

2011 Level I Mock Exam: Morning Session

The morning session of the 2011 Level I Chartered Financial Analyst® Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of 1.5 minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

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

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Questions 1 through 18 relate to Ethical and Professional Standards.

1. Gabrielle Gabbe, CFA has been accused of professional misconduct by one of her competitors. The allegations concern Gabbe's personal bankruptcy filing ten years ago when she was a college student and had a large amount of medical bills she could not pay. By not disclosing the bankruptcy filing to her clients, did Gabbe *most likely* violate any CFA Institute Standards of Professional Conduct?
 - A. No.
 - B. Yes, related to Misconduct.
 - C. Yes, related to Misrepresentation.

2. Bryan Barrett, CFA has 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?
 - A. No.
 - B. Yes, related to Misrepresentation.
 - C. Yes, related to Communication with Clients.

3. 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 has determined that 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?
 - A. Market Manipulation
 - B. Preservation of Confidentiality
 - C. Material Non Public Information

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4. Diana Fairbanks, CFA is married to an auditor who is employed at a large accounting firm. When her husband mentions a computer firm he audits will receive a qualified opinion she thinks nothing of it. Later that week when she reviews a new client account she notices there are substantial holdings of this computer firm. When she does a thorough Internet search for news on the company, she does not find anything about its most recent audit or any other adverse information. Which of the following actions concerning the computer stock should Fairbanks *most likely* take to avoid violating the CFA Institute Standards of Professional Conduct?
- A. Take no investment action.
 - B. Complete a thorough and diligent analysis of the company and then sell the stock.
 - C. Sell the stock immediately as she has a reasonable basis for taking this investment action.
5. Sherry Buckner, CFA manages equity accounts for government entities whose portfolios are conservative and risk averse. Since the objective of her clients is to maximize returns with the lowest possible risk, Buckner considers adding to their holdings a new, thinly-traded, leveraged derivative product which she believes has the potential for high returns. To make her investment decision, Buckner relies upon comprehensive research from an investment bank that has a solid reputation for top quality research. After her review of that research, Buckner positions her accounts so that each has a 10% allocation to the derivative product. Did Buckner *most likely* violate any CFA Institute Standards of Professional Conduct by purchasing the derivative for her clients?
- A. No.
 - B. Yes, related to Suitability.
 - C. Yes, related to Loyalty, Prudence and Care.
6. Teresa Staal, CFA is an investment officer in a bank trust department. She manages money for celebrities and public figures, including an influential local politician. She receives a request from the politician's political party headquarters to disclose his stock holdings. The request indicates local law requires the disclosure. What steps should Staal *most likely* take to ensure she does **not** violate any CFA Institute Standards of Professional Conduct?
- A. Provide the information and inform her client.
 - B. Send the requested documents and inform her supervisor.
 - C. Check with her firm's compliance department to determine her legal responsibilities.

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7. Sergio Morales, CFA believes he has found evidence his supervisor is engaged in fraudulent activity concerning 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 upon disclosing his evidence, is told he should mind his own business. Concerned his job is at risk, Morales provides his evidence, along with copies of the client's most recent account statements, to a government whistle blower program. Morales is *least likely* to have violated which of the following CFA Institute Standards of Professional Conduct?
- A. Duties to Clients
 - B. Duties to Employers
 - C. Communication with Clients
8. Leng Bo, CFA is a bond portfolio manager for individual investors. Last year, a client whose portfolio is limited to investment-grade bonds approved Bo's purchase of a below investment grade bond. Because yields in the high grade fixed income markets declined, Bo subsequently decides to enhance this client's portfolio by investing in several additional bonds with ratings one or two notches below investment grade. The investment strategy implemented by Bo *most likely* violated which of the following CFA Institute Standards of Professional Conduct?
- A. Suitability
 - B. Communications with Clients
 - C. Independence and Objectivity
9. Sisse Brimberg, CFA is responsible for performance presentations at her investment firm. The presentation that Sisse uses states her firm:
- 1. deducts all fees and taxes;
 - 2. uses actual and simulated performance results;
 - 3. bases the performance on a representative individual account.
- Based on the above information, which of the following is the *most* appropriate recommendation to help Brimberg meet the CFA Institute Standards of Professional Conduct in her performance presentations? She should present performance based on:
- A. a gross of fee basis.
 - B. actual not simulated results.
 - C. a weighted composite for all similar portfolios.

