2021 CFA® Exam Prep

SAMPLE

IFT Mock Exams

Level III

Mock Exam 1

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QUESTION 1 HAS THREE PARTS (A, B, C) FOR A TOTAL OF 10 MINUTES.

An advisor for Freans Capital Management is working with a new client, Tom Braidwood. He asks Braidwood a series of diagnostic questions to determine whether he may have any of the following investment behavioral biases:

- Loss aversion
- Endowment
- Regret aversion
- Illusion of control
- Overconfidence
- Framing

SAMPLE

Sample diagnostic questions are shown in Exhibit 1.

Exhibit 1

Freans Capital Management
Sample Diagnostic Questions

1. If offered two free lottery tickets, will you select your own numbers or have a machine do it?
2. At what price are you willing to sell off the investment holdings received as an inheritance?
3. How do you generally attribute the success of your decisions?

A. Identify the behavioral bias that each diagnostic question in Exhibit 1 is *most likely* to reveal**.**
Note: Each diagnostic question is designed to reveal a different bias.

3 minutes (Answer 1-A on the template provided)

Tom Braidwood informs his advisor that he has always been willing to take a small chance of losing up to 7 percent of the portfolio annually. He says that he can accept any asset classes to meet his financial goals if the following constraint is considered.
"Expected return – 1.645 × Expected standard deviation ≥ –7%."

After listening to him, the advisor decides to strive for a mean-variance efficient portfolio.

Braidwood tells the advisor that his previous wealth advisor, Andy, made the following statements to him.

Statement 1: It is always recommended to know the historical performance of the CEO of the company before investing in it. Though Frio Industries has not shown any significant stock price appreciation over many years compared to its peers, recent newspaper headlines have been published about its new CEO. The CEO joined Frio after successfully managing APCO's operations for over a decade. Given his previous track record, investing in Frio shares will lead up to a good investment.

Statement 2: Global Equity Funds have increased by 1.5 – 2.0 times the historical average over the past two years. In view of this, I expect global equity funds to face a reversal in the near future. As a result, it is preferred to reallocate funds from equities to fixed-rate portfolio assets.

B. **Evaluate** the decision made by the advisor regarding Braidwood's portfolio preference.

2 minutes (Answer 1-B on the template provided)

C. **Select** the behavioral finance concept (availability, confirmation, framing, gambler's fallacy, representativeness, overconfidence, hot hand fallacy) *best* exhibited in *each* of Andy's two statements. **Justify** your response with one reason.

5 minutes (Answer 1-C on the template provided)

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Answer Question 1 on This Page

1-A. Identify the behavioral bias that each diagnostic question in Exhibit 1 is *most likely* to reveal**.**

Note: Each diagnostic question is designed to reveal a different bias.

Diagnostic Question	**Identify the behavioral bias that *each* diagnostic question in Exhibit 1 is *most likely* to reveal.** **(circle one)**
1. If offered two free lottery tickets, will you select your own numbers or have a machine do it?	• Loss aversion • Endowment • Regret aversion • Illusion of control • Overconfidence • Framing
2. At what price are you willing to sell off the investment holdings received as an inheritance?	• Loss aversion • Endowment • Regret aversion • Illusion of control • Overconfidence • Framing

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3. How do you generally attribute the success of your decisions?	• Loss aversion • Endowment • Regret aversion • Illusion of control • Overconfidence • Framing

1-B. Evaluate the decision made by the advisor regarding Braidwood's portfolio preference**.**

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1-C. Select the behavioral finance concept (availability, confirmation, framing, gambler's fallacy, representativeness, overconfidence, hot hand fallacy) *best* exhibited in *each* of Andy's two statements. **Justify** your response with one reason.

Andy's statement	**Select the behavioral finance concept *best* exhibited in *each* of advisor's two statements.** **Note: No behavioral finance concept can be used more than once.** (circle one)	**Justification**
1. It is always recommended to know the historical performance of the CEO of the company before investing in it. Though Frio Industries has not shown any significant stock price appreciation over many years compared to its peers, recent newspaper headlines have been published about its new CEO. The CEO joined Frio after successfully managing APCO's operations for over a decade. Given his previous track record, investing in Frio shares will lead up to a good investment.	• Availability • Confirmation • Framing • Gambler's fallacy • Representativeness • Overconfidence • Hot hand fallacy	

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2. Global Equity Funds have increased by 1.5 – 2.0 times the historical average over the past two years. In view of this, I expect global equity funds to face a reversal in the near future. As a result, it is preferred to reallocate funds from equities to fixed-rate portfolio assets.	• Availability • Confirmation • Framing • Gambler's fallacy • Representativeness • Overconfidence • Hot hand fallacy	

SAMPLE

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Afternoon exam sample from IFT Portal

SAMPLE

1.

