equity companies invest and get actively involved in the management of portfolio companies.

CFA Level I

"Introduction to Alternative Investments," Terri Duhon, George Spentzos, and Scott D. Stewart

Section 4.2.2

Question
201 of 240
Do management fees *most likely* get paid to the manager of a hedge fund, regardless of the fund's performance?

	No, only when the fund's net asset value exceeds the previous high-water mark
	No, only when the fund's gross return is positive
	Yes

Question not answered
Regardless of performance, the management fee is always paid to the fund manager.

CFA Level I

"Introduction to Alternative Investments," Terri Duhon, George Spentzos, and Scott D. Stewart

Section 3.3.1

Question
202 of 240
For a stock that pays no dividends, the value of an American call option is *most likely*:

	the same as the value of a European call option with otherwise identical features.
	greater than the value of a European call option with otherwise identical features.
	less than the value of a European call option with otherwise identical features.

Question not answered
American call prices can differ from European call prices only if the underlying stock is dividend paying. In the absence of such cash payments, European and American call options have the same value.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 4.3

Question
203 of 240
Which statement *best* describes the early exercise of American options? Early exercise may be advantageous for:

	both deep-in-the-money calls and deep-in-the-money puts.
	deep-in-the-money puts.
	deep-in-the-money calls.

Question not answered
Only deep-in-the-money put options may be exercised early. The price cannot fall below zero and thus the additional upside of such an option is limited.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 4.3

Question
204 of 240
When valuing a call option using the binomial model, an increase in the probability that the underlying will go up, *most likely* implies that the current price of the call option:

	remains unchanged.
	increases.
	decreases.

Question not answered
The probability that the underlying will go up is not part of the binomial model for pricing options. This probability is irrelevant, since the options are priced using risk-neutral probabilities. These are derived by constructing a hedged portfolio in the absence of arbitrage opportunities.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 4.2

Question
205 of 240
Valuation of a swap during its life will *least likely* involve the:

	use of replication.
	application of the principle of no arbitrage.
	investor's risk aversion.

Question not answered
Risk neutrality, not risk aversion, is a key element of derivatives pricing, including swaps.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 1

Question
206 of 240
The pricing of forwards and futures will *most likely* differ if:

	interest rates exhibit zero volatility.
	futures prices and interest rates are negatively correlated.
	futures prices and interest rates are uncorrelated.

Question not answered
The pricing of forwards and futures will differ if futures prices and interest rates are negatively correlated. A negative correlation between futures prices and interest rates makes forwards more

desirable than futures in the long position.

CFA Level I

"Basics of Derivative Pricing and Valuation," Don M. Chance

Section 3.2

Question
207 of 240
An investor purchases ABC stock at $71 per share and executes a protective put strategy. The put option used in the strategy has a strike price of $66, expires in two months, and is purchased for $1.45. At expiration, the protective put strategy breaks even when the price of ABC is closest to:

	$72.45.
	$64.55.
	$67.45.

Question not answered
To break even, the underlying stock must be at least as high as the amount expended up front to establish the position. To establish the protective put, the investor would have spent $71 + $1.45 = $72.45.

CFA Level I

"Risk Management Applications of Option Strategies," Don M. Chance

Section 2.2.2

Question
208 of 240
A trader buys 500 shares of a stock on margin at $36 a share using an initial leverage ratio of 1.66. The maintenance margin requirement for the position is 30%. The stock price at which the margin call will occur is *closest* to:

	$25.20.
	$30.86.
	$20.57.

Question not answered
Initial equity (%) in the margin transaction = 1/Leverage ratio = 1/1.66 = 0.60;
Initial equity per share at the time of purchase = $36 × 0.60 = $21.60;
Price (P) at which margin call occurs:
Equity per share/Price per share = Maintenance margin (%)
= ($21.60 + P – $36)/P = 0.30;
0.7P = $14.40;
P = $20.57.

CFA Level I

“Market Organization and Structure,” Larry Harris

Section 5.2

Question
209 of 240
Industry analysis is *least* useful to those who are engaged in:

	a top-down investment approach.
	indexing and passive investing strategies.
	portfolio performance attribution.

Question not answered
Indexing and passive investing strategies would not engage in over- or underweighting of industries, industry rotation, or timing investments in industries. Therefore, industry analysis is not useful to such investors or portfolio managers.