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10. Eileen Fisher, CFA has been a supervisory analyst at SL Advisors for the past ten years. Recently, one of her analysts was found to be in violation of the CFA Institute Standards of Professional Conduct. Fisher has placed limits on the analyst's activities and is now monitoring all of his investment activities. Although SL did not have any compliance procedures up to this point, to avoid future violations, Fischer has put in place procedures exceeding industry standards. Did Fisher *most likely* violate any CFA Institute Standards of Professional Conduct?
- A. Yes.
 - B. No, because she has taken steps to ensure the violations will not be repeated by the analyst.
 - C. No, because she is taking steps to implement compliance procedures that are more than adequate.
11. 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 this vendor when it applies to her country and would like to use a local vendor on whom she has already conducted due diligence. Which of the following actions concerning the research vendor should La Valle *most likely* take to avoid violating the CFA Institute Standards of Professional Conduct?
- A. Use the local research vendor.
 - B. Use the bank-approved research vendor.
 - C. Use both the local and the bank-approved research vendors.
12. 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 upon the next six months 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:
- A. separate fact from opinion.
 - B. include earnings estimates.
 - C. identify limitations of the analysis.

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13. Yao Tsang, CFA has a large percentage of his net worth invested in the Australian mining company, Outback Mines, which he has held for many years. Tsang is in the process of moving to a new employer where he is responsible for initiating research on mining companies. Shortly after his move, Tsang is asked to complete a research report on Outback. In order to meet the CFA Institute Standards of Professional Conduct concerning his stock holding, which of the following actions is *most* appropriate for Tsang to take?
- A. Disclose his stock holding to his employer and to clients.
 - B. Sell his stock holdings to eliminate any potential conflict of interest.
 - C. Refuse to write the report and ask his employer to assign another analyst to complete the analysis.
14. Teresa Avila, CFA is a micro cap investment analyst at a hedge fund. The fund requires Avila to hold any securities she recommends for the fund in her own account as well. Because Avila has such a small account, whenever she trades for her own portfolio she combines the transactions with those of the hedge fund so she is sure to have her account aligned with the fund. Has Avila *most likely* violated any CFA Institute Standards of Professional Conduct?
- A. No.
 - B. Yes, related to Misconduct.
 - C. Yes, related to Priority of Transactions.
15. Ken Kawasaki, CFA shares a building with a number of other professionals who are also involved in the investment management business. Kawasaki makes arrangements with several of these professionals, including accountants and lawyers, to refer clients to each other. There is an expectation that an informal score is kept so that the referrals will equal out over time, so there are no cash payments. Kawasaki never mentions this arrangement to clients or prospective clients. Does Kawasaki's agreement with the other building occupants *most likely* violate any CFA Institute Standards of Professional Conduct?
- A. No.
 - B. Yes, related to referral fees.
 - C. Yes, related to communication with clients.

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16. Stian Klun, CFA is preparing a brochure to advertise his firm. The brochure includes the following disclosures:

"I am a CFA so I am a member of the CFA Institute which I believe constitutes the most elite group of professionals within the investment management business. In order to become a CFA charterholder I had to complete a comprehensive program of study in the investment management field."

Klun is *least likely* to have violated the CFA Institute Standards of Professional Conduct related to referencing the:

- A. CFA Institute.
 - B. CFA Program.
 - C. CFA Designation.
17. Holly Baker, CFA is explaining the CFA Institute Code of Ethics to a client. Which of the following statements could Baker make to *most likely* reflect disciplinary sanctions the CFA Institute may impose? Sanctions include:
- A. fines for violations.
 - B. revocation of membership.
 - C. banishment from the industry.
18. Which of the following *least likely* forms the basic structure for enforcement of the CFA Institute Professional Conduct Program?
- A. Bylaws
 - B. Rules of Procedure
 - C. Board of Governors

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Questions 19 through 32 relate to Quantitative Methods

19. Assume that a stock's price over the next two periods is as shown below.

Time = 0	Time = 1	Time = 2
$S_0 = 100$	$S_u = 110$	$S_{uu} = 121$
	$S_d = 92$	$S_{ud,du} = 101.20$
		$S_{dd} = 84.64$

The initial value of the stock is \$100. The probability of an up move in any given period is 40% and the probability of a down move in any given period is 60%. Using the binomial model, the probability that the stock's price will be \$101.20 at the end of two periods is *closest* to:

- A. 16%.
 - B. 24%.
 - C. 48%.
20. Use the following values from Student's t-distribution to establish a 95% confidence interval for the population mean given a sample size of 10, a sample mean of 6.25, and a sample standard deviation of 12. Assume that the population from which the sample is drawn is normally distributed and the population variance is not known.

Degrees of freedom	$p = 0.10$	$p = 0.05$	$p = 0.025$	$p = 0.01$
9	1.383	1.833	2.262	2.821
10	1.372	1.812	2.228	2.764
11	1.363	1.796	2.201	2.718

The 95% confidence interval is *closest* to:

- A. a lower bound of -2.33 and an upper bound of 14.83.
 - B. a lower bound of -2.20 and an upper bound of 14.70.
 - C. a lower bound of -0.71 and an upper bound of 13.20.
21. A sample of 438 observations is randomly selected from a population. The mean of the sample is 382 and the standard deviation is 14. Based on Chebyshev's inequality, the endpoints of the interval that must contain at least 88.89% of the observations are *closest* to:
- A. 340 and 424.
 - B. 354 and 410.
 - C. 396 and 480.

