Standards of Professional Conduct & Guidance: Investment Analysis, Recommendations, and Actions

Test ID: 7440156

Question #1 of 42

Question ID: 412559

Standard V(B), Communication with Clients and Prospective Clients, *least likely* requires members to:

✗ **A)** **use reasonable judgment regarding the inclusion or exclusion of relevant factors in research reports.**

✗ **B)** disclose the general principles of investment processes used to analyze and select securities, and construct portfolios.

✓ **C)** make clear buy or sell recommendations on the securities covered in research reports.

Explanation

There is no obligation to make buy or sell recommendations on securities that are covered by research reports.

Questions #2-7 of 42

Vera Sandro recently joined Seamark Securities as a portfolio manager. Sandro also recently took the Level III examination in the Chartered Financial Analyst program, but has not yet received her results. Seamark is a medium-sized firm that employs many CFA Institute members.

Sandro has been asked by her supervisor, Ledia Ferrazzo, CFA, to write a brief biography to be included in the promotional brochure Sandro hands out to prospective clients. Sandro included the following sentences in her biography: "Vera Sandro, a Chartered Financial Analyst Level III candidate, has focused educational and investment experience in the small-cap stock market. She has consistently achieved better-than-average market returns and expects to do so in the future as well." The brochure was printed and is being used by Sandro as a marketing tool.

Soon after joining Seamark, Sandro attended a conference at which Liam Wright presented several computerized spreadsheets that he had developed to value high-tech stocks. During the presentation, Sandro copied the spreadsheets on her laptop computer. Later, Sandro made major changes to Wright's initial model. After testing the new model, Sandro was impressed with the results. Wright used Standard & Poor's data as inputs for the model, but Sandro used data supplied by Moody's Investors Service. Sandro wrote a research report describing the revised model and its results in detail and sent the report to her biggest client, along with some stock picks selected by the model.

Ferrazzo, the head portfolio manager for Seamark, often meets corporate executives in the course of her evaluation of potential investments. A week ago, Ferrazzo had lunch with Ralph Henderson, a senior vice president of Kellogg Industries, a maker of luxury linens. Ferrazzo told Henderson that she was looking for an appropriate investment in the fabric industry for her large client, Parker Jones. Henderson responded that he thought his company was well-positioned in the market, though he admitted to underestimating the demand for silk sheets in the region. After lunch, Ferrazzo read a research report that said all of Kellogg's silk plants were running at capacity, and the company might have trouble meeting the long-term demand. Two days later, Ferrazzo observed another senior vice president of Kellogg at a restaurant having dinner with the chief financial officer of Bradley Textiles, a maker of various kinds of silk fabrics. It is widely known in the market that Bradley is seeking a potential merger partner, as the founder and CEO is ready to retire.

Ferrazzo did additional research and concluded that Kellogg Industries and Bradley Textiles had complementary product lines in several areas and similar management cultures. She also remembered reading in Forbes a story in which Kellogg's CFO was quoted as saying the company had the financial wherewithal for a merger and an interest in expansion. Ferrazzo's research indicated that Bradley's market value exceeded its intrinsic value, suggesting that Kellogg was unlikely to pay a high merger premium. Nonetheless, Ferrazzo proceeded to purchase stock in Bradley on behalf of her clients. Six months later, Kellogg acquired Bradley and paid a 40 percent premium over market price.

Sandro shares a workspace with Don Wilson, a CFA charterholder. Wilson recommends that one of his clients buy Alpha Co. shares based upon detailed research conducted by a Seamark analyst. Sandro recommends that one of her clients sell Alpha Co. shares based upon comprehensive research conducted by another brokerage firm.

Seamark has evaluated prospective brokers to execute trades on behalf of its investment-management clients. The findings are as follows:

- White Brokerage Co. offers best price and execution, charges an average of $99 for a typical trade, and provides generous soft dollars.
- Green Brokers Inc., offers good price and execution, charges an average of $59 for a typical trade, and provides moderate soft dollars.
- Blue Brokerage Services Inc., offers best price and execution, charges an average of $79 for a typical trade, and provides moderate soft dollars.