CFA Level I
“Introduction to Industry and Company Analysis,” Patrick W. Dorsey, Anthony M. Fiore, and Ian Rossa O’Reilly
Section 2

Question
210 of 240
If securities markets are semi-strong-form efficient, the *most* appropriate role of a portfolio manager is to:

	manage portfolios with appropriate diversification and asset allocation, taking into consideration investor preferences.
	invest by analyzing publicly available information to consistently generate abnormal returns.
	exploit appropriate trading rules and serial correlations for achieving excess returns.

Question not answered
If markets are semi-strong-form efficient (which also encompasses weak-form efficiency), the role of a portfolio manager is not necessarily to beat the market, but rather to establish and manage a portfolio consistent with the portfolio’s objectives, with appropriate diversification and asset allocation, while taking into consideration the risk preferences and tax situation of the investor.

CFA Level I
“Market Efficiency,” W. Sean Cleary, Howard J. Atkinson, and Pamela Peterson Drake
Section 3.4.3

Question
211 of 240
Which of the following statements concerning different types of market indices is *least* accurate?

	Commodity indices are subject to different weighting methods for specific commodities.
	Hedge fund indices are subject to survivorship bias from voluntary reporting.
	Equity indices draw from a larger number of constituent securities than fixed-income indices.

Question not answered
The fixed-income universe includes securities issued by governments, government agencies, and corporations with a variety of types and characteristics. The number of fixed-income securities is many times larger than the number of equity securities.

CFA Level I

"Security Market Indices," Paul D. Kaplan and Dorothy C. Kelly

Sections 6.1, 7.1, 7.3

Question
212 of 240
Participating preference shares are *least likely* to entitle the shareholders to participate in:

	additional distribution of the company's assets upon liquidation.
	additional dividends if the company's profits exceed a predetermined level.
	corporate decisions through voting rights.

Question not answered

Participating preference shares do not entitle the shareholders to participate in corporate decisions through voting rights. But they do entitle them to (1) an additional dividend if the company's profits exceed a prespecified level and (2) additional distribution of the company's assets upon liquidation, above the par.

CFA Level I
"Overview of Equity Securities," by Ryan C. Fuhrmann and Asjeet S. Lamba
Section 3.2

Question
213 of 240

Compared with public equity markets, which of the following statements is *most* accurate about private equity markets? Operating in the private market:

	offers stronger incentives to improve corporate governance.
	allows management to better adopt a long-term focus.
	allows more opportunities to raise capital.

Question not answered

The management of a public firm is under pressures to meet shorter-term demands, such as meeting quarterly sales and earnings projections from analysts. Private owners are thus better able to focus on longer-term value creation opportunities.

CFA Level I

"Overview of Equity Securities," Ryan C. Fuhrmann, and Asjeet S. Lamba

Section 4

Question
214 of 240
Which of the following is *most* accurate concerning key characteristics of different types of preference shares?

	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.

	Preference shareholders rank above subordinated bondholders with respect to claims on the company's net assets upon liquidation.
	Preference shares have characteristics of both debt and equity securities.

Question not answered
Preference shares have characteristics of both debt securities and common shares. Similar to interest payments on debt securities, the dividends on preference shares are fixed but not contractual obligations. Similar to common shares, preference shares can be perpetual and can pay dividends indefinitely.

CFA Level I
"Overview of Equity Securities," Ryan C. Fuhrmann and Asjeet S. Lamba
Section 3.2

Question
215 of 240
A corporate manager pursuing a low-cost strategy will *most likely*:

	engage in offering products of unique quality or type.
	have strong market research teams for product development and marketing.
	invest in productivity-improving capital equipment.

Question not answered
A corporate manager pursuing a cost leadership strategy must be able to invest in productivity-improving capital equipment for achieving cost controls and being able to offer products and services at lower prices than the competition.

CFA Level I

"Introduction to Industry and Company Analysis," Patrick W. Dorsey, Anthony M. Fiore, and Ian Rossa O'Reilly

Section 6

Question
216 of 240
An industry experiencing intense competitive rivalry among incumbent companies is *best* characterized by:

	differentiated products and low exit barriers.
	customers basing purchase decisions largely on price.
	a small number of competitors and low fixed costs.

Question not answered
The factor that most influences customer purchase decisions is likely to also be the focus of competitive rivalry in the industry. In general, industries in which price is a large factor in customer purchase decisions tend to be more competitive than industries in which customers value other attributes more highly.

