CFA-LEVEL-1 Q&As

CFA Level I Chartered Financial Analyst

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QUESTION 1

An investor should purchase a stock if A. its estimated value is greater than its market value.

B. the company that issued it is expected to be the industry leader.

C. its estimated value is greater than its book value.

D. the company that issued it is one of the best performing firms in one of the best performing industries in the economy.

Correct Answer: A

Book value has little relevance to purchasing decisions. A company that is expected to perform well may have a stock that is overvalued because of the very positive attention surrounding it. Instead, an investor should purchase a stock if its estimated value is greater than its market value. This implies that the market is undervaluing the stock, the investor can buy it for less than it is worth, and receive excess returns as the market eventually realizes its mistake.

QUESTION 2

Sunil Vaskar is an employee of Glamorgan, a reputable investment banking firm. Glamorgan is a major underwriter for an equity issued by a private firm, Raindrop Waterworks. Sunil has accidentally discovered that the preliminary prospectus issued by Raindrop contains material overstatements about the scope of its businesses and future earning potential. Sunil:

A. must report his findings to his supervisor and consult his legal department.

B. must sever all connections with Glamorgan and dissociate himself from its activities.

C. need not do anything because the prospectus has been distributed and is, in any case, preliminary.

D. must report the case to the SEC since there has been a violation of laws governing equity issues.

Correct Answer: A

Standard I requires that suspected violation of laws be reported to appropriate supervisory people in the firm. It is also advisable to consult the legal department and dissociate oneself from the illegal activity. Sunil has to dissociate himself from the underwriting process involving Raindrop but he does not have to sever connections with his employer, Glamorgan.

QUESTION 3

What is the building\\'s net income?

A. $42,646.

B. $49,307.

C. $35,985.

D. $29,324.

Correct Answer: C

52,919 x .68 = 35,985

QUESTION 4

A cash flow statement using the indirect method

A. is as informative as using the direct method.

B. begins with a firm\\'s cash collections.

C. uses major categories of gross cash receipts and payments.

D. provides little new information into a firm\\'s cash-generating ability.

Correct Answer: D

Because of the indirect format, it is not possible to compare operating cash inflows and outflows by function with the revenue and expense activities that generated them.

QUESTION 5

Sterling Drachma is a senior investment consultant currently researching a few high-risk internet stock companies which recently started trading on NASDAQ. Sterling manages 5 large and private investment accounts for which he has discretionary investment authority. Sterling is about 3 years away from retirement and his retirement portfolio is managed by Franc Escudo. Sterling has concluded from his research that two of the internet stocks he has been following are great buys and instructs Franc to divert part of the retirement investments into these stocks. Franc executes the orders as soon as he receives them. Sterling then instructs his brokers to buy the stocks for the two discretionary accounts that he knows are inclined toward high-risk investments. He does not buy any for the remaining three accounts since those are income-oriented, low-risk accounts. In this sequence of events, which of the following is/are true?

I. Franc has violated Standard IV (B.1) - Fiduciary Duties - by investing retirement account funds in the high-risk stocks.

II. Sterling has violated Standard IV (B.3) - Fair Dealing - by not treating all his accounts equally.

III.

Sterling has violated Standard IV (B.4) - Priority of Transactions - by trading for his retirement account before trading for his client accounts.

A.

I, II and III

B.

I and III only

C.

II and III only

D.

III only

Correct Answer: D

Franc is managing a personal portfolio and as such must execute the orders of his client. The fact that it is a retirement account makes no difference in this situation. Franc would be in violation if he was managing a pension portfolio or a personal trust portfolio and the investments were deemed in violation of plan directives. Franc, however, should try to understand Sterling\\'s motives in the redeployment of funds since this could prevent his client from what could be reckless investment. Sterling, for his part, as definitely violated Standard IV (B.4) - Priority of Transactions - by trading for his retirement account before trading for his client accounts. Personal transactions should never take precedence over client and employer transactions. He has, however, not violated Standard IV (B.3) - Fair Dealing - by not treating all his accounts equally. Standard IV (B.3) requires a fair treatment of all clients, not an equal treatment precisely because different accounts have different investment needs and risk appetites. The internet stocks should only be bought for accounts for which they are a suitable investment.