



# CFA-LEVEL-1<sup>Q&As</sup>

CFA Level I Chartered Financial Analyst

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**QUESTION 1**

A company currently sells 75,000 units annually. At this sales level, its EBIT is \$4 million, and its degree of total leverage is 2.0. The firm's debt consists of \$15 million in bonds with a 9.5 percent coupon. The company is considering a new production method which will entail an increase in fixed costs but a decrease in variable costs, and will result in a degree of operating leverage of 1.6. The president, who is concerned about the stand-alone risk of the firm, wants to keep the degree of total leverage at 2.0. If EBIT remains at \$4 million, what amount of bonds must be retired to accomplish this?

- A. \$9.19 million
- B. \$8.42 million
- C. \$6.58 million
- D. \$4.44 million
- E. \$7.63 million

Correct Answer: C

$$DTL = (DOL)(DFL)$$

$$2.0 = 1.6(DFL)$$

$$1.25 = DFL$$

$$1.25 = \$4,000,000 / (\$4,000,000 - I)$$

$$\$5,000,000 - 1.25(I) = \$4,000,000$$

$$I = \$800,000$$

$$\text{Debt} = \$800,000 / 0.095 = \$8,421,053$$

$$\text{Must retire} = \$15,000,000 - \$8,421,053 = \$6.58 \text{ million of debt}$$

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**QUESTION 2**

Under the null hypothesis,  $H_0$ ,  $x = y$ . Under the alternative hypothesis,  $x$  does not equal  $y$ . If the critical  $z$ -statistic for the desired significance level is 1.68 and you find the  $z$ -statistic to be -3.2, you should:

- A. Reject the alternative hypothesis.
- B. Reject the null hypothesis.
- C. Fail to reject the null hypothesis.
- D. Accept the null hypothesis.

Correct Answer: B



Since the z-statistic is larger in magnitude than the critical value, you should reject the null hypothesis. Note that all the other alternatives loosely mean the same thing.

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### QUESTION 3

Which of the following is true about Standard III (B) - Duty to Employer?

- A. It prohibits a departing employee from making arrangements to enter independent practice prior to leaving current employment.
- B. It precludes a member from entering into an independent business that is in direct competition with the employer.
- C. It requires the employee to obtain written permission from the employer as well as the outside entity before entering independent practice.
- D. It requires departing employee to give all the details about the independent practice before leaving the current employment.

Correct Answer: C

Standard III (B) - Duty to Employer - does not preclude a member from entering into independent practice while still employed. It does require the employee to obtain written permission from the employer as well as the outside entity before doing this. It does not prohibit a departing employee from making arrangements to enter independent practice prior to leaving current employment, as long as such preparations do not constitute a breach of loyalty toward the employer.

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### QUESTION 4

If the discount relative to the NAV of a closed-end investment company \_\_\_\_\_ during the holding period, the investor will likely experience \_\_\_\_\_ excess returns.

- A. does not change; zero
- B. increases; positive
- C. declines; positive
- D. declines; negative

Correct Answer: C

It is intuitive that if the discount increases, the share price has decreased relative to the NAV and the investor loses because he had originally bought the shares at a higher price. The analysis of these discounts remains a major question in modern finance.

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### QUESTION 5

The mean amount of gasoline and services charged by Key Refining Company credit customers is \$70 per month. The distribution of amounts spent is approximately normal with a standard deviation of \$10. What is the probability of selecting a credit card customer at random and finding the customer charged between \$70 and \$83?



- A. 0.4032
- B. None of these answers
- C. 0.1962
- D. 0.3413
- E. 0.4750

Correct Answer: A

$z = (x-u)/\sigma$ .  $z_1 = 70 - 70/10 = 0$  and  $z_2 = 83 - 70/10 = 1.3$ . For  $z = 1.3$ , the area under the curve is 0.4032.

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### QUESTION 6

Which of the following statements is false?

- A. real GDP excludes earnings by domestic citizens abroad
- B. the change in real GDP plus the inflation rate equals growth in nominal GDP
- C. changes in nominal GDP include the impact of changes in the money supply
- D. real GDP measures strictly changes in national output
- E. change in nominal GDP is always greater than the change in real GDP

Correct Answer: E

The change in nominal GDP usually exceeds that of real GDP because inflation is usually positive. However, in a flat or declining price environment real GDP would exceed nominal GDP change.

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### QUESTION 7

Increasing which factor in the dividend discount model, without changing the other two, would be least likely to increase a stock's price-to-earnings (P/E) ratio?

