CFA-LEVEL-1 Q&As

CFA Level I Chartered Financial Analyst

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QUESTION 1

The most commonly held view of capital structure, according to the text, is that the weighted average cost of capital ________.

A. increases proportionately with increases in leverage

B. does not change with leverage

C. none of these answers

D. increases with moderate amounts of leverage and then falls

E. first falls with moderate levels of leverage and then increases

Correct Answer: E

The optimal capital structure must strike a balance between risk and return which maximizes the firm\\'s stock price. Using more debt raises the risk borne by stockholders, however, using more debt leads to a higher expected rate of return.

QUESTION 2

What is the building\\'s net income?

A. $42,646.

B. $49,307.

C. $35,985.

D. $29,324.

Correct Answer: C

52,919 x .68 = 35,985

QUESTION 3

Under a system of fixed exchange rates, which of the following will most likely increase a balance of payments deficit?

A. an increase in foreign-aid grants

B. an increase in foreign-aid grants and expansionary monetary policy, which will drive prices up and interest rates down

C. expansionary monetary policy, which will drive prices up and interest rates down

D. a reduction in income from investments abroad

E. restrictive monetary policy, which will keep prices down and interest rates up

Correct Answer: C

Expansionary monetary policy will create inflation and cause interest rates to fall. Both of these consequences will cause the demand for U.S. exports and assets to fall which will increase the balance of payments deficit.

QUESTION 4

As the director of capital budgeting for Denver Corporation, you are evaluating two mutually exclusive projects with the following net cash flows: YearProject XProject Z 0-$100,000-$100,000 150,000 10,000 240,000 30,000 330,000 40,000 410,000 60,000 If Denver\\'s cost of capital is 15 percent, which project would you choose?

A. Project Z, since it has the higher NPV.

B. Project X, since it has the higher NPV.

C. Neither project.

D. Project X, since it has the higher IRR.

E. Project Z, since it has the higher IRR.

Correct Answer: C

(In thousands)

NPV(X) = -100 + 50(PVIF(15%,1)) + 40(PVIF(15%,2)) + 30(PVIF(15%,3)) + 10(PVIF(15%,4)) = -100 + 50

(0.8696) + 40(0.7561) + 30(0.6575) + 10(0.5718) = -0.833 = -$833. NPVZ = -100 + 10(PVIF(15%,1)) + 30

(PVIF(15%,2)) + 40(PVIF(15%,3)) + 60(PVIF(15%,4)) = -100 + 10(0.8696) + 30(0.7561) + 40(0.6575) + 60

(0.5718) = -8.013 = -$8,013.

At a cost of capital of 15%, both projects have negative NPVs and, thus, both would be rejected.

QUESTION 5

Mrs. Davis was in the habit of keeping $500 in currency in her jewelry chest in case she ever needed cash and the bank was closed. However, she recently got a combination debit/ATM card that gives her access to her checking account 24 hours a day. She deposits her $500 in cash into her checking account. How does this immediately impact the monetary base and the effective amount money available for transactions?

A. decrease, increase

B. increase, decrease

C. no change, decrease

D. both increase

E. no change for either

F. decrease, no change

G. both decrease

Correct Answer: F

Effectively, there is no difference in how Mrs. Davis is using money, simply a different vehicle for spending it. Therefore the effective level of money in circulation has not changed. However, where the monetary base previously had including her $500 in currency, it would now only include the percentage of this money held in reserve by her bank. The monetary base equals currency plus bank reserves. Therefore the monetary base would decrease. Innovations like debit cards have decreased the need to hold currency. Therefore certain measures of the money supply may decrease despite no real change in the money level in circulation.