Question #2 of 42

Question ID: 461204

With regard to Ferrazzo's purchase of Bradley stock, she violated:

✗ **A)** **Standard III(E): Preservation of Confidentiality and Standard II(A): Material Nonpublic Information.**

✗ **B)** Standard III(E): Preservation of Confidentiality, but not Standard V(A): Diligence and Reasonable Basis.

✓ **C)** Standard V(A): Diligence and Reasonable Basis, but not Standard II(A): Material Nonpublic Information.

Explanation

Ferrazzo's disclosure of the name of her client, Parker Jones, to Henderson violated Standard III(E): Preservation of Confidentiality. Ferrazzo used the mosaic theory to determine that Kellogg was pursuing an acquisition and did not violate Standard II(A): Material Nonpublic Information. The purchase of Bradley violated Standard V(A): Diligence and Reasonable Basis, because Ferrazzo had reason to believe that even if Bradley was going to be acquired, the premium was likely to be low. The fact that she got lucky and guessed right does not satisfy the Standard.

Question #3 of 42

Question ID: 461205

Regarding the high-tech stock model, which of the following actions is least likely to help Sandro avoid violating the standards regarding plagiarism and research reports?

✗ **A)** **Acknowledging Standard & Poor's as the original data source and Moody's Investors Service as the new data source.**

✗ **B)** Acknowledging Wright's development of the initial model.

✓ **C)** Providing basic information about technology stocks in the research report.

Explanation

To comply with Standard I(C): Misrepresentation, Sandro should have gotten permission from Wright to copy the spreadsheets. The Standard also requires that Sandro identify Wright as the source of the initial model despite the fact that she made major changes to it. The plagiarism standard permits publishing factual information from Moody's and S&P without acknowledgment, but the use of different data sources could affect the performance of the model, and should be disclosed to satisfy Standard V(B): Communication with Clients and Prospective Clients. Because the report is going to an individual client, Sandro need not provide basic information about technology stocks, according to Standard V(B): Communication with Clients and Prospective Clients.

Question #4 of 42

Question ID: 461206

The production of the advertising represented a violation of:

✗ **A) Standard IV(A): Loyalty to Employer and Standard I(C): Misrepresentation.**

✓ **B)** Standard IV(C):Responsibilities of Supervisors, but not Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program.

✗ **C)** Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program, and Standard I(C): Misrepresentation.

Explanation

Sandro's description of her CFA standing is truthful in this case because she is still technically a CFA candidate. Sandro is not allowed to imply that she can continue to produce superior returns, and as such violated the misrepresentation standard. Ferrazzo, in her supervisory role, should have prevented the violation but did not. Standard IV(A): Loyalty to Employer refers to independent practice, and is not relevant to this situation.

Question #5 of 42

Question ID: 461207

Ferrazzo may use which of the following brokers?

✗ **A) Blue and Green only.**

✓ **B)** White and Blue only.

✗ **C)** Blue only.

Explanation

The CFA Institute Soft Dollar Standards dictate members must always seek best price and execution. Soft-dollar arrangements must provide a benefit to clients, be disclosed, and be reasonable in relation to the research and execution services provided. Because both White and Blue provide best price and execution, it is within Ferrazzo's discretion to pay more for White's services as long as the research benefit is reasonable. Both White and Blue may be used.

Question #6 of 42

Question ID: 461208

Which of the following statements regarding Alpha Co. is *least* accurate?

✗ **A) Both Wilson and Sandro have a reasonable basis for their recommendations.**

✗ **B)** The fair-dealing standard has not been violated.

✓ **C)** Sandro has breached a fiduciary duty to her client.