Course Dashboard

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Level III Mock1(PM) Titan Case

Titan Asset Management is a well-managed firm that offers various kinds of mutual funds and investment plans for private and institutional clients. The board of directors of Titan had adopted the CFA Institute Asset Manager Code of Professional Conduct (Asset Manager Code) a year ago to establish and promote ethical behavior within the firm. The board has just instituted a review of each manager's ability to ensure his department's compliance with the Asset Manager Code. Amara Bhatia, CFA, the recently appointed chief compliance officer, is responsible for reviewing and evaluating each department's compliance.

Bhatia meets with Tom Preston, CEO of Titan, to discuss how well the procedures have been implemented over the last year to address the Manager's responsibility outlined in the Asset Manager Code's six principles. Preston responds, "We tried to address the following principles while implementing the policies and procedures of the Code:

Principle 1: Act for the benefit of clients and be professional and ethical in all our dealings at all times.

Principle 2: Act with skill, competence, and diligence. Communicate accurately and promptly with our clients while maintaining independence and objectivity.

Principle 3: Stay abreast of all rules of the capital markets."

Bhatia then reviews three current compliance procedures of the firm that were under Preston's supervision before her appointment:

Risk management process	The risk profile of a client's investment matches his risk appetite and ability. A comprehensive risk management process is administered for portfolios and investment strategies, identifying, measures, and managing risk. The risk management techniques implemented are consistent with the investment style and philosophy of our portfolio managers.
Portfolio information review	Accurate and complete portfolio information is provided to clients. The investment committee regularly does a review to confirm the accuracy of such information.
Business-continuity plan review	Procedures for safeguarding client accounts and handling inquiries in case of emergencies or market disruptions. The current plan requires to back up all of the firm's computer systems and client records daily. The back-ups are stored in an offsite storage facility. Titan employs the services of an external recovery firm to carry out specific emergency plans. The recovery firm is responsible for the coverage of critical business functions. It implements plans to communicate with employees, critical vendors, and suppliers in the event of a facility or communication disruption. The same firm also provides plans for contacting and communicating with clients in an extended disruption.

Bhatia next discusses the client disclosure policies with Shiras Nathan, head of customer relations. Nathan states, "Regarding the Asset Manager Code relating to client services, we ensure the following policies: All disclosures are accurate and complete, and we show all our calculations, including the complicated ones. We communicate with clients regularly and provide performance reports whenever they request them. All conflicts of interests arising due to the firm or employee holdings in the same securities as clients, allocation of investments among similar portfolios, use of soft dollars, and directed brokerage arrangements are disclosed."

Finally, Bhatia asks about disclosures regarding management fees. Nathan responds that the disclosures contain the following information:

"Titan charges a 2% asset-based management fee. In addition to the management fee, clients pay distribution and service fees to buy and sell shares in a fund that cannot exceed 0.75 percent of a fund's average net assets per year. Titan charges fees that may not exceed 0.25 percent for marketing material or prospectuses sent to potential investors."

After completing her evaluations, Bhatia works on her report suggesting recommendations before presenting them in the upcoming board meeting.

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Answered Review

Review question

Question 1

Q-Code: 21-L3-02-AMCC-107763

Which of the principles is *inconsistent* with the Asset Manager Code of Professional Conduct?

A Principle 1.

B Principle 2.

C Principle 3.

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After completing her evaluations, Bhatia works on her report suggesting recommendations before presenting them in the upcoming board meeting.

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Answered Review

Review question

Question 2 **Q-Code:** 21-L3-02-AMCC-107768 ?

Which of the three compliance procedures reviewed by Bhatia is *consistent* with the required and recommended standards of the Asset Manager Code of Professional Conduct?

A ○ The risk management process.

B ○ Portfolio information.

C ○ Business-continuity plan.

