CFA-LEVEL-1 Q&As

CFA Level I Chartered Financial Analyst

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QUESTION 1

When formulating an investment policy for a client, which of the following falls under "investor objectives?"

A. proxy voting

B. none of these answers

C. return objectives

D. time horizon

E. liquidity needs

F. investable funds

Correct Answer: C

Return objectives are considered under "investor objectives." Liquidity needs, time horizon and proxy voting are considered under "investor constraints."

QUESTION 2

Which of the following is/are required by AIMR-PPS with regards to calculation of returns?

I. The return for after-tax composites that hold both taxable and tax-exempt securities should be stated on an equivalent, "pre-tax" basis.

II. Real Estate must be appraised annually unless client agreements state otherwise.

III.

For commingled fund-of-funds structure, segregated Irrs net of trading expenses must be presented.

A.

I, II and III

B.

III only

C.

I and III only

D.

none of them

Correct Answer: D

The return for after-tax composites that hold both taxable and tax-exempt securities should be stated on an "after-tax" basis and should not be "grossed" up. Real Estate investments must be appraised every three years and the valuations reviewed quarterly unless client agreements state otherwise. For separately managed accounts commingled fund-of-funds structure, cumulative Irrs net of trading expenses must be presented.

QUESTION 3

Which of the following rules apply for calculations under the Performance Presentation Standards?

A. Accrual accounting must be used for fixed-income securities.

B. All of these answers.

C. Total return, including realized and unrealized gains and losses, must be used.

D. Time-weighted rate of return must be used.

Correct Answer: B

All of these answers are general rules applying to calculation of returns under the PPS.

QUESTION 4

Your assistant has just completed an analysis of two mutually exclusive projects. You must now take her report to a board of directors meeting and present the alternatives for the board\\'s consideration. To help you with your presentation, your assistant also constructed a graph with NPV profiles for the two projects. However, she forgot to label the profiles, so you do not know which line applies to which project. Of the following statements regarding the profiles, which one is most reasonable?

A. If one of the projects has a NPV profile which crosses the X-axis twice, hence the project appears to have two IRRs, your assistant must have made a mistake.

B. If the two projects\\' NPV profiles cross once, in the upper left quadrant, at a discount rate of minus 10 percent, then there will probably not be a NPV versus IRR conflict, irrespective of the relative sizes of the two projects, in any meaningful, practical sense (that is, a conflict which will affect the actual investment decision).

C. If the two projects both have a single outlay at t = 0, followed by a series of positive cash inflows, and if their NPV profiles cross in the lower left quadrant, then one of the projects should be accepted. Both would be accepted if they were not mutually exclusive.

D. Whenever a conflict between NPV and IRR exist, then, if the two projects have the same initial cost, the one with the steeper NPV profile probably has less rapid cash flows. However, if they have identical cash flow patterns, then the one with the steeper profile probably has the lower initial cost.

E. If the two projects have the same investment cost, and if their NPV profiles cross once in the upper right quadrant, at a discount rate of 40 percent, this suggests that a NPV versus IRR conflict is not likely to exist.

Correct Answer: B

A conflict will exist if the cost of capital is less than the crossover rate. In this case the cost of capital must be greater than minus 10 percent and, therefore, there will probably not be a NPV versus IRR conflict.

QUESTION 5

Which of the following is/are FALSE about Basic EPS and Diluted EPS?

I. Basic EPS excludes anti-dilutive securities but Diluted EPS must include these.

II. Basic EPS ignores instruments like convertible bonds and warrants but Diluted EPS does not.

III.

The Treasury stock method, when applied to Basic EPS, compares the average stock price during the period to the strike price in determining conversion.

A.

III only

B.

I and III

C.

I, II and III

D.

II only

Correct Answer: B

Note that the questions asks for false statements. (I) is false since both methods exclude anti-dilutive securities from computations. Further, since the Basic EPS ignores all potentially dilutive securities and takes into account only simple capital structure instruments (stocks, bonds, preferred equity), it has no need for the Treasury Stock method i.e. the Treasury stock method is never used in the computation of Basic EPS.