300Hours: CFA Level 1 Practice Test 2

This Chartered Financial Analyst (CFA®) Practice Test has 60 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 90 minutes (1.5 hours) for this session of the exam.

Once completed, please submit your answers at go.300hours.com/L1Mock2 to get your score, performance benchmark and answer explanations.

1. Ethical and Professional Standards

A firm's code of ethics should *most likely*:

    A. be shared with clients.
    B. contain legal terminology.
    C. include detailed procedures for compliance.

2. Ethical and Professional Standards

In the middle of a recession, managing director Victor Costa knows his firm has been struggling for the last two years. Costa was given a report to market the firm, which showed the firm to have the best returns in the firm's history. While speaking with potential new clients, Costa hands out the report to attempt to bring new clients into the firm.

Has Costa *most likely* violated the Standards?

    A. Yes.
    B. No, because he did not create the research report.
    C. No, because he did not know the actual return figures for the firm.

3. Ethical and Professional Standards

Brian Sheppard is registered to take the Level III CFA exam. In a conversation with Sheppard about his preparations, his supervisor, Rita McDowell, CFA, makes the following comment: 'The Global Investment Performance Standards (GIPS) were not tested on the Level III CFA exam when I took it because they were not in the Candidate Book of Knowledge (CBOK) at that time.' Upon hearing this, Richard Holbrook, CFA, adds: 'GIPS wasn't tested on the Level III exam when I took it three years ago, but they were in the CBOK.'

What is the *most accurate* assessment of this conversation?

    A. The Standards have not been violated.
    B. Only Holbrook has violated the Standards.
    C. Both Holbrook and McDowell have violated the Standards.

4. Ethical and Professional Standards

Samantha Bjork, CFA, has been offered an equity analyst position at a firm that has not adopted a formal code of ethics.

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Which of the following statements is *most likely* correct? Bjork:

    A. must refuse to accept a position with any firm that has not adopted a code of ethics.
    B. may accept the position and should encourage the firm to adopt a code of ethics if she does.
    C. must refuse to accept a position with any firm that has not adopted the CFA Institute's Code of Ethics.

5. Ethical and Professional Standards

Sharon Fletcher, who was recently awarded her CFA charter, is reviewing the following two statements that appear in her firm's latest monthly newsletter for clients:

Statement 1: "Sharon Fletcher has joined the ranks of Chartered Financial Analysts working at our firm."

Statement 2: "Fletcher believes that the CFA designation is the most prestigious designation in our industry."

Which of the following is the *most accurate* assessment of these statements?

    A. Only Statement 1 is inconsistent with the Standards.
    B. Both Statement 1 and Statement 2 are consistent with the Standards.
    C. Both Statement 1 and Statement 2 are inconsistent with the Standards.

6. Ethical and Professional Standards

Hillary Goff, CFA, is an investment banker with Robertson & Davis, a financial services firm with multiple lines of business. When making presentations to potential new investment banking clients in a range of industries, she promises that her firm will provide full research coverage if the potential client signs on as an investment banking client. Goff does not mention that the two analysts currently employed by her firm both cover companies in various subsectors of the transportation sector.

Goff *most likely* violated the Standards with respect to:

    A. Misrepresentation only.
    B. Independence and Objectivity only.
    C. both Misrepresentation and Independence and Objectivity.

7. Ethical and Professional Standards

Walter Simon, CFA, manages an equity fund. One of the investors in Simon's fund is the Prince Family Trust, which is administered by its trustee, David Bollinger. The Trust's beneficiary is Debbie Prince, who requires long-term care for a chronic illness. The Trust generates income to help pay for Debbie's care, and any additional costs are covered by her sister and legal guardian, Ann Prince.

Simon's duty of loyalty is *most likely* owed to:

- A. Ann Prince.
- B. Debbie Prince.
- C. his fund's mandate.

8. Ethical and Professional Standards

Teddy Larson, CFA, a portfolio manager with Pedigo Investments, exercises proxies on behalf of his clients most of the time, but not all the time. When Larson does exercise these proxies, he often does so in accordance with the wishes of management.

Has Larson *most likely* violated the Standards?

- A. No.
- B. Yes, by failing to vote all proxies.
- C. Yes, by often voting proxies in accordance with management's wishes.