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22. The following ten observations are a sample drawn from a normal population: 25, 20, 18, -5, 35, 21, -11, 8, 20, and 9. The mean of the sample is *closest* to:
- A. 14.00.
 - B. 15.56.
 - C. 17.20.
23. 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:
- A. -0.37%
 - B. 0.25%
 - C. 8.99%
24. A sample of 25 observations has a mean of 8 and a standard deviation of 15. The standard error of the sample mean is *closest* to:
- A. 1.60.
 - B. 3.00.
 - C. 3.06.
25. The probability of event A is 40%. The probability of event B is 60%. The joint probability of AB is 40%. The probability that A or B occurs or both occur is *closest* to:
- A. 40%.
 - B. 60%.
 - C. 84%.
26. A consumer purchases an automobile using a loan. The amount borrowed is €30,000 and the terms of the loan call for the loan to be repaid over five years using equal monthly payments with an annual nominal interest rate of 8% and monthly compounding. The monthly payment is *closest* to:
- A. €608.29.
 - B. €626.14.
 - C. €700.00.

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27. The dollar discount on a U.S. Treasury bill with 91 days until maturity is \$2,100. The face value of the bill is \$100,000. The bank discount yield of the bill is *closest* to:
- A. 8.31%.
 - B. 8.40%.
 - C. 8.58%.
28. One is *most likely* to reject the null hypothesis when the p-value of the test statistic:
- A. is negative.
 - B. exceeds a specified level of significance.
 - C. falls below a specified level of significance.
29. When an investigator wants to test whether a particular parameter is larger than a specific value, the null and alternative hypothesis are *best* defined as:
- A. $H_0: \theta = \theta_0$ versus $H_a: \theta \neq \theta_0$
 - B. $H_0: \theta \leq \theta_0$ versus $H_a: \theta > \theta_0$
 - C. $H_0: \theta \geq \theta_0$ versus $H_a: \theta < \theta_0$
30. A hypothesis test fails to reject a false null hypothesis. This is *best* described as a:
- A. Type I error.
 - B. Type II error.
 - C. test with little power.
31. Which of the following statements is *most* accurate?
- A. The first quintile generally exceeds the median.
 - B. The first quintile generally exceeds the first decile.
 - C. The first quintile generally exceeds the first quartile.
32. Assuming no short selling, diversification benefit is *most likely* to occur when the correlations among the securities contained in the portfolio are:
- A. equal to positive one.
 - B. less than positive one.
 - C. greater than positive one.

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Questions 33 through 44 relate to Economics

33. 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:
- A. elastic.
 - B. inelastic.
 - C. perfectly elastic.
34. Regarding a company's production function, both labor costs and capital costs are *best* described as:
- A. fixed in the long run.
 - B. variable in the long run.
 - C. variable in the short run.

35. Consider the following data for 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*:

- A. 21.
 - B. 23.
 - C. in excess of 24.
36. Assume that two firms in a duopoly enter into a collusive agreement in an attempt to form a cartel and restrict output, raise prices, and increase profits. Given this, the *most likely* outcome according to the Nash equilibrium is that:
- A. both firms cheat.
 - B. both firms comply.
 - C. one firm cheats and the other firm complies.

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37. The tools used by the U.S. Federal Reserve system (the Fed) to implement monetary policy *most likely* include:
- A. transfer payments.
 - B. open market operations.
 - C. raising or lowering income taxes.
38. Suppose inflation increases due to increases in government spending and a reduction in taxes. Such inflation is *best* described as:
- A. cost-push inflation.
 - B. demand-pull inflation.
 - C. monetarist cycle theory.
39. The price of a good falls from \$15 to \$13. Given this decline in price, the quantity demanded of the good rises from 100 units to 120 units. The price elasticity of demand for the good is *closest* to:
- A. 1.3.
 - B. 1.5.
 - C. 10.0.
40. The supply curve for a particular factor of production with total income consisting solely of economic rent is *most likely*:
- A. vertical.
 - B. horizontal.
 - C. perfectly elastic.
41. In competitive markets, when the efficient quantity is produced, the *least likely* result is to:
- A. maximize total surplus.
 - B. generate underproduction.
 - C. minimize deadweight loss.
42. A minimum wage above the equilibrium wage is *best* characterized as a:
- A. price floor.
 - B. price ceiling.
 - C. means of minimizing unemployment.

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43. The crowding-out effect is *most likely* associated with:
- A. falling real interest rates.
 - B. government budget deficits.
 - C. government budget surpluses.
44. Successful product development, advertising, and the creation of brand names are *most likely* to have a positive impact on the economic profits of the producer under:
- A. a monopoly.
 - B. perfect competition.
 - C. monopolistic competition.

