Question #1 of 47

Which of the following is not part of the general steps of the portfolio management process?

A) Feedback.

B) Performance evaluation.

C) Planning.

Question #2 of 47

Diversification can reduce:

A) systematic risk.

B) macroeconomic risks.

C) unsystematic risk.

Question #3 of 47

Which of the following *most accurately* identifies the three main steps in the portfolio management process?

A) Planning, asset allocation, security selection.

B) Planning, execution, feedback.

C) Objectives, constraints, risk tolerance.

Question #4 of 47

Which of the following is not a step in the portfolio management process?

A) Execution.

B) Developing an IPS.

C) Feedback.

Question #5 of 47

Which of the following *best* represents the general steps of the planning phase of the portfolio management process? Determining:

A) the investor's time horizon.

B) investor objectives and constraints.

C) the investor's tax situation and unique circumstances.

Question #6 of 47

The guidelines in the investment policy statement are important because they:

A) allow continuity in implementation by current and subsequent managers.

B) dictate how subsequent managers should change portfolio implementation.

C) determine how to make portfolio shifts after dramatic short-term value declines.

Question #7 of 47

Individual investors and institutional investors can be impacted differently by different constraints. Which constraints have a large impact on individual investors and a large impact on pension funds, respectively?

A) Liquidity concerns for individual investors and tax considerations for pensions.

B) Tax considerations for individual investors and legal and regulatory issues for pensions.

C) Legal and regulatory issues for individual investors and tax considerations for pensions.

Question #8 of 47

The investment policy statement is *least likely* to contain which of the following?

A) Investor contact phone numbers and addresses.

B) Identification of responsibilities of parties involved.

C) Portfolio adjustment guidelines.

Question #9 of 47

The investment policy statement does not contain:

A) guidelines for adjusting portfolio composition.

B) industry specifics for potential investment.

C) a client description.

Question #10 of 47

Which of the following statements regarding the ethical conduct necessary for managing portfolios is *least* accurate?

A) The portfolio manager should not presume that they have more knowledge than the client.

B) The portfolio manager should meet standards of competence.

C) The standard of conduct is embodied by the CFA Institute Code and Standards.

Question #11 of 47

Horace Cline buys large-cap stocks and shorts S&P 500 Index futures. What investment strategy does Cline practice?

A) Semi-active.

B) Active.

C) Growth.

Question #12 of 47

Max and Anna Klushefski have both turned 30 in the last year. The couple decides that 30 is the right age to start thinking more about their future, so they meet with a financial planner, Thelma Black. Both Max and Anna work. Their 401k plans have a combined value of $135,000 and this represents their only investment assets. Anna, a schoolteacher, is pregnant with their first child and plans to quit her job when the child is born. The couple hopes to have at least two more children. Max makes $95,000 per year as a junior executive at a clothing firm. The couple has been banking Anna's salary for the last two years, as they can live on what Max makes.

Max and Anna had not thought much about their future, but in response to Black's questions, they come up with two goals:

- Anna wants to stay out of the work force until all of their children are out of the house.
- Max wants to retire at 65 with at least $2 million in their portfolio.

Neither Max nor Anna knows much about investing, but Max's friends tell him that stocks are the best option because equities earn the best returns. Max and Anna want to invest most of their money in stocks.

Based only on the information presented above, the Klushefskis':

A) time horizon should be multistage.

B) investment objectives are unrealistic.

C) ability to take risk conflicts with their willingness to take risk.

Yoo Jin, CFA, is the Chief Investment Officer of Park, Kim & Lee Investment Management (PKL), which specializes in private wealth management for affluent families. Yoo has recently met with a potential new client, the Ahn family. PKL was highly recommended by a business associate of eldest member of the family, Ahn Kwan, and three generations of the family are considering investing with the firm to establish a new investment portfolio. The portfolio is intended solely to provide capital for the fourth and youngest generation of the family and their descendents, so the family can maintain its position in future generations. Portfolio income is not currently needed to support the three eldest generations of the Ahn family because the business ventures provide an income sufficient to maintain a luxurious lifestyle.

Since the elderly Ahn Kwan is not in sufficiently good health to attend the meeting in person, the family represented at this initial conference by Ahn Kwan's eldest son, Ahn Yong. He explains to Yoo that the family wants to take a cautious approach to its investments. The family takes substantial risk in its business ventures and does not want to risk its capital.