Explanation

The use of a comprehensive research report is reasonable basis for a buy or sell recommendation. The fair-dealing standard has not been violated, as neither client was put at a disadvantage by the advice, even though the analysts' advice was contradictory. The fair-dealing standard requires the notification of clients who trade in opposition to the firm's official recommendation, so the trade should not be executed until the client is told about the firm's buy rating. While Sandro's advice differs from that of her colleague and is based on a competitor's research, she did not necessarily breach a fiduciary duty, if the investment made sense for the client. There are numerous investments that are appropriate for certain types of clients and inappropriate for others.

Question #7 of 42

Question ID: 461209

Which of the following statements regarding Sandro's biography is *least* accurate?

- ✗ **A) Sandro must disclose her stake in a thinly traded, family-owned construction company.**
- ✓ **B)** Sandro can begin using the CFA designation as soon as she receives her exam results.
- ✗ **C)** Sandro need not deliver a copy of the Code and Standards to Ferrazzo.

Explanation

Just because Sandro receives her results from CFA Institute, she still must satisfy all of the requirements before she can use the designation. The standard governing use of the CFA mark states that there is no acceptable term for a partial designation. According the Standards of Practice Handbook, 9th Edition, delivering a copy of the Code and Standards is no longer required. Standard VI(A): Disclosure of Conflicts, requires the disclosure of all security ownership that might interfere with a member's duties. While the stock is thinly traded, it still might be of interest to Seamark clients, and Sandro must disclose her ownership. In addition, if she holds a position in the company or on the board that could take up some of her time, Standard IV(A): Loyalty to Employer, also comes into play.

Question #8 of 42

Question ID: 461218

Midland Investment Banking issues a prospectus for its open-end Midland Gold Fund. In the prospectus, the investment policy is disclosed as, "We will maintain an investment posture of 50% or more in gold stocks and/or bullion, depending upon market conditions." This policy is maintained until the price of gold falls by 20%, leaving the fund 40% invested in gold stocks and bullion. Management decides that since the allocation was affected by market conditions, no action to either change the investment policy or to rebalance the portfolio is required. This decision is:

- ✗ **A) under the circumstances, not in violation of the Code and Standards.**
- ✗ **B)** in violation of the Standard concerning fiduciary duties to clients.
- ✓ **C)** in violation of the Standard concerning disclosure of investment processes.

Explanation

Standard V(B) Communication with Clients and Prospective Clients requires members to disclose "general principles and investment processes" to clients and to "promptly disclose any changes that might significantly affect those processes." Under the Standard, Midland management is required either to:

1. rebalance the portfolio in a timely manner so as to maintain compliance with the investment policy or
2. communicate an intended change in that policy well in advance of the actual change so as to afford investors time to act prior to the change in investment policy taking place.

Midland is in violation of the Standard.

Question #9 of 42

Question ID: 412537

Bill Fox, CFA, has been preparing a research report on New London Wire and Cable, one of his major investment clients. He had completed much of his analysis and had planned on having his report typed and bound today. Unfortunately, his briefcase was stolen while he ate breakfast, and he lost all his notes and working papers. The lost materials included his notes from management interviews, conversations with suppliers and competitors, dates of company visits, and his computer diskette containing much of his quantitative analysis. Fox's client needs this report tomorrow. In a panic, Fox called New London's vice president of finance and was faxed a copy of the company's most recent financial projections. Fox remembered that his own analysis showed that management's estimates were too high. He did not remember the exact amount, so he revised New London's figures downward 10%. Fox also incorporated some charts and graphs on New London from a research report he had received last week from a small regional research firm and used some information from a Standard & Poor's reference work. With the help of his secretary, a Xerox machine, and some creative word processing, Fox got the report done in time for the evening Fedex pick up. On the way home from the office that night, Fox wondered if he had violated any CFA Institute Standards of Professional Conduct. Fox has:

✓ **A) violated the requirement to have a reasonable basis for a recommendation, the prohibition against plagiarism, and the requirement to maintain appropriate records.**

✗ **B)** violated the requirement to have a reasonable basis for a recommendation and the prohibition against plagiarism.

✗ **C)** violated none of the Standards.

