

300Hours: CFA Level 1 Practice Test 1

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/L1Mock1 to get your score, performance benchmark and answer explanations.

1. Ethical and Professional Standards

Asmita Mack, CFA, lives in the country of Onionland. Each morning, Asmita crosses the border to the neighboring country of WDC where she manages client portfolios. This morning, a positive earnings report was announced for HawkBlack, Inc. (ticker KANE). Asmita would like to invest in the stock and believes it would benefit her clients as well. WDC has a law that restricts portfolio managers from investing in securities owned by their clients. Onionland has no such law.

To comply with the Standard, what is the *minimum* that Asmita must do?

- A. Not invest personally in KANE
- B. Purchase KANE for her client's portfolio before her personal portfolio
- C. Purchase KANE for both portfolios simultaneously

2. Ethical and Professional Standards

Joyce Price issues weekly investment reports. Joyce looks for trends and commonalities within the research community. She then presents the findings as her own research and doesn't cite any sources. Joyce gives them to her boss, Soojung Yu, CFA. Soojung peer-reviews the reports and does not mention anything about citing sources.

Has Soojung *most likely* violated the Standards?

- A. Yes
- B. Yes, if Joyce is a CFA member, charterholder, or candidate
- C. No

3. Ethical and Professional Standards

Henry Williamson, CFA, is also a Fellow of the Society of Actuaries (SOA). Henry is required to abide by the SOA's Code of Conduct as a fellow. Part of that Code of Conduct is as follows:

PRECEPT 4. An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.

If Henry issues actuarial communications that do not adhere to the actuarial standards of practice, what Standard would Henry *most directly* violate?

- A. Knowledge of the Law
- B. Loyalty, Prudence, and Care
- C. Communication with Clients and Prospective Clients

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4. Ethical and Professional Standards

Ronald Pitt manages equity portfolios for a group of high net-worth individuals. His friend, a rich businessman, also has his portfolio managed by Ronald. Ronald learns of a security recommended as 'buy' by his company's research team. Ronald thoroughly reads the detailed report and concludes that the recommended stock is worth buying. He first buys the stock for his friend and then goes on to buy the stock for other client accounts.

Which of the following statements relating to violation of CFA Institute Standards of Professional Conduct is *most likely* true?

- A. Ronald violates standard V(A), Diligence and Reasonable Basis
- B. Ronald violates standard III (B), Fair Dealing
- C. Ronald violates both standards V(A) and III (B)

5. Ethical and Professional Standards

Which of the following statements does *not* form part of the performance presentation guidance provided in the CFA Institute Standards of Professional Conduct?

- A. Terminated accounts should be included while presenting historical performance.
- B. All appropriate disclosures to fully explain performance should be made, including disclosures relating to use of simulation or other models to calculate results.
- C. Comparable performance numbers for similar funds of competitors should be provided along with the company's own fund.

6. Ethical and Professional Standards

Joe Tichy, CFA, works with Oasis Investments as an investment advisor. Prior to joining Oasis, Joe worked with another investment management firm. Joe took no records from the previous firm and didn't have a non-compete agreement with the previous firm. Joe remembers some of the clients of his previous firm and contacts them after he joins Oasis as he feels that some of them might follow him to the new firm.

Which of the following statements relating to violation of CFA Institute Standards of Professional Conduct is *most likely* true?

- A. Joe does not violate any of the CFA Institute Standards of Professional Conduct.
- B. Joe violates the CFA Institute Standards of Professional Conduct, as he must seek permission from his previous employer before contacting clients of that firm.

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- C. Joe should not contact clients of his previous firm as it is against the interest of his previous employer. As a charter holder, Joe is supposed to be loyal to his previous firm even after discontinuing employment.