As the discussion proceeds, he informs Yoo that the family is also interested in exploring new investment opportunities for their existing portfolios as well. The three adult generations of the Ahn family have so far kept their money in various bank accounts because of concern about possible losses in the securities market. The accounts generally pay an interest rate between 4% and 5%. Ahn Kwan, however, has been persuaded by his business associate that the family is losing an important opportunity to increase its returns by not investing in the stock market. The Korean equity market soared more than 40% in the previous year, and Ahn Kwan realizes that keeping money in interest-bearing accounts is costing the family substantially in missed opportunities. He has agreed to consider moving a substantial portion of the family's assets over to PKL since he has been assured that PKL is a responsible, cautious firm.

In discussing the move into equities, Ahn Yong explains his father's position. "My father has devoted his entire life to establishing the success of his family. The financial position of his children, his grandchildren, and their descendants is of primary importance to him. He does not want to risk losing money that he has worked decades for."

Ahn Yong elaborates on his father's concerns by saying, "My father has seen what happened in Japan. The peak in the Nikkei index came in 1989, and the market has never recovered. Anyone who invested back then lost nearly two-thirds of his money. My father does not want that to happen to our family."

Yoo Jin asks, "We would of course only invest your family's money in markets that you want to participate in. Would your father want the family's money invested in the Japanese market?" Ahn Yong asserts emphatically, "My father is only interested in participating in the Korean markets. He does not want our money invested overseas."

The portfolio manager who would be responsible for the Ahn family portfolios is Shin Sun, CFA. In reviewing the meeting with Shin, Yoo explains that in her view, the family's goals are inconsistent and education is required to resolve the inconsistency. Yoo notes that the family is only interested in investing in the Korean equity market, but the Korean equity market is highly volatile. It would not be possible to create a portfolio consisting solely of Korean equities that would be consistent with Ahn Kwan's investment risk tolerance.

Shin makes the case that the family has a very high risk tolerance. Shin argues, "The time horizon of the Ahn family is virtually infinite, since the money is intended for future generations. In addition, the portfolio has no current income requirements. In this case, they can have a very high risk tolerance. Certainly the Ahn family is in an excellent position to invest in the Korean equity market."

Shin suggests, "Educating a new client can be a very delicate issue. That is especially true when the client is the elderly head of a very successful family. I would not want to tell Ahn Kwan that we cannot do what he wants. We should follow his instructions and invest the family's money in a portfolio of Korean equities. If that is what he says, then it is our duty to follow his wishes." Shin concludes that PKL should construct a portfolio consistent with the Ahn family's substantial ability to assume risk.

Question #13 of 47

The *most* accurate explanation of the importance of portfolio perspective is that investors, analysts and portfolio managers should evaluate an individual investment in a portfolio in the context of:

A) not just the investment's expected returns but also the investment's level of risk.

B) how much incremental risk the investment adds to the investor's portfolio.

C) the level of systematic risk the investment holds.

Question #14 of 47

Which of the following is *least likely* to determine an individual investor's ability to accept risk?

A) Long-term wealth target.

B) Liabilities.

C) Market expectations.

Question #15 of 47

The two principal risk objective measurements are *best* described as:

A) tracking risk and absolute risk.

B) absolute risk and qualitative risk.

C) absolute risk and relative risk.

Question #16 of 47

Regarding Shin's and Yoo's assertions about the family's risk tolerance and the implications for the management of their portfolios:

A) Yoo's statement is incorrect; Shin's statement is correct.

B) Yoo's statement is correct; Shin's statement is incorrect.

C) Yoo's statement is correct; Shin's statement is correct.

Question #17 of 47

A return objective should *best* be considered from the perspective of:

A) return from income relative to return from capital gains.

B) required return.

C) total return.

Question #18 of 47

Which is *least likely* to be considered one of the three integrative steps in the portfolio management process?

A) Developing an investment policy statement.

B) Feedback.

C) Planning.

Question #19 of 47

Which of the following statements about investment policy statements (IPS) is *least* accurate? The IPS:

A) helps insure against short-term shifts in strategy when either market environments or portfolio performance cause panic or overconfidence.

B) is an informal statement of objectives and constraints.

C) can be readily implemented by current or future investment advisors.

Question #20 of 47

Which of the following is not considered an investment constraint?

A) High-risk securities.