9. Ethical and Professional Standards

Mary Ciccarelli, CFA, is an equity analyst with Strathairn Capital, a financial services firm with multiple lines of business, including sell-side research and investment banking. Ciccarelli's supervisor, Dale Jackman, informs her that the firm's review committee will not allow a "sell" rating to be published for Riverdale Industries (RVI), one of the firms she covers.

In order to adhere with the recommended procedures for compliance with the Standards, Ciccarelli should *most likely*:

- A. encourage her firm to cease all trading of RVI shares.
- B. refuse to disseminate any further information about RVI to clients.
- C. encourage her firm to disseminate only factual information about RVI to clients.

10. Quantitative Methods

You invest USD 15,000 in a bank account crediting 5% interest per year, compounded annually.

After how many completed years will your account value increase to *more than* USD 25,000?

- A. 10
- B. 11
- C. 12

11. Quantitative Methods

An investor is analyzing stock returns. He hypothesizes that the population mean return is at least 6%. Upon testing, the investor rejects the hypothesis that the population mean return is at least 6%.

If the population mean return is actually 6.8%, the result of the hypothesis testing was:

- A. A Type I error.
- B. A Type II error.
- C. Correct.

12. Quantitative Methods

Assuming that all else remains the same, which of the following *most likely* decreases the width of a confidence interval?

- A. Increased sample size
- B. Increased sample mean
- C. Increased sample standard deviation

13. Quantitative Methods

Possible returns on a stock can be represented by a discrete random variable, X, with the following cumulative distribution function:

x	F(x)
25%	1.0
20%	0.8

15%	0.6
10%	0.3
5%	0.2

The stock return that is *most likely* to occur is:

A. 10 %
B. 15 %
C. 20 %

14. Quantitative Methods

The following data is gathered about a stock:

Year	Annual Return
1	7.3%
2	12%
3	4.4%
4	6.1%
5	2%

Given a coefficient of variation of 0.5244, the variance of the stock returns is *closest* to:

A. 0.001
B. 0.033
C. 0.064

15. Quantitative Methods

At the end of 2012, an investor buys 2 shares of stock for USD 82 per share. She purchases 3 more shares of the same stock at the end of 2013 for USD 78 per share, then sells all 5 shares at the end

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of 2014 for USD 90 per share. A dividend of USD 4 per share was paid during 2013, and a dividend of USD 1.50 per share was paid during 2014. Assume that no dividends are reinvested.

The money-weighted rate of return for the investor's portfolio is *closest* to:

A. 5 %
B. 8 %
C. 12 %

16. Quantitative Methods

An investor is considering two different investments. One is a series of 25 annual payments of USD 15,310 each. The other investment pays USD 13,075 per year indefinitely. The first payment for both investments takes place at the end of the first year.

The interest rate at which the present values of these two investments are equal is *closest* to:

A. 4 %
B. 8 %
C. 12 %

17. Economics

An econometric analysis of market structure will *most likely* involve the calculation of which of the following measures?

A. Concentration ratio
B. Herfindahl-Hirschman index
C. Elasticities of supply and demand

18. Economics

Domestic demand exceeds domestic supply within the United States for a particular type of baby pacifiers produced both in domestic and foreign markets. Therefore, the United States currently imports additional quantities of these pacifiers from foreign producers. The United States government is contemplating imposing a quota or tariff on this pacifier such that the equilibrium price rises by USD 1. Assume that the United States government cannot extract rents from foreign producers under this quota.

How does the welfare loss to the United States in the market for these pacifiers compare under a quota and tariff?

    A. The welfare loss would be greater under the quota.
    B. The welfare loss would be greater under the tariff.
    C. The welfare loss would be equivalent under the quota and tariff.

19. Economics

Which of the following statements would *most likely* be a key property of an ideal currency regime?

    A. Currencies would circulate only within a nation's borders.
    B. Each country would be able to establish completely independent monetary policy in pursuit of domestic objectives.
    C. The exchange rate between any two currencies would be floating.

20. Economics

You are a novice economist and are studying monetary policy along with the functions of money and the money creation process.

According to the quantity theory of money, what is *most likely* the best way to fight inflation, and which statement is most likely correct about the monetary base?

