CFA-LEVEL-1 Q&As

CFA Level I Chartered Financial Analyst

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QUESTION 1

Which of the following can be found in Standard II?

A. Members shall not participate in plagiarism.

B. Members shall maintain appropriate records to support the reasonableness of recommendations.

C. Members shall maintain knowledge of and comply with all applicable laws.

D. Members shall not undertake any independent practice in competition with employer without written consent.

E. Members shall make reasonable efforts to achieve public dissemination of material nonpublic information disclosed in breach of a duty.

Correct Answer: A

Standard II states: "Members shall not copy or use, in substantially the same form as the original, material prepared by another without acknowledging and identifying the name of the author, publisher or source of such material."

QUESTION 2

By what factor will earnings per share will have to change for a 5% change in earnings multiplier to induce a change of 9% in the price of the stock?

A. -12.62%

B. +14.45%

C. -3.67%

D. +3.81%

Correct Answer: D

Stock price = earnings multiplier * earnings per share. Therefore, the earnings multiplier will have to increase by 1.09/1.05 - 1 = 3.81%.

QUESTION 3

Assume an investor makes the following investments:

During year one, the stock paid a $5.00 per share dividend. In year 2, the stock paid a $7.50 per share

dividend. The investor\\'s required return is 35.0 percent.

The dollar-weighted return is:

A. 48.9%.

B. 16.1%.

C. 46.5%.

D. 102.4%.

Correct Answer: A

To calculate the dollar-weighted return:

Step 1: Determine the timing and sign (inflow, outflow) of the cash flows

Purchase share 2, $75.00 outflow

Received dividend from share 2, $7.50 inflow

Sell share 1, $100.00 inflow,

Sell share 2, $100.00 inflow.

Step 2: Calculate the net cash flows for each year (all amounts in $)

Step 3: Use your financial calculator to solve for IRR (or use trial and error)

Calculating IRR_A with the TI Business Analyst II Plus®			
Key Strokes	*Explanation*	*Display*	
[CF]→[2nd]→[CLR WORK]	Clear Memory Registers	CF0=	0.00000
50.0→[+/-]→[ENTER]	Initial Cash Outlay	CF0=	-50.00000
[↓]→70.0→→[+/-] [ENTER]	Period 1 Cash Flow	C01=	-70.00000
[↓]	Frequency of Cash Flow 1	F01=	1.00000
[↓]→215.0→[ENTER]	Period 2 Cash Flow	C02=	-70.00000
[↓]	Frequency of Cash Flow 2	F02=	1.00000
[IRR]→[CPT]	Calculate IRR	IRR=	48.86069

Calculating IRR_A with the HP12C®		
Key Strokes	*Explanation*	*Display*
[f]→[FIN]→[f]→[REG]	Clear Memory Registers	0.00000
50.0 [CHS]→[g]→[CF_0]	Initial Cash Outlay	-50.00000
70.0 [CHS]→[g]→[CF_j]	Period 1 Cash flow	-70.00000
215.0→[g]→[CF_j]	Period 2 Cash flow	215.00000
[f]→[IRR]	Calculate IRR	48.86069

QUESTION 4

An economy is currently in a state of equilibrium, at full employment. If a sudden supply shock were to decrease aggregate supply, which of the following effects will occur in the short run?

I. Real interest rates will increase.

II. Prices will rise.

III. Aggregate demand will remain unaffected.

IV.

The SRAS will shift to the left.

A.

II and III

B.

I and III

C.

I, II and III

D.

I, II and IV

Correct Answer: D

The decrease in the aggregate supply curve will be represented by a movement of the short-run supply curve to the left. In the short run, this will cause an increase in prices since the demand curve does not move. Aggregate demand will fall, unemployment will rise above the natural rate and aggregate output will fall. The total disposable income in the economy will decrease and consumers will liquidate part of their savings to maintain stable consumption. This will decrease the supply of loanable funds, raising interest rates in the short run.

QUESTION 5

Consider the following information about a common stock:

Price per share: $115.88 Next dividend per share: $2.80 Required return: 15.25% per year Expected growth rate: 12.75% per year

What is the value of this common stock?

A. $129

B. $112

C. $101

D. None of these answers is correct.

E. $103

F. The answer cannot be determined from the information provided.

Correct Answer: B

To determine the value of a common stock using the Infinite Period Dividend Discount Model, use the following equation:

{V = [d1 / (k - g)]}

Where: V = the value of the common stock at t0, d1 = the annual dividend at t1 (which is found by multiplying d0 by (1 + g), k = the investor\\'s required rate of return, and g = the anticipated annual growth rate.

In this example, all of the necessary information has been provided, and incorporating this information into the Infinite Period DDM will lead to the following:

{V = [$2.80 / (0.1525 - 0.1275] = $112}

This value is very close to the value of the common stock in the open market.

An important observation: notice that we have valued this common stock as a perpetuity, rather than a finite series of cash flows. The reasoning behind this approach should be somewhat intuitive. Specifically, unlike a bond, whose cash flows possess a finite lifespan, the cash flows (i.e. dividends) produced by a common stock could theoretically last forever. Is this a realistic assumption for most common stocks? What about a stock that pays little or no dividend?