B) Unique considerations.

C) Liquidity requirements.

Question #21 of 47

In which step of the portfolio management process developing an IPS occur?

A) Feedback

B) Planning.

C) Strategic asset allocation.

Question #22 of 47

Which of the following is not considered to be an investment constraint?

A) Risk tolerance.

B) Tax concerns.

C) Time horizon.

Question #23 of 47

The investment policy statement does not contain which of the following?

A) Portfolio position listing.

B) Evaluation of investor risk preferences.

C) Asset allocation guidelines.

Question #24 of 47

Which of the following statements regarding the effect of investors' time horizon on portfolio choice is *least* accurate?

A) Endowments and foundations typically invest with an average or below average tolerance for risk.

B) Longer time horizons may indicate an investor's greater ability to take risk, even if willingness is not apparent.

C) Legal and regulatory factors usually do not affect the investment policies of individual investors.

Question #25 of 47

Ophelia McGillicutty, a retired airline executive, has been buying and selling stocks for more than 50 years. At 74, she controls a modest investment portfolio of $280,000. Over the last three decades, McGillicutty has given away millions of dollars to charities. She lives comfortably on her pension and her deceased husband's Social Security benefits. McGillicutty keeps the bulk of her investments in stocks, although her children and grandchildren say she is taking on too much risk at her age.

McGillicutty should be *most* concerned about:

A) tax considerations.

B) liquidity.

C) diversification.

Question #26 of 47

Kelsey Opelt is a portfolio manager and is providing advice for Jay Steele, a retiree. Opelt has been working with Steele for many years. They have a good relationship and Opelt has taught Steele the basic of investments. Steele has fairly steady liquidity requirements. His house is paid for, he has good health insurance, and he has a steady pension. He only requires $1,000 a month in spending money that allows him to enjoy retirement. His children are grown and financially independent. His wife Harriet passed away five years ago. Because of Steele's steady lifestyle, low liquidity requirements, and investment knowledge, Opelt has not adjusted Steele's portfolio for capital market expectations in many years. The portfolio has performed quite well recently, due to an average return in the stock market of 25% over the past three years. Opelt should:

A) monitor the portfolio and capital market expectations more closely.

B) not perform any actions because Steele's circumstances have not changed, and are not expected to change, for many years.

C) not interfere with the portfolio because it is performing so well.

Question #27 of 47

Jack Weatherford is a portfolio manager and is providing advice for Maria Conn, an accountant. From his brief conversation with Conn, Weatherford has learned that Conn is 43 years old and her goal is to save for retirement. Weatherford has been extremely busy lately but would like to get Conn started with an asset allocation as soon as possible. Weatherford and Conn discuss the possibility of temporarily parking Conn's assets in an ultra-low-cost domestic equity index fund, and then reallocate her assets later when they have finalized Conn's investment policy statement. Which of the following statements is *most* accurate? Weatherford should:

A) require Conn to make the near-term investment decisions so that Weatherford avoids fiduciary responsibility for potential investment losses.

B) invest Conn's assets in the domestic equity fund immediately so does not miss out on market returns.

C) refuse to invest Conn's assets at the current time.

Question #28 of 47

Investment constraints are best defined as factors:

A) encouraging investment choices.

B) determining investment choices.

C) restricting investment choices.

Question #29 of 47

Investor objectives relate to which of the following? Evaluating:

A) capital market and security factors.

B) risk and return factors.

C) asset allocation and security factors.

Question #30 of 47

Which one of the following alternatives correctly outlines the importance of the portfolio perspective?

A) Market participants should attempt to eliminate the unsystematic risk associated with each security by forming portfolios that will diversify away this risk.

B) Market participants should analyze the risk-return trade-off of a portfolio as a whole, not the risk-return trade-off of the individual investments in a portfolio.

C) Market participants should focus on the systematic risk of the components of a portfolio not the unsystematic risk of the components of a portfolio.

Question #31 of 47

A defined benefit pension plan would *most likely* have which of the following set of return objectives and risk tolerance?

	Return Requirements	Risk Tolerance
A)	Fund pension	Plan features, funding
B)	Pension liablility + inflation	Risk tolerance of beneficiaries
C)	Life cycle stage of beneficiaries	Risk tolerance of beneficiaries

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Question #32 of 47

Which of the following is not typically included in an investment policy statement?