<u>Explanation</u>

New London's report is potentially self serving, so Fox did not exercise diligence or have an adequate basis for his recommendation. In addition, Fox did not acknowledge his source of the charts and graphs. Finally, he did not maintain adequate records.

Question #10 of 42

Question ID: 412539

An analyst has found an investment with what appears to be a great return-to-risk ratio. The analyst double-checks the data for accuracy, keeps careful records, and is careful to not make any misrepresentations as he simultaneously sends an e-mail to all his clients with a "buy" recommendation. According to Standard V(A), Diligence and Reasonable Basis, the analyst has:

✓ **A) fulfilled all obligations.**

✗ **B)** violated the Standard if he does not verify whether the investment is appropriate for all the clients.

✗ **C)** violated the Standard by communicating the recommendation via e-mail.

<u>Explanation</u>

If the analyst had been an investment manager, it would have been inappropriate for him to make a blanket recommendation for all of his clients without considering the unique needs of each. However, the analyst is merely stating that given the qualities of the investment, it is an attractive buy. He has kept adequate records, and made fair disclosure of his rating decision.

Question #11 of 42

Question ID: 412536

Todd Gable, CFA, was attending a noon luncheon when he overheard two software executives talking about a common vendor, Datagen, about how wonderful they thought the company was, and about a rumor that a major brokerage firm was preparing to issue a strong buy recommendation on the stock. Gable returned to the office, checked a couple of online sources, and then placed an order to purchase Datagen in all of his discretionary portfolios. The orders were filled within an hour. Three days later, a brokerage house issued a strong buy recommendation and Datagen's share price went up 20%. Gable then proceeded to gather data on the stock and prepared a report that he dated the day before the stock purchase.

Gable has:

✗ **A) violated the Standards by using the recommendation of another brokerage firm in his report.**

✓ **B)** violated the Standards by not having a reasonable basis for making the purchase of Datagen.

✗ **C)** violated the Standards by improper use of inside information.

Explanation

Standard V(A) requires members to have a reasonable and adequate basis for taking investment actions. Overhearing a conversation does not provide adequate basis. It is not improper to use overheard conversations that do not include inside information, nor is it improper to reference another firm's report to substantiate adequate basis, if the other report is justified.

Question #12 of 42

Question ID: 461219

An analyst has constructed an investment policy statement (IPS) and a portfolio for a new client, Stephanie Sasser. He has also provided written guidelines on the processes used to make investment management decisions. Six month later, Sasser questions the analyst about several portfolio holdings. Due to a large allocation in financial services stocks during a severe market downturn, her portfolio has underperformed the benchmark by a large margin. Although the analyst remembers discussing the over-allocation with Sasser, and receiving her approval, he is unable to find supporting documents. Which of the following Standards has the analyst *most likely* violated?

✗ **A) Standard V(A) Diligence and Reasonable Basis.**

✓ **B)** Standard V(C) Record Retention.

✗ **C)** Standard V(B) Communications with Clients and Prospective Clients.

Explanation

Standard V(C) Record Retention requires analysts to develop and maintain "...records to support their investment analysis, recommendations...with clients and prospective clients." The analyst is unable to document the over-allocation with respect to the benchmark; this is most likely a violation of Standard V(C).

Question #13 of 42

Question ID: 412534

Susan Plumb is the supervisor of her firm's research department. Her firm has been seeking the mandate to underwrite Wings

Industries' proposed secondary stock offering. Without mentioning that the firm is seeking the mandate, she asks Jack Dawson to analyze Wings common stock and prepare a research report. After reasonable effort, Dawson produces a favorable report on Wings stock. After reviewing the report, Plumb then adds a footnote describing the underwriting relationship with Wings and disseminates the report to the firm's clients. According to CFA Institute Standards of Professional Conduct, these actions are:

✗ **A) a violation of Standard V(A), Diligence and Reasonable Basis.**

✓ **B)** not a violation of any Standard.