Questions 45 through 68 relate to Financial Statement Analysis

45. Common-size financial statements are *most likely* an output of which step in the financial analysis framework?
- A. Collect data
 - B. Process data
 - C. Analyze/interpret data
46. Which of the following statements is *most* accurate?
- A. Accrued revenue arises when a company receives cash prior to earning the revenue.
 - B. A valuation adjustment for an asset converts its historical cost to its depreciated value.
 - C. Accrued expenses arise when a company incurs expenses that have not yet been paid as of the end of the accounting period.
47. Under IFRS, which of the following is *most likely* one of the fundamental principles underlying the preparation of financial statements?
- A. Reliability
 - B. Consistency
 - C. Understandability

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48. To be recognized as a financial statement element under the IFRS Framework for the Preparation and Presentation of Financial Statements an element *most* appropriately needs to:
- A. have a cost or value that can be measured with reliability.
 - B. normally be carried at historical cost, current cost or fair market value.
 - C. provide certainty that any future economic benefit associated with the item will flow to or from the enterprise.
49. A company uses the percentage-of-completion method to recognize revenue from its long term construction contracts and estimates percent completion based on expenditures incurred as a percentage of total estimated expenditures. A three-year contract for €10 million was undertaken with a 30% gross profit anticipated. The project is now at the end of its second year, and the following end-of-year information is available:

	Year 1	Year 2
Costs incurred during year	€3,117,500	€2,582,500
Estimated total costs	7,250,000	7,600,000

The gross profit recognized in year 2 is *closest* to:

- A. €17,500.
- B. €80,000.
- C. €60,000.

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50. The following financial information is available at the end of the year.

Security	Share Information		Other features
	Authorized	Issued & outstanding	
Common stock	500,000	250,000	Currently pays a dividend of \$1 per share.
Preferred stock, series A	50,000	12,000	Nonconvertible, cumulative; pays a dividend of \$4 per share.
Preferred stock, series B	50,000	30,000	Convertible; pays a dividend of \$7.50 per share. Each share is convertible into 2.5 common shares.
Additional Information: Retained earnings at start of year = \$6,000,000 Reported income for the year = \$1,000,000			

The diluted EPS is *closest* to:

- A. \$2.91.
 - B. \$2.93.
 - C. \$3.08.
51. At the start of the year, a company acquired new equipment at a cost of €50,000, estimated to have a 3 year life and a residual value of €5,000. If the company depreciates the asset using the double declining balance method, the depreciation expense that the company will report for the third year is *closest* to:
- A. €55.
 - B. €3,328.
 - C. €3,705.

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52. Assume a company has the following portfolio of marketable securities which was acquired at the end of 2009:

Category	Original Cost in € as at the Year End, 2009	Fair Market Value in € as at the Year End, 2010
Held for trading	12,000,000	12,500,000
Available for sale	17,000,000	16,000,000

If the company reports under IFRS instead of U.S. GAAP, its net income will *most likely* be:

- A. the same.
 - B. €500,000 lower.
 - C. €500,000 higher.
53. The use of financial ratio analysis is *most likely* limited in which of the following situations? When:
- A. providing a means of evaluating management's ability.
 - B. comparing companies using different accounting methods.
 - C. providing insights into microeconomic relationships within a company that help analysts project earnings and free cash flow.
54. Which of the following statements is *most* accurate regarding cash flow statements prepared under IFRS and U.S. GAAP?
- A. Under U.S. GAAP, bank overdrafts should be classified as a financing cash flow.
 - B. Under IFRS, interest paid can be reported either as an operating or an investing cash flow.
 - C. Both the direct and indirect formats of cash flow statements are allowed under IFRS and U.S. GAAP, but indirect is encouraged under IFRS only.

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55. The following is selected data from a company's operations:

Net Income	\$100,000
Increase in Accounts receivable	12,000
Increase in Accounts payable	9,000
Depreciation and amortization	8,000

The cash flow from operations is *closest* to:

- A. \$89,000.
 - B. \$105,000.
 - C. \$111,000.
56. An equity analyst is forecasting the next year's net profit margin of a heavy equipment manufacturing firm, by using the average net profit margin over the past three years. In making his profit projection, he is concerned about the following three items:

1.	The company suffered losses from discontinued operations in each of the past three years.
2.	The most recent year's tax rate was only one half the prior two years' rate as a result of a fiscal stimulus.
3.	The company experienced gains on the sale of investments in each of the past three years.

Which of the following statements about the preparation of the forecast is *most* accurate?
The analyst would:

- A. use the most recent tax rate because that is the best predictor of future tax rates.
- B. exclude the gains on the sale from investments because the company is a manufacturing firm.
- C. include the discontinued operations because they appear to be an on-going feature for this company.