A) Identification of duties.

B) Names of specific managers or mutual funds that should be used.

C) A client description.

Question #33 of 47

A money manager who crafts portfolios using all of Standard & Poor's sector index exchange traded funds (ETFs), aggressively overweighting and underweighting sectors, follows what investment strategy?

A) Active.

B) Semi-active.

C) Passive.

Question #34 of 47

The investment policy statement is important because it helps:

A) direct short-term investment portfolio decisions as a result of short-term responses to overreacting markets.

B) direct long-term investment portfolio decisions and promotes adjustments in response to panic and overreaction.

C) direct long-term investment portfolio decisions that deter adjustments due to panic and overconfidence.

Question #35 of 47

Equity pricing models assume which risk is priced?

A) Both systematic and unsystematic.

B) Systematic.

C) Unsystematic.

Question #36 of 47

Karen Mogdans is a money manager working on an account for Jim Howell. In order to channel Mogdans' knowledge of the risk and return characteristics of different asset classes into a strategic asset allocation for Howell, she needs:

A) an investment policy statement (IPS).

B) a return target.

C) a rebalancing strategy.

Question #37 of 47

The objective of achieving a 10% annual rate of return is an example of a(n):

A) required return objective.

B) relative return objective.

C) absolute risk objective.

Question #38 of 47

William Parthley, age 69, has had bad luck with his investments in recent years and decides to consult Moira Wembley, CFA, for advice.

Parthley's portfolio is composed of 90% stocks and 10% bonds, with a total value of $2.6 million. Classifying himself as conservative, Parthley blamed the aggressive allocation on a previous money manager, and says he wants to substantially increase the fixed-income weighting of his portfolio.

From his portfolio, Parthley hopes to fund his retirement at a rate of $7,000 per month, adjusted for inflation. He has also promised his alma mater at least $2 million upon his death. Parthley is in good health, and most of the men in his family have lived into their late 80s.

Based solely on the information presented above, Wembley can conclude that there is *most likely* a conflict between Parthley's:

A) return requirements and asset allocation.

B) willingness to take risk and ability to take risk.

C) return requirements and asset allocation as well as his willingness to take risk and ability to take risk.

Question #39 of 47

Which of the following factors are *least likely* to affect the formulation of an investment policy statement for a university's endowment fund?

A) Social considerations.

B) Multi-stage time horizons.

C) Tax considerations.

Question #40 of 47

Which of the following does not relate to return objectives? Specifying:

A) portfolio real after-tax returns.

B) return requirements.

C) security-specific returns.

Herbert von Soltanini, CFA, manages a variety of balanced portfolios for Great Performance Asset Management (GPAM). GPAM has a broad base of clients covering the entire spectrum of institutional investors. The firm manages money globally, but the bulk of its clients are located in Europe and the Americas.

Soltanini is scheduled to travel to the US in a few weeks for annual meetings with key clients in New York, Boston, and Chicago. Great Performance requires portfolio managers to review the investment policy statements (IPS) of each client before the annual meeting to ensure that the IPS still meets the current requirements of the client, and that the IPS is up to date before any revisions are made to it as a result of the annual meeting.

In preparation for the trip, Soltanini asked his assistant, Domenico Bachandel, to review the relevant United States-based clients and the status of their investment policy statements.

Bachandel immediately finds a potential discrepancy in the IPS among the firm's pension fund clients, and asks Soltanini for a meeting to discuss the problem.

Soltanini manages portfolios for many large plans. Although the majority of the plans are defined benefit, there are also several defined contribution plans for which Soltanini manages investment funds. The status of the defined benefit plans varies considerably. Most try to maintain contributions in line with actuarial requirements, but Soltanini's defined benefit pension clients cover the full spectrum, from severely underfunded to significantly overfunded.

In addition, the range of beneficiaries varies widely as well. Some of Soltanini's oldest client relationships are with the defined benefit plans sponsored by long-established firms. These firms' employee bases often consist mostly of skilled manufacturing workers with high salaries and generous pension benefits. They generally have a very large proportion of retirees and extremely high requirements for current income to pay the benefits of the plan's retirees. Often, their plans are severely underfunded. A clear example is Riverbank Manufacturing, which covers all employees with a defined benefit plan. The plan is extremely generous and drastically underfunded because more plan participants are retired than are currently employed.