✗ **C)** a violation of Standard VI(A), Disclosure of Conflicts.

Explanation

The fact that the firm is seeking the mandate does not preclude the research department from performing analytical work on the security. As long as the final recommendation is based upon reasonable facts, not the desire to obtain the mandate, there is no violation.

Question #14 of 42

Question ID: 412552

Rhonda Meyer, CFA, is preparing a research report on Moon Ventures, Inc. In the course of her research she learns the following:

- Moon had its credit rating downgraded by a prominent rating agency 3 years ago due to sales pressure in the industry. The rating was restored 3 months later when the pressure resolved.
- Moon's insider trading has been substantial over the last 3 months. Holdings of Moon shares by officers, directors, and key employees were reduced by 50% during that period.

In Meyer's detailed report making a buy recommendation for Moon, both the credit rating downgrade and the insider trading were omitted from the report.

Meyer has:

✗ **A) violated the Code and Standards by not including the insider trading information and by not including the credit rating downgrade in her report.**

✓ **B)** violated the Code and Standards by not including the insider trading information in her report.

✗ **C)** not violated the Code and Standards in her report.

Explanation

Standard V(B), Communication with Clients and Prospective Clients, requires analysts to use reasonable judgment regarding the inclusion or exclusion of relevant factors in their research reports. It would not be unreasonable to exclude the temporary credit downgrade from 3 years earlier.

Question #15 of 42

Question ID: 412532

An analyst writes a report and includes the forecasts of an econometric model developed by the firm's research department. The analyst identifies the source of the forecast and includes all the relevant statistics concerning the model and his opinion of the model's accuracy. With respect to Standard V(A), Diligence and Reasonable Basis, the analyst has:

✗ **A)** **violated the Standard by not testing the model himself.**

✓ **B)** complied with the Standard.

✗ **C)** violated the Standard by including quantitative details in a report.

Explanation

Including quantitative details in a report is not a violation of the Standard. The analyst has more of an obligation to give an opinion on the accuracy of the model than withhold such an opinion. Although the analyst should use reasonable care to verify information included in a report, retesting models developed by the research department of a firm is not explicitly required.

Questions #16-21 of 42

LMS Securities is a boutique broker-dealer specializing in private placements for technology companies. The firm also provides aftermarket support for the companies that go public after private rounds of financing. This support includes market making and research coverage.

Susan Jones, CFA, is an analyst at LMS Securities. She is responsible for a subset of the companies for which LMS offers research coverage. She recently received her annual CFA Institute Professional Conduct statement, but has not yet filled it out and turned it in. Steve Brown is an analyst who directs the due diligence process for LMS Securities' private placements. Brown passed the Level II exam five years ago, and has registered for the Level III exam every year since then, but has never taken it. He is registered for the Level III CFA exam next June, but nobody at the office believes he will actually take the test.

Sunrise Technologies is a longtime client of LMS Securities. LMS arranged four levels of private financing, for Sunrise, providing in-depth business consulting as well as handling all of the private placements. Sunrise went public 90 days ago and is currently trading at $14 per share.

Kenneth Karloff, CEO of LMS Securities, instructed Jones to write a favorable research report on Sunrise Technologies right before the company went public, setting a price target of at least $30 per share. Jones has developed a number of alternative cash flow projections for Sunrise Technologies. She picks an optimistic scenario to justify a $30 price target and issues a positive report using those projections.

After Sunrise Technologies has gone public, Karloff decides to help Jones to write a more-detailed research report on the company. Karloff provides Jones with information about the product pipeline and sensitive patent litigation that was given to him in confidence by Sunrise executives while the company was private. Given the product pipeline and legal outlook, Jones revises her cash flow models to reflect greater growth, then writes a positive report and advises LMS's clients to buy the stock.

LMS Securities has an arrangement with Clampett Securities, an investment adviser, under which the investment manager uses its client brokerage to obtain LMS's research. Clampett manages accounts for wealthy individual investors. About half of Clampett's clients have a growth objective, while the rest seek income.