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57. An analyst gathered the following data for two companies in the same industry:

	Company A	Company B
Days in sales outstanding	28	32
Days of inventory on hand	32	35
Days of payables	42	40
Current assets	\$203,000	\$189,000
Total assets	581,000	469,000
Current liabilities	73,000	71,000
Total liabilities	429,000	350,000
Shareholders' equity	152,000	119,000

Which of the following is the *most* appropriate conclusion the analyst can make?
Compared to Company B, Company A:

- A. is more liquid.
 - B. has more financial risk.
 - C. has a longer time between cash outlay and cash collection.
58. A company incurs the followings costs related to its inventory during the year:

Cost	¥ millions
Purchase price	100,000
Trade discounts	5,000
Import duties	20,000
Shipping of raw materials to manufacturing facility	10,000
Manufacturing conversion costs	50,000
Abnormal costs as a result of waste material	8,000
Storage cost prior to shipping to customers	2,000

The amount charged to inventory cost (in millions) is *closest* to:

- A. ¥175,000.
 - B. ¥177,000.
 - C. ¥185,000.
59. Compared with using the FIFO method to account for inventory, during a period of rising prices, which of the following ratios is *most likely* higher for a company using LIFO?
- A. Current ratio
 - B. Gross margin
 - C. Inventory turnover

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60. A company which prepares its financial statements using IFRS wrote down its inventory value by €20,000 in 2009. In 2010, prices increased and the same inventory was worth €30,000 more than its value at the end of 2009. Which of the following statements is *most* accurate? In 2010, the company's cost of sales:
- A. was unaffected.
 - B. decreased by €20,000.
 - C. decreased by €30,000.
61. A Mexican corporation is computing the depreciation expense of a piece of manufacturing equipment for the fiscal year ended December 31, 2010 using the information below. The company takes a full year's depreciation in the year of acquisition.

Date of purchase	January 1, 2010
Cost of equipment	MXN 2,000,000
Estimated residual value	MXN 200,000
Expected useful life	10 years
Total productive capacity	5,000,000 units
Production in 2010	800,000 units

- The depreciation expense (in MXN) will *most likely* be:
- A. 180,000 lower using the straight-line method compared with the double-declining balance method.
 - B. 140,000 higher using the units-of-production method compared with the straight-line method.
 - C. 112,000 higher using the double-declining method compared with the units-of-production method.
62. A company, which prepares its financial statements in accordance with IFRS uses the revaluation model to value land. At the end of the current year the land value of the land has increased and will be adjusted on the balance sheet. Which of the following statements is *most* accurate? In the current period the revaluation of the land will:
- A. increase return on sales.
 - B. increase return on assets.
 - C. decrease the debt to equity ratio.

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63. At the beginning of the year a company purchased a fixed asset for \$500,000 with no expected residual value. The company depreciates similar assets on a straight-line basis over 10 years, while the tax authorities allow declining balance depreciation at the rate of 15% per year. In both cases the company takes a full year's depreciation in the first year and the tax rate is 40%. Which of the following statements concerning this asset at the end of the year is *most* accurate?
- A. The tax base is \$500,000.
 - B. The deferred tax asset is \$10,000.
 - C. The temporary difference is \$25,000.
64. A company, which prepares its financial statements in accordance with IFRS issues £5,000,000 face value ten year bonds on January 1, 2010 when interest rates are 5.50%. The bonds carry a coupon of 6.50%, with interest paid annually on December 31. The carrying value of the bonds as of December 31, 2011 will be *closest* to:
- A. £4,695,562.
 - B. £5,301,000.
 - C. £5,316,000.
65. Compared to classifying a lease as a financing lease, if a lessee reports the lease as an operating lease it will *most likely* result in a:
- A. lower return on assets.
 - B. higher debt-to-equity ratio.
 - C. lower cash from operations.
66. A company reports that to maintain good relations with its suppliers, it has entered into a financing arrangement with a bank whereby it will periodically have the bank pay its suppliers the amounts owed and it will then repay the bank in the following period. The motivation for the company's behavior is *most likely* to:
- A. improve its current ratio.
 - B. improve its relations with its suppliers.
 - C. manage the timing of operating cash flows.

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67. An equity manager conducted a stock screen on 5,000 U.S. stocks that comprise her investment universe. The results of the screen are presented in the table below.

Criterion	% of Stocks Meeting Criterion
Price per share/Sales per share <1.25	35.0
Total asset/Equity ≤ 2.5	48.2
Dividends >0	58.6
Consensus forecast EPS >0	75.0
Meeting all 4 criteria simultaneously	10.8

If all the criteria were completely independent of each other, the number of stocks meeting all four criteria would be *closest* to:

- A. 293.
 - B. 371.
 - C. 540.
68. When analyzing a company that prepares its financial statements according to U.S. GAAP, calculating the price/tangible book value ratio instead of the price/book value ratio is *most* appropriate if it:
- A. grows primarily through acquisitions.
 - B. develops its patents and processes internally.
 - C. invests a substantial amount in new capital assets.