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	consistent with the investment style and philosophy of our portfolio managers.
Portfolio information review	Accurate and complete portfolio information is provided to clients. The investment committee regularly does a review to confirm the accuracy of such information.
Business-continuity plan review	Procedures for safeguarding client accounts and handling inquiries in case of emergencies or market disruptions. The current plan requires to back up all of the firm's computer systems and client records daily. The back-ups are stored in an offsite storage facility. Titan employs the services of an external recovery firm to carry out specific emergency plans. The recovery firm is responsible for the coverage of critical business functions. It implements plans to communicate with employees, critical vendors, and suppliers in the event of a facility or communication disruption. The same firm also provides plans for contacting and communicating with clients in an extended disruption.

Bhatia next discusses the client disclosure policies with Shiras Nathan, head of customer relations. Nathan states, "Regarding the Asset Manager Code relating to client services, we ensure the following policies: All disclosures are accurate and complete, and we show all our calculations, including the complicated ones. We communicate with clients regularly and provide performance reports whenever they request them. All conflicts of interests arising due to the firm or employee holdings in the same securities as clients, allocation of investments among similar portfolios, use of soft dollars, and directed brokerage arrangements are disclosed."

Finally, Bhatia asks about disclosures regarding management fees. Nathan responds that the disclosures contain the following information:

"Titan charges a 2% asset-based management fee. In addition to the management fee, clients pay distribution and service fees to buy and sell shares in a fund that cannot exceed 0.75 percent of a fund's average net assets per year. Titan charges fees that may not exceed 0.25 percent for marketing material or prospectuses sent to potential investors."
After completing her evaluations, Bhatia works on her report suggesting recommendations before presenting them in the upcoming board meeting.

1 2 3 4

Answered Review

Review question

Question 3 **Q-Code:** 21-L3-02-AMCC-107769

Which of Nathan's client service policies is *consistent* with the Asset Manager Code of Professional Conduct?

A ○ Performance reports frequency.

B ○ Complete, accurate disclosures, including complex calculations.

C ○ Conflicts of interests' disclosures.

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	consistent with the investment style and philosophy of our portfolio managers.
Portfolio information review	Accurate and complete portfolio information is provided to clients. The investment committee regularly does a review to confirm the accuracy of such information.
Business-continuity plan review	Procedures for safeguarding client accounts and handling inquiries in case of emergencies or market disruptions. The current plan requires to back up all of the firm's computer systems and client records daily. The back-ups are stored in an offsite storage facility. Titan employs the services of an external recovery firm to carry out specific emergency plans. The recovery firm is responsible for the coverage of critical business functions. It implements plans to communicate with employees, critical vendors, and suppliers in the event of a facility or communication disruption. The same firm also provides plans for contacting and communicating with clients in an extended disruption.

Bhatia next discusses the client disclosure policies with Shiras Nathan, head of customer relations. Nathan states, "Regarding the Asset Manager Code relating to client services, we ensure the following policies: All disclosures are accurate and complete, and we show all our calculations, including the complicated ones. We communicate with clients regularly and provide performance reports whenever they request them. All conflicts of interests arising due to the firm or employee holdings in the same securities as clients, allocation of investments among similar portfolios, use of soft dollars, and directed brokerage arrangements are disclosed."

Finally, Bhatia asks about disclosures regarding management fees. Nathan responds that the disclosures contain the following information:

"Titan charges a 2% asset-based management fee. In addition to the management fee, clients pay distribution and service fees to buy and sell shares in a fund that cannot exceed 0.75 percent of a fund's average net assets per year. Titan charges fees that may not exceed 0.25 percent for marketing material or prospectuses sent to potential investors."
After completing her evaluations, Bhatia works on her report suggesting recommendations before presenting them in the upcoming board meeting.

1 2 3 **4**

Answered Review

Review question

Question 4 **Q-Code:** 21-L3-02-AMCC-107770

Are the firm's disclosures regarding management fees *consistent* with the required and recommended standards of the Asset Manager Code?

A ○ Yes.

B ○ No, because the average or expected expenses or fees clients are likely to incur are not mentioned.

C ○ No, because complicated language is used.

Back Finish Quiz

SAMPLE

Question: 1. Topic: Portfolio Management – Behavioral Finance. Minutes: 10

1-A. Identify the behavioral bias that each diagnostic question in Exhibit 1 is *most likely* to reveal**.**
Note: Each diagnostic question is designed to reveal a different bias.
Reference: *The Behavioral Biases of Individuals, Section 3, 4 & 5.2. LOS. c.*
Grading scheme: 1 mark each for correctly identifying behavioral bias for each diagnostic question.