7. Ethical and Professional Standards

Simon Leone, CFA, financial analyst at Trinity Investments, provides financial planning and investment advice to large auto companies. Moto Company, the second largest car manufacturer, is planning to renew its IT infrastructure and has sought advice from Simon to finance the project. To better understand the cashflow requirements, Moto Company sends Simon the proposal from Diwan Technologies, the company internally selected by Moto Company for the project, though the project is yet to be formally awarded. Simon tells her friend, Jack, who handles the IT Sector portfolio about the major contract that Diwan Technologies has secured. Acting on the information, Jack increases his holding of the Diwan Technologies stock.

Which of the following statements is/are *most likely* correct?

- A. By divulging information about the project to her friend, Simon violates Standard III (E), preservation of confidentiality
- B. By acting on information provided by Simon, Jack violates Standard II (A), material non-public information.
- C. Both statements are most likely correct

8. Ethical and Professional Standards

Which of the following issues *most strongly* illustrates one of the needs for the Global Investment Performance Standards?

- A. Insider trading
- B. Survivorship bias
- C. Fraud

9. Ethical and Professional Standards

Krystal French, CFA, issues monthly investment reports. These reports aggregate a wide number of analysis reports. Krystal looks for trends and commonalities within the research community. Krystal then presents the findings as her own research and doesn't cite any sources.

Krystal is *most likely* in violation of which Standard?

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- A. Misrepresentation
- B. Performance Presentation
- C. Diligence and Reasonable Basis

10. Quantitative Methods

If you were to finance a \$25,000 car purchase with a 6 year, 5% compounded monthly loan, your monthly payments will be *closest* to:

- A. 400
- B. 410
- C. 420

11. Quantitative Methods

A portfolio manager has a tight tracking error of 50 basis points. The manager expects to be within this tracking error for a given quarter 85% of the time.

If that expectation is correct and each quarter is independent, the probability that the manager is within the tracking error for at least 7 of the next 8 quarters is *closest* to:

- A. 35 %
- B. 65 %
- C. 75 %

12. Quantitative Methods

The percentage returns for a stock for a 5-year period are provided below:

2008	12%
2009	9%
2010	-2%
2011	12%
2012	8%

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What is the standard deviation of the stock returns? You should treat the 5 year period as the population, not as a sample.

- A. 0.0515
- B. 0.2656
- C. 0.078

13. Quantitative Methods

A 10 Year semi-annual 8% coupon bond is selling at \$967. If the yields increase by 50 basis points the price is expected to fall to \$924 and if the yields decrease by 50 Basis points the price is expected to rise to \$1010.

The effective duration is *closest* to:

- A. 4.55
- B. 17.79
- C. 8.89

14. Quantitative Methods

Which of the following statements regarding Internal Rate of Return (IRR) and Net Present Value (NPV) is/are *most likely* correct?

1. If the NPV and IRR methods give conflicting decisions for mutually exclusive projects, the IRR method should be used to select the project.
 2. A project may have positive NPV even if its IRR is less than the cost of capital
 3. IRR is the discount rate at which the NPV of the project is zero.
 4. A project's IRR can be positive even if the NPV is negative.
- A. Statements 1 and 2 are correct
 - B. Statements 3 and 4 are correct
 - C. Statements 2, 3 and 4 are correct

15. Quantitative Methods

George purchases a share of stock for \$35. At the beginning of the next year, he purchases another share of the same stock for \$40. At the end of each of the two years, the stock pays a dividend of \$1.5. At the end of the second year, George sells both the shares for \$45 each.

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The time-weighted rate of return that George earns is:

- A. 16.2 %
- B. 17.4 %
- C. 18.5 %

16. Quantitative Methods

A bond is selling for 101. It matures in 3 months and pays a coupon of 2 at maturity (in addition to the face of 100).

The effective annual yield is *closest* to:

- A. 1.0 %
- B. 2.5 %
- C. 4.0 %

17. Economics

In January, Herman bought 10 apples and 10 pears. In February, the price of apples increased and Herman only bought 8 apples. At the same time, pears became less expensive and Herman bought 12 pears.