Questions 69 through 78 relate to Corporate Finance

69. A project has the following annual cash flows:

Year 0:	Year 1:	Year 2:	Year 3:	Year 4:
-\$4,662,005	\$22,610,723	-\$41,072,261	\$33,116,550	-\$10,000,000

Which of the following discount rates *most likely* produces the highest net present value (NPV)?

- A. 8%
- B. 10%
- C. 15%

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70. 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?
- A. Bonds
 - B. Common stock
 - C. Preferred stock
71. Other factors held constant, the reduction of a company's average accounts payables due to suppliers offering less trade credit will *most likely*:
- A. reduce the operating cycle.
 - B. increase the operating cycle.
 - C. not affect the operating cycle.
72. 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?
- A. Dividend discount model
 - B. Capital asset pricing model
 - C. Bond-yield-plus risk-premium
73. An inventory system that reduces average inventory without affecting sales will *most likely* reduce the:
- A. quick ratio.
 - B. inventory turnover.
 - C. cash conversion cycle.
74. A company currently has sales of €1,200 thousand and it makes the following forecasts for the next year:

Sales growth next year:	10%
Cost of goods sold as a proportion of sales:	75%
Salary, general, and administrative expenses as a proportion of sales:	10%

The expected gross profit for next year (in thousands) is *closest* to:

- A. €198.
- B. €300.
- C. €330.

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75. The following information is available for a firm.

Market Risk Premium:	7.0%
Risk-free Rate:	2.0%
Comparable Firm Return:	10.4%
Comparable Firm Debt-to-Equity Ratio:	1.0
Comparable Firm Tax Rate:	40.0%

The firm's unlevered beta is *closest* to:

- A. 0.75.
 - B. 1.05.
 - C. 1.20.
76. 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:

- A. 1.43.
 - B. 2.00.
 - C. 2.86.
77. A share repurchase method that requires existing shareholders to indicate the number of shares they will tender over a range of prices is *most likely* an example of a:
- A. Dutch auction.
 - B. repurchase by direct negotiation.
 - C. purchase of shares on the open market.
78. The annual cost of trade credit assuming a 365-day year for terms 3/10 net 40 is *closest* to:
- A. 32.0%.
 - B. 43.3%.
 - C. 44.9%.

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Questions 79 through 90 relate to Equity Investments

79. The type of efficiency that exists in an economy that uses resources in such a way that they are most valuable is *best* described as:

- A. operational.
- B. allocational.
- C. informational.

80. A market has the following limit orders standing on its book for a particular stock:

Buyer	Bid Size (# of shares)	Limit Price (\$)	Seller	Offer Size (# of shares)	Limit Price (\$)
1	500	18.50	1	200	20.20
2	300	18.90	2	300	20.35
3	400	19.20	3	400	20.50
4	200	20.10	4	100	20.65
5	100	20.15	5	200	20.70

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

- A. \$20.35.
 - B. \$20.50.
 - C. \$20.58.
81. Which of the following statements is *most* accurate with respect to rebalancing and reconstitution of security market indices?
- A. Equal weighted indices require frequent rebalancing.
 - B. Turnover within an index results from a reconstitution but not from rebalancing.
 - C. A price-weighted index requires rebalancing more than a market-capitalization-weighted index.

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82. The data for four stocks in an index are as follows:

Stock	Shares Outstanding	% Shares in Market Float	Beginning of Period Price (\$)	End of Period Price (\$)	Dividends Per Share (\$)
A	5,000	90	40	45	1.00
B	2,000	100	68	60	0.50
C	6,000	70	60	70	1.50
D	4,000	40	20	24	0.80

Assuming the beginning value of the float-adjusted market-capitalization-weighted equity index is 100, the ending value is *closest* to:

- A. 109.1.
B. 110.9.
C. 111.3.
83. If a securities market is efficient, it is *most likely* that:
- A. security prices would react only to the “unexpected” elements of information.
B. investors would prefer active investment strategies to passive investment strategies.
C. the time frame for price adjustment allows many traders to earn profits with little risk.
84. A financial analyst utilizing his analytical expertise and up-to-date information buys a company’s stock. His close friends, who lack information or expertise, imitate the financial analyst’s action and buy the stock. Which of the following statements concerning this behavioral bias is *most* accurate?
- A. It improves market efficiency.
B. It is identical to representativeness.
C. It is inconsistent with rational behavior.
85. Returns from a depository receipt are *least likely* impacted by which of the following factors?
- A. Exchange rate movements
B. Analysts' recommendations
C. The number of depository receipts