    A. Increase the money supply; The monetary base includes both narrow and broad money
    B. Reduce the money supply; Controlling the monetary base is an instrument of monetary policy
    C. Reduce the money supply; The monetary base includes the sum of M1 and M2

21. Economics

You have consulted with an econometrician who specializes in economic forecasting. She has estimated the following equation based on historical data using the neoclassical growth model.

Potential Output Growth = 1.4 + 0.68 x Growth of Labor + 0.32 x Growth of Capital

How would you *most likely* interpret the intercept (1.4) and the coefficient of the labor growth rate (0.68), again assuming the neoclassical growth model?

    A. Demand for production and growth rate of total factor productivity, respectively
    B. Growth rate of total factor productivity and labor's share of income, respectively

C. Aggregate supply and demand for production, respectively

22. Economics

Assume a traditional short-run aggregate supply curve is upward sloping. Prices increase, resulting in higher profits.

Which of the following would *most likely* be a result of these conditions?

- A. Firms will produce less
- B. Prices may not adjust to changes in demand in the short-run
- C. Laborers will work less

23. Financial Reporting and Analysis

A company that issues financial reports in accordance with US GAAP enters into a capital lease. Over the first year, the company pays USD 500,000, of which USD 300,000 is interest on the lease and the remaining USD 200,000 goes towards the value of the equipment.

The impact of this payment on the company's operating cash flow during the first year is *closest* to:

- A. USD 200,000
- B. USD 300,000
- C. USD 500,000

24. Financial Reporting and Analysis

Which of the following statements is *most accurate*? The carrying amount of a deferred tax asset:

- A. must be stated in present value terms.
- B. may change as a result of a reassessment of its recoverability.
- C. will not change in the absence of changes in the amount of taxable temporary differences.

25. Financial Reporting and Analysis

An analyst gathers the following information with respect to the machine used by a company that issues financial statements in accordance with US GAAP.

Undiscounted expected future cash flows	USD 21,000
Present value of expected future cash flows	USD 18,000
Fair value	USD 19,000
Estimated selling cost	USD 3,000

The company is currently carrying this asset at USD 20,000. Based on the information presented above, the company will *most likely*:

A. continue carrying this asset at USD 20,000.
B. revise the carrying value of this asset down to USD 16,000.
C. revise the carrying value of this asset down to USD 18,000.

26. Financial Reporting and Analysis

An analyst observes the following information for a company:

Net profit margin	4%
Sales as a percentage of average total assets	134%
Equity as a percentage of average total assets	83%

This company's return on equity is *closest* to:

A. 4.45 %
B. 5.36 %
C. 6.46 %

27. Financial Reporting and Analysis

An analyst gathers the following information for a company's performance during the month of January (31 days).

| Cost of goods sold | USD 60,000 |
| Ending inventory | USD 420,000 |

Beginning inventory	USD 380,000

This company's days of inventory on hand (DOH) is *closest* to:

    A. 197
    B. 207
    C. 217

28. Financial Reporting and Analysis

An analyst gathers the following information from a company's 2013 financial statements:

Net income	USD 3,000,000
Common shares outstanding	500,000
Preferred shares outstanding	100,000
Preferred dividend per share	USD 10
Debt repaid	USD 2,000,000

The company's basic earnings per share for 2013 is *closest* to:

    A. USD 3.33
    B. USD 4.00
    C. USD 6.00

29. Financial Reporting and Analysis

Which of the following events listed would *most likely* be included in a company's comprehensive income?

    A. Repayment of the principal on a USD 420,000 loan
    B. Unrealized gain of USD 35,000 on derivatives contracts accounted for as hedges
    C. Issuance of 10,000 additional shares of common stock, USD 15 par, USD 22 market value

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30. Financial Reporting and Analysis

Which of the following inventory costing methods is *allowed* under US GAAP but not IFRS?

    A. FIFO
    B. Specific identification
    C. LIFO

31. Financial Reporting and Analysis

Issuing long-term debt is *most accurately* described as:

    A. a financing activity that increases the issuer's assets.
    B. an investing activity that increases the issuer's liabilities.
    C. a financing activity that increases the lender's liabilities.

32. Financial Reporting and Analysis

Which of the following statements is *most accurate*?