Which of the following inflation indices would be calculated assuming Herman always bought 8 apples and 12 pears?

- A. The Laspeyres index
- B. The Paasche index
- C. The Fisher index

18. Economics

Which of the following forms of trading blocs allow for unrestricted trade of goods and services among its members?

- I. Free trade areas
 - II. Customs unions
 - III. Common market
-
- A. I and II
 - B. II and III

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- C. I, II, and III

19. Economics

Which of the following are accurate in an oligopoly with stable equilibrium?

- I. Marginal revenue is greater than marginal price.
 - II. All companies are producing the same level of output.
- A. I only
 - B. II only
 - C. Neither I nor II

20. Economics

The exchange rate between two currencies has decreased to 101.34. The price currency has appreciated by 7.5 percent against the base currency. The initial exchange between the two currencies was *closest* to:

- A. 94.27
- B. 108.94
- C. 109.56

21. Economics

Which of the following statements is/are *most likely* correct?

- I. The demand for a country's currency is a downward-sloping function of its exchange rate.
 - II. Purchasing power parity refers to the relation between interest rates for two currencies and changes in their exchange rates.
 - III. Interest rate parity refers to the relation between countries' inflation rates and exchange rates of their currencies.
- A. Only statement I is correct
 - B. Both statements II and III are correct
 - C. All statements are correct

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22. Economics

Which of the following statements relating to obstacles to efficient allocation of resources is/are *most likely* incorrect?

- I. Price ceilings set below the equilibrium price lead to shortages, bribery, poor quality and black marketeering.
 - II. Subsidies decrease equilibrium quantities and lead to dead weight losses from overproduction.
 - III. Production quotas decrease equilibrium quantities and lead to dead weight losses from underproduction.
- A. Both statements I and II
 - B. Both statements I and III
 - C. Only statement II

23. Financial Reporting and Analysis

A bookstore earned \$200,000 over the past year. At a tax rate of 40%, that bookstore incurs an income tax expense of \$80,000. Under which of the following accounting systems would the expense typically be categorized as an operating activity?

- I. IFRS
 - II. U.S. GAAP
- A. I only
 - B. II only
 - C. I and II

24. Financial Reporting and Analysis

Company XYZ purchases land for \$5,000,000. XYZ intends to hold the land for a long term (20 years) and rent the land out to generate income. Under IFRS, at which price is the company allowed to use on its financial reports for the value of the land:

- I. \$5,000,000
 - II. The current market price
- A. I only
 - B. II only
 - C. Either I or II

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25. Financial Reporting and Analysis

Medialink is an American company specializing in business intelligence consulting. One of Medialink's current project is a 2-year commitment with Isotics, with a total estimated revenue of \$2.0 million and estimated cost of \$1.0 million. Costs are expected to be spread out evenly over each month.

After the first month, under IFRS, Medialink's recognized revenue is expected to be *closest* to:

- A. 0
- B. USD40,000
- C. USD80,000

26. Financial Reporting and Analysis

Given the following data, determine the cash flow from operations:

Sales = \$2,100m

Increase in inventory = \$200m

Depreciation = \$125m

Increase in accounts receivable = \$75m

Decrease in accounts payable = \$70m

After tax profit margin = 35%

Gain on sale of machinery = \$30m

- A. USD515m
- B. USD545m
- C. USD485m

27. Financial Reporting and Analysis

Security Solutions Corp has an outstanding bond obligation on their balance sheet with a carrying value of \$275,000. The bond was issued 5 years ago, and has since lost significant value due to increasing interest rates. The company intends to re-purchase the bond for \$250,000.

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Which of the following statements accurately portrays the transaction that will be recorded to demonstrate the redemption?