In contrast, Soltanini has more recently developed relationships with many firms in the service sector, especially financial services, communications, and technology. Most of these firms have defined contribution plans, but Soltanini also manages several defined benefit plans sponsored by service sector firms as well.

The defined benefit plans for the newer clients tend to be fully-funded. In fact, many of them are significantly overfunded because the firms make large pension contributions in good years to give themselves the flexibility to reduce required contributions in bad years. These plans tend to have a very small percentage of retirees – in many cases, less than 5% – and very high turnover among workers, so that only a small percentage become vested in the plan.

In addition, these plans tend to offer less generous pension benefits than the plans established earlier by the manufacturing firms. Consequently, many of Soltanini's service sector clients find that funding their defined benefit plans is relatively inexpensive for the plan sponsor. Sunrise Telecom is a perfect example of this. Only 3% of the plan participants at Sunrise are retired, and it experiences a very high turnover among workers. Previous contributions to the pension plan have provided sufficient portfolio assets to make the plan substantially overfunded.

Bachandel is concerned because his review showed a great divergence of investment objectives in the IPS for the various pension clients and several of the IPS for the plans appear to conflict. The IPS for the plan at Riverbank Manufacturing indicates a very low tolerance for risk, while that for Sunside Telecom indicates a very high risk tolerance. Given that these are both defined benefit plans, Bachandel wonders why the IPSs are so different.

At the meeting with Soltanini, Bachandel suggests one possible explanation for the discrepancies by saying, "The return requirements for defined benefit pension plans don't have to be similar since they are determined by the life cycle stage of the beneficiaries." Soltanini points out, "The risk tolerance of the plan will depend on the risk tolerance of the beneficiaries."

Bachandel also raises concern about the IPS statements in general, since the problems extend beyond the pension fund clients. He sees a striking difference in the IPS of the various insurance companies for which Great Performance manages portfolios, as well.

Bachandel clarifies for Soltanini, "The return requirements for life insurance companies depend primarily on policy pricing and financial strength." He hypothesizes to Soltanini that this fact could explain the discrepancies in their stated return requirements. Soltanini adds that all their insurance company clients will most likely have similar risk tolerances. "The risk tolerance at both life and casualty insurance companies is likely to be below average because of regulatory constraints."

Bachandel and Soltanini decide that there is no obvious problem with the client investment policy statements. They agree to wait and review the IPS with the clients at the upcoming annual meetings.

Question #41 of 47

The *most likely* event to be successfully diversified away in a portfolio would be:

A) unanticipated corporate loss.

B) unanticipated inflation.

C) business cycle risk.

Question #42 of 47

Regarding Bachandel's and Soltanini's assertions about the risk tolerance of defined benefit pension plans:

A) Soltanini’s statement is incorrect; Bachandel’s statement is incorrect.

B) Soltanini's statement is incorrect; Bachandel's statement is correct.

C) Soltanini's statement is correct; Bachandel's statement is correct.

Question #43 of 47

Which of the following is *least likely* to be considered part of the planning phase of the portfolio management process?

A) Developing an investment policy statement.

B) Determining the appropriate investment strategy.

C) Selecting appropriate individual investments.

Question #44 of 47

Regarding Bachandel's and Soltanini's assertions about the return requirements and risk tolerances for insurance companies:

A) Soltanini's statement is correct; Bachandel's statement is correct.

B) Soltanini's statement is correct; Bachandel's statement is incorrect.

C) Soltanini's statement is incorrect; Bachandel's statement is correct.

Question #45 of 47

The *most accurate* characterization of the proper use of strategic asset allocation would be:

A) active investment strategies should be used instead of strategic asset allocation when the portfolio manager believes he can exceed market returns.

B) market expectations determine the objectives and constraints of the investor, which translate into strategic asset allocation.

C) forecasts of risk-return characteristics of asset classes included in the portfolio connect market expectations to the objectives and constraints of the investor.

Question #46 of 47

Which of the following is *least likely* to be considered one of the five main classes of investment constraints?

A) Time horizon.

B) Tax considerations.

C) Willingness to assume risk.

Question #47 of 47

Which of the following is *least likely* to be an advantage of a valid investment policy statement?

A) Promotes long-term discipline in investment decisions.

B) Allows for a continual dynamic process in meeting investor objectives.

C) Provides for short-term strategy shifts in response to short-term dramatic value declines.