- A. The expected dividend payout ratio.
- B. The required rate of return on the stock.
- C. The expected constant growth rate of dividends.

Correct Answer: B

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### QUESTION 8

A Japanese investor purchasing a U.S. government bond

- A. causes the yen to appreciate.



B. creates a demand for yen and a supply of dollars in the foreign exchange market.

C. causes the dollar to depreciate.

D. creates a demand for dollars and a supply of yen in the foreign exchange market.

Correct Answer: D

A foreigner must pay for a U.S. bond using U.S. dollars. Therefore, the investor must exchange Japanese yen on the foreign exchange market for U.S. dollars. This transaction increases the supply of Japanese yen and the demand for U.S. dollars.

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### QUESTION 9

Firms report payments for capital leases in the cash flow statement

A. only as financing cash flows.

B. partly as operating cash flows and partly as investing cash flows.

C. only as investing cash flows.

D. partly as operating cash flows and partly as financing cash flows.

Correct Answer: D

Interest expense is classified as CFO and amortization of the lease obligation is reported as cash from financing activities.

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### QUESTION 10

You wish to count the number of ways in which  $n$  objects can be assigned to  $k$  different categories, with  $n_i$  members in the  $i$ th category. The counting method you should use is:

A. The permutation rule.

B. The binomial formula.

C. None of these answers is correct.

D. The multinomial formula.

Correct Answer: D

The number of ways that you can arrange  $n$  objects so that there are  $n_1$  of one kind,  $n_2$  of another kind, and so on, up to  $n_k$  of a  $k$ th kind, is found by using the multinomial formula:  $n! / [(n_1)! * (n_2)! * \dots * (n_k)!]$ .

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**QUESTION 11**

The following account is affected when recording a return of inventory to the vendor under a perpetual inventory system:

- A. merchandise inventory
- B. cash
- C. accounts receivable
- D. purchase returns and allowances

Correct Answer: A

When inventory is purchased, Merchandise Inventory is debited, and credited when returned. The periodic system records purchases in an account called Purchases and returns are booked to Purchases Returns and Allowances.

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**QUESTION 12**

If business decision makers suddenly become more optimistic about future sales and profits, which of the following will most likely occur?

- A. The interest rate will fall, causing both investment and GDP to rise.
- B. Income will increase and actual saving will remain constant.
- C. Actual investment will increase but consumption will decrease, leaving GDP unchanged.
- D. Investment will increase, causing both aggregate demand and GDP to increase.

Correct Answer: D

If business decision makers are optimistic about the future, they will increase their private investment and stimulate other parts of the economy. Thus, aggregate demand and aggregate output will increase.

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**QUESTION 13**

You are examining a portfolio composed of 33% money-market investments, 9.5% bonds, and 57.5% stocks. Last year, the return on the money-market investments was 4%; the return on bonds was 9%, and the return on stocks was -11%.

What is the portfolio weighted average return?

- A. -4.05%.
- B. -4.15%.
- C. None of these answers is correct.
- D. -3.90%.



Correct Answer: B

The portfolio weighted-average mean return is equal to the sum (as  $i$  goes from 1 to  $n$ ) of  $w_i * X_i$ , where  $w_i$  is the percentage weight in the portfolio of the  $i$ th asset, and  $X_i$  is the investment return of the  $i$ th asset. Here, we get a weighted mean of  $0.33 * 0.04 + 0.095 * 0.09 + 0.575 * -0.11 = -4.15\%$ .

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#### QUESTION 14

James Martindale, CFA, manages a small mutual fund specializing in defensive equity investments. Martindale has purchased 10,000 shares of BLM stock for the portfolio after deciding that the stock would contribute to meeting the fund's objectives. Which of the following characteristics would make BLM stock suitable for Martindale's mutual fund?

- A. A high beta.
- B. Low systematic risk.
- C. Higher rate of return than other stocks with similar risk characteristics.

Correct Answer: B

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#### QUESTION 15

What monthly payment, beginning next month, would pay off a debt of \$1,000 over 15 months, if the interest rate on the debt is 18% per year, compounded monthly?

- A. \$5.12
- B. \$66.67
- C. \$74.94
- D. \$68.92
- E. \$76.51

Correct Answer: C

On the BAII Plus, press 15 N, 18 divide 12 = I/Y, 1000 PV, 0 FV, CPT PMT. On the HP12C, press 15 N, 18 ENTER 12 divide i, 1000 PV, 0 FV, PMT. Note that the answer will be displayed as a negative number. Make sure the BAII Plus has the value of P/Y set to 1.

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