    A. IFRS do not allow the revaluation model to be used for intangible assets
    B. IFRS require the revaluation model to be applied to all assets within an asset class
    C. If a company chooses to use the revaluation model for one asset class, IFRS require the use of this model for all of its asset classes

33. Financial Reporting and Analysis

Compared to the percentage-of-completion method, the completed contract method of revenue recognition for long-term contracts is *most likely*:

    A. less conservative and more objective.
    B. more conservative and more subjective.
    C. more conservative and more objective.

34. Financial Reporting and Analysis

Which of the following would *most likely* be considered a financing activity on a cash flow statement under US GAAP?

A. Sale of land
B. Receipt of dividends
C. Retiring of long-term debt

35. Corporate Finance

Many large institutional investors are increasingly incorporating environmental, social, and governance (ESG) issues into their views of investment performance.

Which of the following *best* represents these groups and their shared investment philosophy?

A. Socially responsible owners who believe global economic growth is not sustainable long-term.
B. Universal owners who believe in sustainable global economic growth and its importance for good investment performance.
C. Long-term investors who believe ESG investing is critical in order to maintain shareholder value.

36. Corporate Finance

Sign Partners designs billboards. The average unit sells for USD 30,000 apiece and costs USD 20,000 to produce. Sign Partners has USD 800K of fixed costs and USD 1.5M of debt repayment.

If the marginal tax rate is 35%, Sign Partner's operating breakeven point is *closest* to how many billboards?

A. 80
B. 40
C. 120

37. Corporate Finance

Borp Incorporated has stock worth USD 60 per share. The dividends on Borp are currently at USD 4 per year, and expected to grow by 5% per year.

Borp's cost of equity is *closest* to:

A. 9 %
B. 7 %
C. 12 %

38. Corporate Finance

Greene Co. has USD 630,000 to invest in capital projects. The company is considering three different projects, each with a positive NPV. The combined cost of the three projects would be USD 840,000.

Which of the following project interactions will Greene Co. will *most likely* have to take into account in order to make a capital budgeting decision?

    A. Project sequencing
    B. Mutually exclusive projects
    C. Capital rationing

39. Equity Investments

A company's share price is *most likely* to decrease as a result of its cost of equity:

    A. falling below the required return.
    B. being greater than its cost of debt.
    C. being more difficult to estimate than its cost of debt.

40. Equity Investments

The difference between a stock at the end of its first day trading on a secondary market after an initial public offering (IPO) and its issue price is known as:

    A. an earnings surprise.
    B. an information cascade.
    C. the degree of underpricing.

41. Equity Investments

Which of the following market structures relies *most heavily* on dealers as a source of liquidity?

    A. Order-driven markets
    B. Quote-driven markets
    C. Continuous trading markets

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42. Equity Investments

An analyst is estimating the value of Cemex Corporation, a cement producer based in Mexico. The average EV/EBITDA for the cement industry is 6.8. The analyst has collected the following forecasted information for Cemex.

- EBITDA= MXN 486 million

- Market value of debt = MXN 1,220 million

- Market value of preferred stock = MXN 430 million

- Cash and cash equivalents = MXN 30 million

The value of equity for Cemex Corporation is *closest* to:

- A. MXN 1,715 million
- B. MXN 1,685 million
- C. MXN 1,655 million

43. Equity Investments

Fundamental analysis, by disseminating value-relevant information, facilitates creation of markets that are:

- A. Weak form efficient
- B. Semi-strong form efficient
- C. Strong form efficient

44. Equity Investments

The target market for a security market index is *most likely* to be selected based on:

- A. asset price.
- B. regulatory environment.
- C. geographic region.

45. Fixed Income

A bond is issued with an interest rate of 6% and semi-annual interest payments. The bond has a maturity of 30 years. Assume that the market rate after 10 years is 7.2%.

The bond would *most likely* be redeemed early if it were a:

- A. Callable bond
- B. Putable bond
- C. Option-free bond

46. Fixed Income

North Co. wants to expand its operations. The company decides to borrow USD 150,000 from a group of lenders to do so. The loan matures in 12 years and has a floating interest rate based on the T-bill rate.

