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QUESTION 1

The stock of Constagrow pays dividends that are expected to grow at a steady rate of 3.2% per year. Investors expect a rate of return of 11.5% from Constagrow stock. If the spread between this required rate of return and the dividend growth rate were to increase by 50 basis points, the percentage change in the stock price would be:

- A. -4.73%
- B. +3.94%
- C. -5.68%
- D. +4.22%

Correct Answer: C

In the usual notation, the Dividend Discount Model gives $P_0 = D_1 / (k - g)$. When $k - g = 11.5\% - 3.2\% = 8.3\%$, the price is given by $P_0 = D_1 / 0.083$. When the spread increases by 50 basis points and all else stays constant, the price becomes $P_1 = D_1 / (0.083 + 0.005) = D_1 / 0.088$. The percentage change in the price equals $(P_1 - P_0) / P_0 = (1 / 0.088 - 1 / 0.083) * 0.083 = 8.3 / 8.8 - 1 = -5.68\%$. Thus, the stock price falls by 5.68% when the spread between k and g increases by 50 basis points, all else equal.

QUESTION 2

All of the following statements about a member's use of clients' brokerage commissions are true except

- A. client brokerage commissions may be directed to pay for the investment manager's operating expenses.
- B. client brokerage commissions should be commensurate with the value of the brokerage and research services received.
- C. client brokerage commissions may be used by the member to pay for securities research used in managing the client's portfolio.
- D. client brokerage commissions should be used by the member to ensure that fairness to the client is maintained.

Correct Answer: A

This question deals with Standard IV (B.1), Fiduciary Duties and the specific topic of soft dollars. All the answers deal with the use of client brokerage commissions and the criteria for their use - (1) fairness to the client and (2) commensurate with the value of the services provided. The only statement that is not true is that client brokerage commissions may not be directed to pay the investment manager's operating expenses.

QUESTION 3

The Income Statement:

- I. reflects the current operating performance of the firm.
- II. indicates whether the firm is healthy and growing or not.



III. explains the changes in assets, liabilities and Equity of the firm.

IV.

is a snapshot of a firm's operations at a given time.

A.

I, II, III and IV

B.

II and III

C.

I only

D.

I and IV

Correct Answer: C

II needs a cash flow statement, in addition. III is not true since the Income statement does not contain all the details which pertain to changes in assets and liabilities. Finally, an income statement shows the performance over a time period and is hence, not a "snapshot" of operations.

QUESTION 4

A current measure of speculative trading activity on the market is the ratio of

A. LSE volume to OTC volume.

B. OTC volume to NYSE volume.

C. mutual fund volume to NYSE volume.

D. TSE volume to NYSE volume.

E. AMEX volume to NYSE volume.

Correct Answer: B

Technicians consider speculative activity high when the OTC volume reaches some high level (such as 112%, for example) relative to NYSE volume. Conversely, they consider speculative activity low when OTC volume reaches some low level (such as 87%, for example) relative to NYSE volume.

QUESTION 5

_____ diversify outside the stock market by combining common stock with fixed-income securities, including government bonds, corporate bonds, convertible bonds, or preferred stock.



- A. Balanced funds
- B. None of these answers
- C. Fixed income funds
- D. Bond funds

Correct Answer: A

Balanced funds diversify outside the stock market by combining common stock with fixed-income securities.

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