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**QUESTION 1**

Armando Delrio, a quantitative analyst with Brown Brothers Brokerage, has been instructed to create a regression analysis comparing the relationship between same store sales figures for a batch of retail stocks and marketing expenses for the same series of stocks. In order to adhere to the traditional seven-step method of hypothesis testing, Armando should begin his analysis by performing which of the following actions? Choose the best answer.

- A. Formulating the hypothesis
- B. Collecting the data
- C. Stating the significance level
- D. None of these answers is correct
- E. Identifying the test statistic
- F. Identifying the probability distribution

Correct Answer: A

Hypothesis testing involves a series of seven explicit steps:

Step 1: Formulating and stating the hypothesis Step 2: Identifying the appropriate test statistic and its probability distribution Step 3: Specifying the significance level Step 4: Stating the decision rule Step 5: Collecting the data and performing the necessary calculations Step 6: Making the statistical decision Step 7: Making the economic/investment decision.

In this example, Armando Delrio, a quantitative analyst, has been instructed to perform a regression analysis in which a hypothesis is tested. The first step in this process is the formulation of the hypothesis.

QUESTION 2

Strategic Systems Inc. expects to have net income of \$800,000 during the next year. Its target, and current, capital structure is 40 percent debt and 60 percent common equity. The Director of Capital Budgeting has determined that the optimal capital budget for next year is \$1.2 million. If Strategic uses the residual dividend model to determine next year's dividend payout, what is the expected dividend payout ratio?

- A. 0%
- B. 56%
- C. 28%
- D. 42%
- E. 10%

Correct Answer: E

Equity requirement = $0.6(\$1,200,000) = \$720,000$. Expected NI \$800,000
Equity requirement 720,000 Available for dividends \$80,000
Payout ratio = $\$80,000 / \$800,000 = 0.10 = 10\%$.

**QUESTION 3**

A portfolio consists of a six-year annuity paying \$250 a year and a perpetuity that pays \$300 a year. The payments start at the end of the year. With a discount rate of 9% per year, the portfolio is worth:

- A. \$5,210
- B. \$3,333
- C. \$4,454
- D. \$4,768

Correct Answer: C

The value of the perpetuity is $300/0.09 = 3,333$. The annuity is worth $(250/0.09) * (1 - 1/(1.09^6)) = 1,121$. The portfolio is thus worth $1,121 + 3,333 = 4,454$.

QUESTION 4

A variable, Z, is regressed against variables X and Y and the following equation is estimated: $Z = -3.0 + 1.2X - 2.5Y + \text{error}$. If $X = 5$ and $Y = 3$, the estimated value of Z is _____.

- A. -3.0
- B. cannot be estimated since the error term is unknown
- C. -1.5
- D. -4.5

Correct Answer: D

With the given data, $Z = -3 + 1.2*5 - 2.5*3 = -4.5$.

QUESTION 5

Which of the following statements about ratios is false?

- A. Analysis of ratios can identify areas that require further investigation.
- B. All of these answers are true.
- C. A ratio expresses a mathematical relation between two, or more, economically important quantities.
- D. The advantage of ratio analysis is that very little skill is required in interpreting the meaning of the ratios.
- E. Ratios must be interpreted with care since factors affecting the numerator can correlate with those affecting the denominator.

Correct Answer: D



The usefulness of ratio analysis is highly dependent upon skillful interpretation by the analyst.

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