CFA Level I
“Introduction to Industry and Company Analysis,” Patrick W. Dorsey, Anthony M. Fiore and Ian Rossa O’Reilly
Section 5.1.6

Question
217 of 240
The following data pertain to a company that can be appropriately valued using the Gordon growth model. The dividend is expected to grow indefinitely at the existing sustainable growth rate.

EPS growth rate (three-year average)	7.50%
Current dividend per share	$3.00
Return on equity	15%
Dividend payout ratio	45%
Investors' required rate of return	16%

The stock’s intrinsic value is *closest* to:

	$41.90.
	$34.62.
	$37.94.

Question not answered
$V_0 = D_0\ (1 + g)/(r – g)$, where
Sustainable growth rate = $g = b$ × ROE; b = (1 – Payout ratio)
g = (1 – 0.45) × 15% = 8.25%;
V_0 = ($3 × 1.0825) ÷ (0.16 – 0.0825) = $41.90.

CFA Level I

“Equity Valuation: Concepts and Basic Tools,” John J. Nagorniak and Stephen E. Wilcox

Section 4.2

Question
218 of 240
Which of the following statements is *most* accurate?

	Convertible preference shares are more volatile and riskier than the underlying common shares.
	Investors owning a small number of common shares would prefer statutory voting to cumulative voting.
	Putable common shares provide benefits to both the issuing company and investors.

Question not answered
The put option feature facilitates raising capital because the shares are more appealing to investors. As such, it provides a benefit to the issuing company. It also helps investors limit their potential losses because they can sell the shares back to the issuing company if the market price falls below the pre-specified put price. Therefore, putable common shares are beneficial to both the issuing company and the investors.

CFA Level I
“Overview of Equity Securities,” Ryan C. Fuhrmann and Asjeet S. Lamba
Section 3

Question
219 of 240
An investor who wants to estimate the enterprise value multiple (EV/EBITDA) of a company has gathered the following data:

Market value (MV) 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

	3.5.
	5.8.
	2.5.

Question not answered
Enterprise Value (EV) = Market capitalization + MV of debt + MV of preferred stock – Cash and short-term investments.
EV = 45 + 10 – 2.5 = 52.5; EV/EBITDA = 52.5/15 = 3.5.

CFA Level I

“Equity Valuation: Concepts and Basic Tools,” John J. Nagorniak and Stephen E. Wilcox

Section 5.4

Question
220 of 240
Which of the following terms in a bond issue *most likely* helps to reduce credit risk?

	Sinking fund arrangement
	Floating rate note
	Term maturity structure

Question not answered
A sinking fund arrangement is a way to reduce credit risk by making the issuer set aside funds over time to retire the bond issue.

CFA Level 1

"Fixed-Income Markets: Issuance, Trading, and Funding," Moorad Choudhry, Steven V. Mann, and Lavone F. Whitmer

Section 6.3.3

Question
221 of 240
A bond is selling for 98.2. It is estimated that the price will fall to 96.6 if yields rise 30 bps and that the price will rise to 100.1 if yields fall 30 bps. Based on these estimates, the effective duration of the bond is *closest to*:

	11.88.
	5.94.
	1.78.

Question not answered

The effective duration of a bond is,where PV_-, PV_0, and PV_+ are the values of the bond when the yield falls, under the current yield, and when the yield rises, respectively, and ∆Curve is the change in the benchmark yield curve. So, EffDur =

CFA Level 1

"Understanding Fixed-Income Risk and Return," James F. Adams and Donald J. Smith

Section 3.2

Question
222 of 240
An investor is *least likely* exposed to reinvestment risk from owning a(n):

	callable bond.
	amortizing security.
	zero-coupon bond.

Question not answered
There are no interim cash flows for a zero-coupon bond until the maturity.

CFA Level I

"Understanding Fixed-Income Risk and Return," James F. Adams and Donald J. Smith

Section 2

Question
223 of 240
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
B	$8,000,000	$6,000,000	7
C	$4,000,000	$6,000,000	6

The portfolio's duration is *closest* to:

	5.33.
	5.20.
	4.75.

Question not answered
The portfolio's duration is a weighted average of the durations of the individual holdings, computed as: (12/24) × (3.0) + (6/24) × (7.0) + (6/24) × (6.0) = 4.75.