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86. Firms with which of the following characteristics are *most likely* candidates for a management buyout (MBO)?
- A. High dividend payout ratios
 - B. Large amounts of overvalued assets and low debt levels
 - C. Large amounts of undervalued assets and high levels of cash flow
87. An industry experiencing intense competitive rivalry among incumbent companies is *best* characterized by:
- A. differentiated products and low exit barriers.
 - B. a small number of competitors and low fixed costs.
 - C. customers basing purchase decisions largely on price.
88. Industry analysis is *least* useful to those who are engaged in:
- A. a top-down investment approach.
 - B. portfolio performance attribution.
 - C. indexing and passive investing strategies.
89. An analyst gathers the following information about a company:

Balance Sheet			
Assets		Liabilities and Shareholders' Equity	
Cash	\$ 5,000	Accounts payable	\$ 10,000
Accounts receivable	15,000	Notes payable	15,000
Inventory	25,000	Long-term debt	40,000
Net fixed assets	<u>80,000</u>	Common shareholders' equity	<u>60,000</u>
Total assets	\$125,000	Total liabilities and equity	\$125,000
Additional Information			
Number of outstanding shares		7,000	
Market value of long-term debt		\$45,000	
Market value of accounts receivable and inventory		90% of reported values	
Net fixed assets		120% of reported value	
Accounts payable and notes payable		Same as the reported value	

Using asset-based valuation approach, the estimated value per share is *closest* to:

- A. \$ 9.57.
- B. \$10.29.
- C. \$11.00.

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90. A stock selling at \$50 has a P/E multiple of 20 on the basis of the current year's earnings. An analyst estimates that next's earnings per share will be 10% higher and that the stock should be valued on a forward looking basis at the industry average P/E of 18. Based on the analyst's assessment, it is *most likely* that the stock is currently:
- A. overvalued.
 - B. fairly valued.
 - C. undervalued.

Questions 91 through 96 relate to Derivative Investments.

91. Two parties agree to a forward contract on a non-dividend paying stock at a price of \$103.00. At contract expiration the stock trades at \$105.00. In a cash-settled forward contract, the:
- A. short pays the long \$2.00.
 - B. short pays the long \$103.00.
 - C. long pays the short \$105.00.
92. A combination of interest rate calls is referred to as an interest rate:
- A. cap.
 - B. floor.
 - C. collar.
93. A European call option on a non-dividend paying stock with a strike price of \$25.00 expires in 3 months. The underlying stock currently trades at \$29.00. The risk-free rate is 5.00%. The lower bound for the European call is *closest* to:
- A. \$0.00.
 - B. \$4.00.
 - C. \$4.30.
94. If the volatility of returns of an underlying security increases, then:
- A. both call and put option prices increase.
 - B. both call and put option prices decrease.
 - C. call prices increase and put prices decrease.

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95. Prices of a futures contract for five consecutive trading-days are provided in the table below. The initial margin requirement is set at \$6.00 per contract and the maintenance margin is \$3.60 per contract.

Day	Futures Price
0	\$120
1	118
2	117
3	119
4	123
5	125

On day 0, a trader enters into a short position for 15 contracts. The ending balance for the margin account on day 5 is *closest* to:

- A. \$15.
 - B. \$60.
 - C. \$210.
96. A dealer quotes a forward rate agreement (FRA) expiring in 30 days, for which the underlying is 90-day LIBOR, at 4.5%. An investor shorts the contract and the dealer goes long for a notional principal of \$15 million. At the expiration of the FRA the rate on 90-day LIBOR is 4.0%. The investor is *most likely* to:
- A. pay the dealer \$6,229.
 - B. pay the dealer \$18,564.
 - C. receive from the dealer \$18,564.

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Questions 97 through 108 relate to Fixed Income Investments.

97. A 10-year bond is issued on January 1, 2010. Its contract requires that its coupon rate change over time as shown in the following table:

Coupon Payment Date Range	Coupon Rate
01/01/2010-12/31/2011	2.0%
01/01/2012-12/31/2013	5.0%
01/01/2014-12/31/2015	7.5%
01/01/2016-12/31/2019	9.0%

This security is *best* described as an example of a:

- A. step-up note.
 - B. floating-rate bond.
 - C. deferred coupon bond.
98. A 5-year floating-rate security was issued on January 1, 2006. The coupon rate formula was 1-year LIBOR + 300 bps with a cap of 10% and a floor of 5% and annual reset. The 1-year LIBOR rate on January 1st of each year of the security's life is provided in the following table:

Year	1-Year LIBOR
2006	3.5%
2007	4.0%
2008	3.0%
2009	2.0%
2010	1.5%

During 2010, the payments owed by the issuer were based on a coupon rate closest to:

- A. 4.5%.
 - B. 5.0%.
 - C. 6.5%.
99. Which of these is the *best* example of an embedded option granted to bondholders?
- A. A prepayment option
 - B. A floor on a floating rate security
 - C. An accelerated sinking fund provision