This type of loan would *most likely* be considered:

- A. A bilateral loan
- B. A syndicated loan
- C. Commercial paper

47. Fixed Income

You are given the following yields for on-the-run US Treasury strips:

Maturity	Yield
1 Year	0.96%
5 Years	2.12%
10 Years	3.61%

Using linear interpolation to estimate the interim spot rate yields, the difference between the 2-year and 4-year rate is *closest to*:

- A. 0.30 %
- B. 0.60 %
- C. 0.90 %

48. Fixed Income

For a bond with a modified duration of 6.5 and a convexity of 71.2, the return impact from the 25 bps spread widening is *closest* to:

    A. -1.647 %
    B. -1.603 %
    C. -1.581 %

49. Fixed Income

Assume an investor buys an annual coupon bond with a 5% coupon, there are 15 years remaining until maturity and the price paid is par. Further assume the investor's investment horizon is 6 years, and that the approximate modified duration of the bond is 10.123 years.

What is the duration gap of the bond at time of purchase?

    A. 4.629
    B. 5.792
    C. 10.629

50. Fixed Income

How are special purpose entities (SPEs) treated during the liquidation process, and how do creditors receive distributions in the US?

    A. SPEs are bankruptcy-remote vehicles with credit risk generally decoupled from the underlying company.
    B. SPEs are bankruptcy-remote vehicles and creditors receive distributions according to the absolute priority rule generally decided by the court system.
    C. SPEs typically have lower credit ratings than their sponsors and creditors receive distributions based on the bankruptcy court's discretion.

51. Derivatives

A stock is currently selling for USD 50. One year from now, the stock will either go up to USD 60 or down to USD 45.

If the current risk-free rate is 5%, which of the following is *closest to* the risk-neutral price of a one-year call option with strike price USD 55 on this stock?

A. 2
B. 2.38
C. 2.5

52. Derivatives

A forward contract is *most likely* categorized as non-deliverable if:

A. cash settlement is specified.
B. the clearinghouse requires an initial margin.
C. the value of the underlying is less than the forward price upon expiry.

53. Derivatives

Which of the following comments is *most likely* to be correct?

A. Risk-neutral valuation models price derivatives by discounting the expected payoffs at the risk-free rate.
B. In risk-neutral valuation models, individual risk preferences are the primary factor in determining the price of derivatives.
C. Risk-neutral valuation models explicitly use real-world probabilities when pricing derivatives.

54. Alternative Investments

Mary Davis is considering purchasing the debt of bankrupt company McKernon Motors. She believes she can help McKernon in reorganizing the company so they can pay their outstanding debts.

Mary is *most likely* engaging in what type of private equity investment strategy?

A. Leveraged Buyout
B. Distressed Investing
C. Venture Capital

55. Alternative Investments

Brooks and Kat concluded in a study that more than a quarter of all hedge funds fail within the first three years due to performance issues.

This *most likely* contributes to which bias regarding hedge funds indices?

    A. Backfill Bias
    B. Survivorship Bias
    C. Short Bias

56. Alternative Investments

Which of the following is *most likely* to be considered a trait of concentrated portfolios?

    A. High diversification
    B. Potential for large losses
    C. Low portfolio volatility

57. Portfolio Management and Wealth Planning

An investor has a portfolio composed of USD 140,000 of Asset A, which has a standard deviation of 15%, and USD 120,000 of Asset B, which has a standard deviation of 20%.

If the correlation between the returns of these two assets is 0.8, the covariance is *closest* to:

    A. 0.0018
    B. 0.0119
    C. 0.024

58. Portfolio Management and Wealth Planning

An analyst makes the following claim: "For open-ended mutual funds, the number of shares outstanding fluctuates as investors buy and sell shares from each other."

Is this statement *most likely* correct?

    A. Yes.
    B. No, because the number of shares outstanding is fixed.
    C. No, because investor do not trade shares directly with each other.

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59. Portfolio Management and Wealth Planning

Compared to mutual funds, separately managed accounts *most likely*:

    A. require a lower minimum investment.
    B. allow investors to hold a broader range of asset classes.
    C. give investors greater control over which assets are held.

60. Portfolio Management and Wealth Planning

Kelsey is interested in the capital market line, and decides to invest her assets in a combination of risk-free Treasury-bills and the S&P 500.

Because she is young and can take on risk, she invests 80% in the S&P 500 (expected yield 6.2%) and 20% in Treasury bills (expected yield 1.5%).

If the standard deviation of the S&P 500 is 10%, the standard deviation of Kelsey's portfolio is *closest to*:

    A. 8 %
    B. 10 %
    C. 6 %