Response:

Diagnostic Question	Identify the behavioral bias that *each* diagnostic question in Exhibit 1 is *most likely* to reveal. (Circle one)
1. If offered two free lottery tickets, would you select your own numbers or have a machine do it?	• Loss aversion • Endowment • Regret aversion • Illusion of control • Overconfidence • Framing
2. At what price are you willing to sell off the investment holdings received as an inheritance?	• Loss aversion • Endowment • Regret aversion • Illusion of control • Overconfidence • Framing
3. How do you generally attribute the success of your decisions?	• Loss aversion • Endowment • Regret aversion • Illusion of control • Overconfidence • Framing

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1-B. Evaluate the decision made by the advisor regarding Braidwood's portfolio preference**.**
Reference: *The Behavioral Finance Perspective, Section 4.3. LOS. d.*
Grading scheme: 2 marks for correct evaluation.

Response:
The advisor's decision is accurate for Tom Braidwood. Braidwood is expressing a portfolio goal that considers expected return and standard deviation. This is consistent with traditional finance, and he is likely to prefer a mean-variance efficient portfolio.

1-C. Select the behavioral finance concept (availability, confirmation, framing, gambler's fallacy, representativeness, overconfidence, hot hand fallacy) *best* exhibited in *each* of Andy's two statements. **Justify** your response with one reason.
Reference: *The Behavioral Biases of Individuals (Section 3, 4 & 5.2. LOS. c.), Behavioral Finance and Investment Processes, (Sec 5.3, LO. e)*
Grading scheme: 1 mark each for correctly selecting behavioral bias. 1.5 marks for each justification.

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Response:

Andy's statement	**Select the behavioral finance concept *best* exhibited in *each* of advisor's two statements. (Circle one)**	**Justification**
1. It is always recommended to know the historical performance of the CEO of the company before investing in it. Though Frio Industries has not shown any significant stock price appreciation over many years compared to its peers, recent newspaper headlines have been published about its new CEO. The CEO joined Frio after successfully managing APCO's operations for over a decade. Given his previous track record, investing in Frio shares will lead up to a good investment.	• Availability • Confirmation • Framing • Gambler's fallacy • Representativeness • Overconfidence • Hot hand fallacy	Representativeness refers to judgments based on stereotypes. It classifies new information based on past experiences and classifications. Andy may be overly optimistic that Frio Industries shares will perform well because Frio Industries' CEO did well at APCO.
2. Global Equity Funds have increased by 1.5 – 2.0 times the historical average over the past two years. Based on this information, I expect global equity funds to face a reversal in the near future. As a result, it is preferred to reallocate funds from equities to fixed-rate portfolio assets.	• Availability • Confirmation • Framing • Gambler's fallacy • Representativeness • Overconfidence • Hot hand fallacy	The gambler's fallacy is a cognitive behavioral bias in which an analyst wrongly projects a reversal to a long-term trend. This reflects a faulty understanding of the behavior of random events. The analyst expects a pattern that has diverged from the long term average to reverse within a specific time.

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1. C is correct. According to the general principles of conduct of the Asset Manager Code, Managers must "uphold the applicable rules governing capital markets," not just stay informed about them. *Asset Manager Code of Professional Conduct.*

2. A is correct. According to the recommendations of Section D(7) of the Asset Manager Code, The risk management process should identify, measure, and manage the risk position of the Manager and its investments, including the sources, nature, and degree of risk exposure. Titan's risk management process seeks to match the risk profile desired by clients with the risk profile of their investments. It is consistent with the risk management process recommended by the Asset Manager Code of Professional Conduct. B is inconsistent because portfolio information, according to D(3), needs a review by an independent third-party. C is inconsistent because the business-continuity plan D(6) lacks plans for monitoring, analyzing, and trading investments if primary systems are unavailable. *Asset Manager Code of Professional Conduct.*

3. C is correct. According to the recommendations of Section F(4), Disclosures, conflicts of interests generated from a brokerage or other entities' relationships, other client accounts and fee structures, etc. should be disclosed to all clients. According to Section F, disclosures should be truthful, accurate, complete, and understandable. It is unlikely that clients would easily understand complicated calculations. Further, communications with clients should be on an ongoing and timely basis. Performance reports should be communicated at least quarterly, not only when clients ask for them. *Asset Manager Code of Professional Conduct.*

4. B is correct. According to the recommendations and guidance of Section F(4d) of the Asset Manager Code, managers must disclose to prospective clients the average or expected expenses or fees clients are likely to incur, and to existing clients, the actual fees and other costs charged to them. *Asset Manager Code of Professional Conduct.*

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