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100. A bond has a 10-year maturity, a \$1,000 face value, and a 7% coupon rate. If the market requires a yield of 8% on the bond, it will *most likely* trade at a:
- A. discount.
 - B. premium.
 - C. discount or premium, depending on its duration.
101. When interest rates fall, the price of a callable bond will:
- A. fall less than an option-free bond.
 - B. rise less than an option-free bond.
 - C. rise more than an option-free bond.
102. 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 duration of the bond is *closest to*:
- A. 1.78.
 - B. 5.94.
 - C. 11.88.
103. The *most* direct disadvantage of investing in a callable security relative to an otherwise identical option-free security is:
- A. increased default risk.
 - B. lower interest payments.
 - C. decreased price appreciation potential.
104. An investor fears that economic conditions will worsen and the market prices of her portfolio of investment-grade corporate bonds will decrease more than her portfolio of government bonds. The investor's fear is *best* described as a fear of:
- A. default risk.
 - B. downgrade risk.
 - C. credit spread risk.
105. What type of risk does the bid-ask spread *most* closely measure?
- A. Default risk
 - B. Inflation risk
 - C. Liquidity risk

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106. On January 1st of the year, an investor purchases \$100,000 in par value of a new Treasury Inflation Protection Security (TIPS) issue that has a 2.5% coupon rate. The annual rate of inflation over the first six months of the year is 4.0% and the annual rate of inflation for the second six months of the year is 3.0%. The amount of coupon interest paid to the investor after the second six months of the year is *closest to*:
- A. \$1,275.
 - B. \$1,294.
 - C. \$1,339.
107. A level payment, fixed-rate, fully amortizing mortgage loan for \$220,000 is obtained with a term of 15 years, a mortgage rate of 6.0% with monthly compounding, and a monthly payment of \$1,856.49. Assuming that the borrower does not prepay or default, the principal that is repaid during the first 3 months is *closest to*:
- A. \$660.
 - B. \$2,281.
 - C. \$3,667.
108. The primary motivation for creating a collateralized mortgage obligation (CMO) is *best* described as the desire to redistribute which risk of investment in residential mortgages?
- A. Default risk.
 - B. Liquidity risk.
 - C. Prepayment risk.

Questions 109 through 114 relate to Alternative Investments.

109. One advantage of exchange traded funds relative to open-end mutual funds is:
- A. they trade throughout the day.
 - B. they offer greater diversification.
 - C. they have smaller bid-ask spreads.
110. A fund manager is compensated with a base management fee plus an incentive fee proportional to the fund's return above a benchmark. This *best* describes the fee structure of:
- A. a hedge fund.
 - B. a mutual fund.
 - C. an exchange traded fund.

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111. The real estate valuation approach that uses a perpetuity discount type model is the:
- A. cost approach.
 - B. income approach.
 - C. sales comparison approach.
112. Capital provided for companies beginning operation but before commercial manufacturing and sales have occurred *best describes* which stage in venture capital investing?
- A. Seed-stage
 - B. Early-stage
 - C. Later-stage
113. A fund that calculates net asset value by subtracting liabilities from assets and dividing the result by a fixed number of shares is *most likely*:
- A. a hedge fund.
 - B. an open-end mutual fund.
 - C. a closed-end mutual fund.
114. A commodity market is in contango when futures prices are:
- A. lower than the spot price.
 - B. higher than the spot price.
 - C. the same as the spot price.

Questions 115 through 120 relate to Portfolio Management.

115. In general, which of the following institutions will *most likely* have a high need for liquidity and a short investment time horizon?
- A. Banks
 - B. Endowments
 - C. Defined benefit pension plans
116. Which of the following is *most likely* a part of the feedback step in the portfolio management process?
- A. Portfolio construction
 - B. Performance measurement
 - C. Developing the investment policy statement

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117. The following table presents historical information for two stocks, RTF and KIU:

Variance of returns for RTF	0.0625
Variance of returns for KIU	0.0900
Correlation coefficient between RTF and KIU	0.4500

The covariance between RTF and KIU is *closest* to:

- A. 0.0025.
 - B. 0.0338.
 - C. 0.0675.
118. Relative to an investor with a steeper indifference curve, the optimal portfolio for an investor with a flatter indifference curve will *most likely* have:
- A. a lower level of risk and return.
 - B. a higher level of risk and return.
 - C. the same level of risk and return.
119. The following table shows data for the stock of JKU and a market-index.

Expected return of JKU	15%
Expected return of market index	12%
Risk free rate	5%
Standard deviation of JKU returns	20%
Standard deviation of market index returns	15%
Correlation of JKU and market index returns	0.75

Based on the capital asset pricing model (CAPM), JKU is *most likely*:

- A. overvalued.
 - B. undervalued.
 - C. fairly valued.
120. A portfolio with equal parts invested in a risk-free asset and a risky portfolio will *most likely* lie on:
- A. the efficient frontier.
 - B. the security market line.
 - C. a capital allocation line.

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