CFA Level I

"Understanding Fixed-Income Risk and Return," James F. Adams and Donald J. Smith

Section 3.4

Question
224 of 240
Consider a $100 par value bond with a 7% coupon paid annually and 5 years to maturity. At a

discount rate of 6.5%, the value of the bond today is $102.08. One day later, the discount rate increases to 7.5%. Assuming the discount rate remains at 7.5% over the remaining life of the bond, what is *most likely* to occur to the price of the bond between today and maturity?

	Decreases then remains unchanged
	Increases then decreases
	Decreases then increases

Question not answered

If the discount rate increases to 7.5% from 6.5%, the price of a bond decreases. At a discount rate of 7.5%, the bond sells at a discount to face value. As a discount bond approaches maturity, it will increase in price over time until it reaches par at maturity.

CFA Level I

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 2.3

Question
225 of 240

Using the following US Treasury forward rates, the value of a 2½-year $100 par value Treasury bond with a 5% coupon rate is*closest* to:

Period	Years	Forward Rate
1	0.5	1.20%
2	1	1.80%
3	1.5	2.30%
4	2	2.70%
5	2.5	3.00%

	$104.87.
	$106.83.
	$101.52.

Question not answered

The value of the bond is

CFA Level I

"Introduction to Fixed-Income Valuation," James F. Adams and Donald J. Smith

Section 4

Question
226 of 240

In a rising interest rate environment, the effective duration of a putable bond relative to an otherwise identical non-putable bond, will *most likely* be:

	the same.
	higher.

	lower.

Question not answered

When interest rates are rising, the put option becomes more valuable to the investor. The ability to sell the bond at par value limits the price depreciation as rates rise. So, the presence of an embedded put option reduces the sensitivity of the bond price to changes in interest rates, resulting in a lower effective duration.

CFA Level 1

"Understanding FixedIncome Risk and Return," James F. Adams and Donald J. Smith

Section 3.3

Question
227 of 240

A bond with a par value of $100 matures in 10 years with a coupon of 4.5% paid semiannually; it 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:

	3.91%.
	1.95%.
	0.98%.

Question not answered

Approximate percentage price change = –[7.81 × (–0.0025)] = 0.01953 or 1.95%.

CFA Level I

"Understanding Fixed-Income Risk and Return," James F. Adams and Donald J. Smith

Section 4.1

Question
228 of 240

Which bonds *most likely* rank the highest with respect to priority of claims?

	Second lien debt
	Senior unsecured bond
	Subordinated debt

Question not answered

Second lien debt has a secured interest in the pledged assets and ranks higher than the unsecured debt, such as senior unsecured bonds and subordinated debt.

CFA Level I

"Fundamentals of Credit Analysis," Christopher L. Gootkind

Section 3.2

Question
229 of 240

Which of the following contingency provisions in a bond *most likely* benefits the issuer?

	Call provision
	Conversion to common shares

	Put provision

Question not answered

A call provision gives the issuer the right to redeem all or part of the bond before the specified maturity date to protect the issuer against a decline in interest rates. Therefore, it benefits the issuer and provides a lower future funding cost.

CFA Level 1

"Fixed-Income Securities: Defining Elements," Moorad Choudhry and Stephen E. Wilcox, CFA

Section 5

Question
230 of 240

Which of the following bonds are *most likely* to be bearer bonds?

	Domestic bonds
	Eurobonds
	Foreign bonds

Question not answered

Most eurobonds are bearer bonds, meaning that the trustee does not keep records of who owns the bonds; only the clearing system knows who the bond owners are.

CFA Level 1

"Fixed-Income Securities: Defining Elements," Moorad Choudhry, and Stephen E. Wilcox

Section 3.2

Question
231 of 240

Samsung Electronics Co has issued a five-year bond with a par value of $1,000 and a coupon rate of 6.5%. This bond is *most likely* to be classified as a:

	consol.
	capital market security.
	surety bond.

Question not answered

Fixed-income securities with original maturities that are longer than one year are called capital market securities. The bond mentioned in the question has a five year maturity and therefore it is a capital market security.

CFA Level I

"Fixed-Income Securities: Defining Elements," Moorad Choudhry and Stephen E. Wilcox

Section 2.1.2

Question
232 of 240

A South Korean electronics company issued bonds denominated in US dollars in the United States and registered with the SEC. These bonds are *most likely* known as a:

	eurobond.

	foreign bond.
	global bond.

