

CFA Level I — Practice Examination

Practice Paper 1

Instructions to candidates

- This paper contains 180 multiple-choice questions.
- Each question has three options (A, B, C). Select the single best answer.
- Recommended time: 4 hours 30 minutes, in two sessions of 2 hours 15 minutes.
- There is no penalty for incorrect answers — attempt every question.
- A financial calculator is permitted.

Candidate name: _____

Date: _____

Time started: _____

Original practice material. Not an official product of, or endorsed by, CFA Institute. CFA® is a registered trademark of CFA Institute.

1. On close inspection, a limitation of the N-firm concentration ratio as a measure of market power is that it:
- A. Accounts fully for potential entry from outside the market.
 - B. Ignores the effect of mergers among the largest firms already counted.
 - C. Always overstates competition relative to the Herfindahl-Hirschman Index.
2. In a review of this topic, under the semi-strong form of market efficiency:
- A. Only past price data is reflected in prices.
 - B. Prices reflect all public information, so fundamental analysis cannot reliably earn abnormal returns.
 - C. Even private inside information is already reflected in prices.
3. When Ravi communicates a recommendation, Standard V(B) requires that Ravi:
- A. Omit the investment process and risks to keep the report brief.
 - B. Distinguish clearly between fact and opinion, and disclose the process and risks.
 - C. Present assumptions as established facts to project confidence.
4. In practice, the free-cash-flow-to-equity (FCFE) model is preferred over the DDM when:
- A. A company pays little or no dividend but generates measurable free cash flow.
 - B. The company has no cash flows at all.
 - C. A company pays a stable, predictable dividend.
5. A non-callable perpetual preferred share pays a fixed annual dividend of \$4. If the required return is 5%, its value is closest to:
- A. \$0.20
 - B. \$80.00
 - C. \$57.14
6. From a technical standpoint, a hallmark of professionalism in investment management is:
- A. Prioritising personal commissions above client needs.
 - B. Placing client interests ahead of one's own and maintaining competence.
 - C. Avoiding any continuing education.
7. A portfolio holds 50% in asset A ($\sigma=10\%$) and 50% in asset B ($\sigma=12\%$), with a correlation of -0.3. Its standard deviation is closest to:
- A. 11.00%
 - B. 7.81%
 - C. 6.56%
8. On close inspection, in corporate issuer analysis, an example of a governance (the 'G' in ESG) factor is:
- A. The company's greenhouse-gas emissions.
 - B. The company's employee health-and-safety record.
 - C. The independence and structure of the board of directors.
9. Examining this carefully, to claim GIPS compliance, a firm must apply the standards:
- A. Only in years when performance is strong.
 - B. To its single best-performing composite.
 - C. On a firm-wide basis, not to selected composites only.
10. A useful criterion for defining an asset class in strategic allocation is that its members should be:
- A. Relatively homogeneous, with low correlation to other classes.
 - B. Highly correlated with every other asset class.
 - C. Chosen so that classes overlap heavily.

11. Examining this carefully, index reconstitution refers to:
- A. Paying dividends to index investors.
 - B. Periodically changing which securities are included in the index.
 - C. Adjusting constituent weights back to target within the same securities.
12. A log-linear regression (dependent variable in natural logs) is most useful when:
- A. The dependent variable grows at a roughly constant rate (exponential growth).
 - B. The relationship between variables is exactly linear.
 - C. The independent variable must be negative.
13. Considering the fundamentals, under a fixed exchange rate regime, the monetary authority commits to:
- A. Maintaining the currency's value against a peg, often via intervention.
 - B. Letting the currency float freely with no intervention.
 - C. Abolishing its own currency entirely.
14. When applying the curriculum here, in an auto-loan ABS, the cash flows to investors come primarily from:
- A. The manufacturer's share dividends.
 - B. Government tax receipts.
 - C. Scheduled loan payments and prepayments by the car buyers.
15. When applying the curriculum here, overcollateralization is a form of credit enhancement in which:
- A. The value of the collateral pool exceeds the value of the securities issued.
 - B. The securities issued exceed the value of the collateral.
 - C. No collateral is posted at all.
16. Which use of the CFA designation by Marcus is consistent with Standard VII(B)?
- A. Claim that holding the CFA charter produces superior investment returns.
 - B. State that one has earned the right to use the CFA designation after completing all requirements.
 - C. Use 'CFA Level II' as a credential to show exam progress.
17. As a matter of principle, risk governance refers to:
- A. The senior-level oversight and direction of an organisation's risk management.
 - B. The day-to-day execution of individual trades.
 - C. A ban on taking any financial risk.
18. On close inspection, the effective-tax-rate reconciliation in the tax note helps an analyst:
- A. Understand why the effective rate differs from the statutory rate.
 - B. Determine the CEO's compensation.
 - C. Calculate the company's revenue.
19. A fund of hedge funds is best described as:
- A. A single hedge fund pursuing one strategy.
 - B. A publicly listed index of all stocks.
 - C. A fund that allocates capital across multiple underlying hedge funds.
20. Priya intends to buy a REIT personally and also to recommend it to clients. Standard VI(B) requires Priya to:
- A. Trade personally first to secure a better entry price.
 - B. Execute client and employer transactions before their own personal trade.
 - C. Trade personally at the same time, since all orders are equal.

KEY TAKEAWAYS

One takeaway for every question — use these to revise after you have checked your answers

Q1 [Concentration measures]

KEY TAKEAWAY

The N-firm concentration ratio sums the largest firms' market shares, and the HHI sums squared shares; higher values mean a more concentrated market.

Q2 [Forms of market efficiency]

KEY TAKEAWAY

Weak-form: prices reflect past prices; semi-strong: all public information; strong: all information, including private.

Q3 [Communication with clients]

KEY TAKEAWAY

Disclose the investment process, risks and limitations; separate fact from opinion and keep clients informed of material changes.

Q4 [Present value models rationale]

KEY TAKEAWAY

Present-value models discount expected cash flows because a share's value is the present value of what it will pay the owner.

Q5 [Preferred stock valuation]

KEY TAKEAWAY

A non-callable perpetual preferred is a perpetuity: $\text{value} = \text{dividend} \div \text{required return}$.

Q6 [Professionalism in investment management]

KEY TAKEAWAY

Manage with professional standards: maintain independence, competence and diligence in analysis and recommendations.

Q7 [Portfolio standard deviation]

KEY TAKEAWAY

For two assets, $\sigma_p = \sqrt{(w_1^2 \sigma_1^2 + w_2^2 \sigma_2^2 + 2 w_1 w_2 \rho \sigma_1 \sigma_2)}$; square root only at the end.

Q8 [ESG factors]

KEY TAKEAWAY

Environmental, social and governance factors can affect cash flows, cost of capital and reputation.