- A. Under GAAP, the company will recognize USD25,000 in income but will need to write down the costs of issuing the debt as a separate transaction.
- B. Under GAAP, the company will recognize USD25,000 in income and will not need to make an adjustment for issuance costs as they are already capitalized within the book value of the bond.
- C. Under IFRS, the company will recognize USD25,000 in income and will need to write down the costs of issuing the debt as a separate transaction.

28. Financial Reporting and Analysis

Company X acquired Company Y for \$800 million. At the time of acquisition, Company Y's book value of assets and liabilities was \$1.5 billion and \$850 million respectively, while fair value assessment came to \$1.8 billion and \$1.2 billion respectively.

What amount of goodwill should Company X record on its balance sheet? Is it necessary for Company X to amortize goodwill?

- A. USD150m goodwill, no amortization necessary
- B. USD200m goodwill, no amortization necessary
- C. USD50m goodwill, amortization is necessary

29. Financial Reporting and Analysis

A company with a net income of \$55,000 is looking to compile its operating cash flows for the period using the indirect method. Over the course of the year, the company saw \$8,000 in depreciation, an increase in deferred tax assets of \$750, increase in accounts receivables of \$850, increase in inventories by \$350, and an increase in accounts payables of \$350.

What is the company's operating cash flow for the year?

- A. USD61,400
- B. USD62,200
- C. USD62,900

30. Financial Reporting and Analysis

Which of the following statements relating to cash flows classification is/are *incorrect*?

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- I. Cash collections from sales are operating cash flows whereas cash tax payments are financing cash flows.
 - II. Cash used for purchase of property, plant and equipment and cash generated from sale of assets are examples of investing cash flows.
 - III. Changes in debt are operating cash flows whereas sale/repurchase of stocks are financing cash flows.
- A. Both statements I and III are incorrect
 - B. Only statement III is incorrect
 - C. Only statement II is incorrect

31. Financial Reporting and Analysis

Unearned revenue can be best classified as which type of an account?

- A. Asset
- B. Liability
- C. Income

32. Financial Reporting and Analysis

You are given the following financial ratios for an anonymous company:

Net profit margin = 2%

Total asset turnover = 5.0

Financial leverage = 5.0

This company's return on equity is closest to:

- A. 5 %
- B. 10 %
- C. 50 %

33. Financial Reporting and Analysis

Which one of the following is *not* a quantitative criterion necessitating a company to disclose separate information about any operating segment?

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- A. The segment constitutes 10 percent or more of combined operating profit, assets, or revenue.
- B. The combined revenue from external customers for all reportable segments is less than 75 percent of the total company revenue.
- C. A single customer represents 20 percent or more of the company's total revenue.

34. Financial Reporting and Analysis

A company had equipment worth \$50 million on 1 January. During the year, they purchased equipment for \$10 million. On 31 December, the equipment account showed \$40 million. All figures are shown at cost, before depreciation.

The amount of equipment sold during the end of the year, at cost, would be *closest* to:

- A. 0
- B. USD20 million
- C. USD40 million

35. Corporate Finance

Which of the following examples would best be described as a drag on liquidity?

- A. Early payment to creditors
- B. A delinquent account receivable
- C. A reduced line of credit

36. Corporate Finance

Of the following, which is the *least* necessary qualification for a member of a company's Board of Directors?

- A. Being in good standing with management
- B. Having attentive and competent expertise
- C. Regularly attending meetings

37. Corporate Finance

The market values of a firm's capital are given below:

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Total debt: \$7 million

Outstanding preferred stock: \$2 million

Outstanding common stock: \$12 million

Before-tax cost of debt: 8%

Before-tax cost of common equity: 12%

Before-tax cost of preferred stock: 9%

Assuming company's marginal tax rate is 35%, what is the weighted average cost of capital (WACC) for the firm?

- A. 10.4 %
- B. 10.0 %
- C. 9.5 %

38. Corporate Finance

Meta Corp. sells 15,000 units of its product at a price of \$10 per unit. The company's fixed costs are \$12,000 and interest expense is \$3,000. The variable cost per unit is \$7.