Question not answered

Bonds issued by entities that are incorporated in another country are called foreign bonds. Therefore, the bonds issued by a South Korean company in the United States are known as foreign bonds.

CFA Level 1

"Fixed-Income Securities: Defining Elements," Moorad Choudhry and Stephen E. Wilcox

Section 3.2

Question
233 of 240
DMT Corp. issued a five-year floating-rate note (FRN) that pays a quarterly coupon of three-month LIBOR plus 125 bps. The FRN is priced at 96 per 100 of par value. Assuming a 30/360 day-count convention, evenly spaced periods, and constant three-month LIBOR of 5%, the discount margin for the FRN is *closest* to:

	400 bps.
	221 bps.
	180 bps.

Question not answered

The interest payment each period per 100 of par value is:

The discount margin can be estimated by solving for DM in the equation:

The solution for the discount rate, r = (0.05+DM)/4 is 1.8025%. Therefore DM = 2.21%, or 221 bps.

CFA Level I
“Introduction to Fixed-Income Valuation,” by James F. Adams and Donald J. Smith
Section 3.4

Question
234 of 240
If the yield-to-maturity on an annual-pay bond is 7.75%, the bond-equivalent yield is *closest* to:

	8.05%.
	7.61%.
	7.90%.

Question not answered

The bond-equivalent yield =

CFA Level 1
“Introduction to Fixed-Income Valuation,” James F. Adams and Donald J. Smith
Section 3.3

Question
235 of 240

The slope of the security market line (SML) represents the portion of an asset's expected return attributable to:

	market risk.
	diversifiable risk.
	total risk.

Question not answered

The slope of the SML is the market risk premium, $E(Rm) - Rf$. It represents the return of the market minus the return of a risk-free asset. Thus, the slope represents the portion of expected return that reflects compensation for market or systematic risk.

CFA Level I

"Portfolio Risk and Return: Part II," Vijay Singal

Section 4.2

Question
236 of 240

In a strategic asset allocation, assets within a specific asset class are *least likely* to have:

	low correlations with other asset classes.
	similar risk and return expectations.
	low paired correlations.

Question not answered

In a strategic asset allocation, assets within a specific asset class have high paired correlations and low correlations with other asset classes.

CFA Level I

"Basics of Portfolio Management and Construction," Alistair Byrne and Frank E. Smudde

Section 3.2

Question
237 of 240

If Investor A has a lower risk aversion coefficient than Investor B, on the capital allocation line, will Investor B's optimal portfolio*most likely* have a higher expected return?

	No, because Investor B has a higher risk tolerance
	No, because Investor B has a lower risk tolerance
	Yes

Question not answered

Investor B has a higher risk aversion coefficient, thus a lower risk tolerance and a lower expected return on the capital allocation line.

CFA Level I

"Portfolio Risk and Return: Part I," Vijay Singal

Section 3.3

Question
238 of 240
A portfolio with equal parts invested in a risk-free asset and a risky portfolio will *most likely* lie on:

	the security market line.
	a capital allocation line.
	the efficient frontier.

Question not answered
A capital allocation line shows possible combinations of a risky portfolio and the risk-free asset.

CFA Level I

"Portfolio Risk and Return: Part II," Vijay Singal

Section 2.1

Question
239 of 240
An analyst observes that the historic geometric nominal return for equities is 9%. Given a real return of 1% for riskless Treasury bills and annual inflation of 2%, the real rate of return and risk premium for equities are *closest* to:

	6.9% and 7.9%.
	7.9% and 5.8%.
	6.9% and 5.8%.

Question not answered
(1 + 0.09)/(1 + 0.02) – 1 = 6.9%, and (1 + 0.69)/(1 + 0.01) – 1 = 5.8%.

CFA Level I

"Portfolio Risk and Return: Part I," Vijay Singal

Section 2.2.3

Question
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A portfolio contains equal weights of two securities having the same standard deviation. If the correlation between the returns of the two securities was to decrease, the portfolio risk would *most likely*:

	remain the same.
	increase.
	decrease.

Question not answered
The formula for the return standard deviation (risk) of a two asset portfolio is

.

The formula for portfolio risk shows that portfolio risk decreases as the correlation decreases.

CFA Level I

"Portfolio Risk and Return: Part I," Vijay Singal

Section 4.1.3