Meta Corp's degrees of operating leverage and financial leverage are:

- A. Degree of operating leverage = 1.1, Degree of financial leverage = 1.36
- B. Degree of operating leverage = 1.36, Degree of financial leverage = 1.1
- C. Degree of operating leverage = 1.36, Degree of financial leverage = 1.36

39. Equity Investments

You are provided with the following information on a non-callable, non-convertible preferred stock:

Face value: £65.00

Annual dividend: £6.35

Maturity: Perpetual

Embedded options: None

Required rate of return: 8.75%

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The intrinsic value of this stock is closest to:

- A. GBP53
- B. GBP63
- C. GBP73

40. Equity Investments

You are provided with the following information on a non-callable, non-convertible preferred stock:

Face value: \$50

Annual dividend: \$2.50

Maturity: Perpetual

Embedded options: None

Required rate of return: 6.25%

The intrinsic value of this stock is closest to:

- A. USD40
- B. USD50
- C. USD60

41. Equity Investments

A stock priced at £35.73 is projected to pay dividends of £1.50, £2.00, and £2.50 at the end of the next three years. At the time of the third dividend, the stock is expected to be worth £36.23.

If the required rate of return for this stock is 10%, the intrinsic value of the stock is closest to:

- A. GBP32
- B. GBP34
- C. GBP36

42. Equity Investments

You are provided the following information about a company Shoes4You:

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Current stock price: \$35

Shares outstanding: 1,000,000

Past year earnings: \$4,000,000

Net book value: \$28,000,000

Past year free cash flow: \$8,000,000

Dividend payout ratio: 20%

Cost of equity capital: 11%

Expected dividend growth rate: 3%

The justified forward P/E ratio for Shoes4You is *closest to*:

- A. 1
- B. 3
- C. 9

43. Equity Investments

Danny and Jack, both equity analysts, are discussing the types of orders in equity markets. During their discussion, Danny makes the following statements:

- I. "Market orders are orders to buy or sell a security at the best price available."
- II. "A 'buy' limit order is placed above the current market price."

Jack agrees with Danny and adds:

- III. "Stop loss orders are orders where a trader borrows stock, sells it, and then purchases the stock later to return the stock back to the original owner."

Which of the statements made by Danny and Jack is/are *incorrect*?

- A. Both statements I and III are incorrect
- B. Both statements II and III are incorrect
- C. Only statement II is incorrect

44. Equity Investments

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Dividends on a stock are expected to grow at 25% for three years, after which, they are expected to grow at 3% per annum, indefinitely.

If the last dividend paid was \$1.25 and the required return rate is 12%, the value of the stock is:

- A. USD24.58
- B. USD32.63
- C. USD28.91

45. Fixed Income

How are upward-sloping yield curves explained by the Pure Expectations Theory?

- A. There are separate markets for long-term and short-term securities, and the long-term market demands greater returns.
- B. Future interest rates are expected to rise.
- C. Investors in long-term securities demand a risk premium for tying their money up longer.

46. Fixed Income

Keisha is looking to avoid purchasing power risk as much as possible. She should consider investing in which type of security?

- A. TIPS
- B. Floats
- C. Bullet bonds

47. Fixed Income

Which of the following statements relating to Z-spread, Option-adjusted spread (OAS) and option cost for callable and puttable bonds is/are *most likely* correct?

- I. For callable bonds, Z-spread is greater than OAS and option cost is greater than 0
 - II. For callable bonds, Z-spread is less than OAS and option cost is greater than 0
 - III. For puttable bonds, Z-spread is less than OAS and option cost is greater than 0
- A. All three statements are correct
 - B. Only statement II is correct
 - C. Only statement I is correct

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48. Fixed Income

Erin purchases a ten-year TIPS bond with a \$25,000 face value. This particular issue pays semiannual coupons at a rate of the CPI + 125 basis points, with a floor of 5%. CPI rates for the first three reset dates are 3.25%, 4.75%, and 5.25%.

The payout from this bond over the first three coupons is *closest* to:

- A. USD2,200
- B. USD3,300
- C. USD4,400

49. Fixed Income

The Kenyan government issues two new series of 10-year optionless bonds. They are completely identical, except that one is denominated in Kenyan Shillings (KES) and the other in British Pounds (GBP). Which offering will *most likely* be given a higher rating by Moody's?

- A. Kenyan Shillings
- B. British Pounds
- C. Both will be the same

50. Fixed Income

Quanced Design is rated Ba1 by Moody's. The company announced a new issue of 5%, 20-year bonds.

These securities will be rated:

- A. Ba1
- B. No higher than Ba1
- C. Not enough information

51. Derivatives

Haspiess Systems, Inc. and Signicomp Manufacturing enter into a netted interest rate swap, with a notional \$75M. Haspiess will pay a fixed 5%, and Signicomp will pay LIBOR + 75bp. LIBOR is 3.5%.

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The first semiannual payment will be *closest* to:

- A. Haspiess paying Signicomp USD600,000
- B. Signicomp paying Haspiess USD600,000
- C. Haspiess paying Signicomp USD300,000

52. Derivatives

The stock of Angle Industries is currently trading at \$60 per share. A 90-day call option on the stock is priced at \$7.50. The exercise price of this option is \$55.

If the applicable risk-free rate of interest is 8%, what is the price of a 90-day put option on Angle Industries with an exercise price of \$55?

- A. USD1.47
- B. USD11.37
- C. USD13.53

53. Derivatives

Which of the following are the *least likely* methods of terminating a swap?

- A. Purchasing a swaption
- B. Selling the swap to a counterparty
- C. Returning the swap to the exchange

54. Alternative Investments

The commodity market initially grew due to producers desiring a hedging vehicle. Recently institutions like pension plans and hedge funds have looked to commodities as a way to diversify and grow, respectively.

Which of the following *least* describes the impact this institutional money has had:

- A. Contango has become less extensive
- B. Rolls have become more expensive
- C. Potential for bubbles has increased

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55. Alternative Investments

Which of the following hedge fund strategies would *most accurately* be described as event-driven?

- A. Purchasing and restructuring distressed debt/equity
- B. Selecting individual securities while remaining market-neutral
- C. Speculating market volatility by purchasing and selling options in the manufacturing sector

56. Alternative Investments

Management fees in private equity are _____ those in hedge funds in that _____.

- A. different from; fees are based on committed capital, not assets under management
- B. similar to; fees are based on assets under management
- C. different from; fees are based on assets under management, not committed capital

57. Portfolio Management and Wealth Planning

The early 21st century saw a few significant stresses on the stock market. The markets dipped deeper and more quickly than many were expecting might happen.

Which of the following statistical metrics *most accurately* describes this event?

- A. High kurtosis
- B. Positive skewness
- C. Low mean

58. Portfolio Management and Wealth Planning

You are given the following portfolio:

Company Name	Amount Invested	Standard Deviation
Isotics	15,000	0.3
Ambiss	5,000	0.1

The portfolio's standard deviation, if the covariance is 0.05, is *closest* to:

- A. 0.2

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- B. 0.23
- C. 0.26

59. Portfolio Management and Wealth Planning

Which of the following is *least* identified as a weakness of the top-down portfolio creation framework?

- A. It is difficult to divide risk up within an investment team.
- B. Investment managers don't seek to maximize their respective returns.
- C. Dividing a portfolio into a team might lead to excess trading and inefficient tax exposure.

60. Portfolio Management and Wealth Planning

The standard deviation of the market portfolio is 0.2. The beta of a company with standard deviation 0.6 and market correlation of 0.4 is *closest* to:

- A. 0.8
- B. 1
- C. 1.2