Question #16 of 42

Question ID: 461211

In order to remain an active member of CFA Institute, Jones must annually:

✓ **A)** **submit her completed Professional Conduct Statement and pay applicable membership dues.**

✗ **B)** submit her completed Professional Conduct Statement, pay applicable membership dues, and complete forty hours of continuing education.

✗ **C)** pay applicable membership dues and complete forty hours of continuing education.

Explanation

To remain an active member, Jones must agree to abide by the Code and Standards and the Professional Conduct Program. This is accomplished by completing the Professional Conduct Statement on an annual basis. In addition, Jones must pay annual membership dues. Continuing education is encouraged but not required to remain an active member. (Study Session 1, LOS 2.a,b)

Question #17 of 42

Question ID: 461212

Which of the following statements regarding the research report on Sunrise Technologies after the company went public is CORRECT?

✗ A) **Jones has violated the misrepresentation Standard with her aggressive growth prediction for Sunrise Technologies; Karloff has violated the plagiarism Standard by disseminating information he received in confidence.**

✓ B) Jones is in compliance with the objectivity Standard because she made her recommendation based facts, not conjecture; Karloff has violated the Standard regarding the use of material nonpublic information.

✗ C) Jones has violated the Standard on research reports because she failed to distinguish between fact and opinion; Karloff is in compliance with the supervisory-responsibilities Standard because he is keeping up with Jones' actions and ensuring her report is accurate.

Explanation

Jones' second research report made reference to hard facts, and her analysis and revision of the cash flow projections seems thorough and reasonable. This time, Karloff did not press her to express a certain opinion, and she found the information about the company compelling. She projected higher growth in cash flow for Sunrise, but nowhere is it said that she guaranteed a hard target. Jones is in compliance with the misrepresentation, objectivity, reasonable-basis, and research-report Standards. Karloff violated the insider-trading Standard because the information was given to him in confidence. He may also have violated his fiduciary duty to Sunrise, which probably kept the information private for a reason. (Study Session 1, LOS 4.a)

Question #18 of 42

Question ID: 461213

According to CFA Institute Standards concerning fair dealing, Jones is required to do which of the following?

✗ A) **Disseminate new investment recommendations to all clients at the same time.**

✓ B) Disclose to all clients whether different levels of service are offered.

✗ C) Ensure that accounts belonging to her immediate family purchase securities only after other clients have had the chance to buy.

Explanation

Jones must disclose different levels of service to all clients. Jones must inform clients about new buy recommendations and advise them not to sell, but she cannot disregard the order if the client still wishes to sell. Family-owned accounts should be handled in the same way as other accounts, and cannot be made to wait until everyone else has acted. The Standard allows for the fact that it is impossible to notify everyone at the same time. (Study Session 1, LOS 2.a,b)

Question #19 of 42

Question ID: 461214

Which of the following statements could Brown put on his resume without violating Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program?

- ✗ **A)** **I am a Level III CFA and should become a chartered financial analyst next year.**
- ✓ **B)** If I pass the Level III test, I may be eligible for my CFA charter late next year.
- ✗ **C)** I am a Level III CFA candidate eligible to receive my charter in November 2005.

Explanation

This statement is quite literally correct, and complies with the Standards. "Level III CFA" is not an acceptable use of the CFA mark. Candidates should not offer a prediction about the time they will earn their charter. While Brown is not likely to take the test, as long as he is registered, he may refer to himself as a candidate. (Study Session 1, LOS 2.a,b)

Question #20 of 42

Question ID: 461215

In order for Clampett Securities to claim compliance with CFA Institute Soft Dollar Standards, the company must:

- ✗ **A)** **comply with all recommended provisions of the Soft Dollar Standards.**
- ✗ **B)** send all purchased research to the client whose brokerage was used to pay for it.
- ✓ **C)** re-evaluate mixed-use research at least once a year.

Explanation

Mixed-use research must be evaluated at least annually. Companies that claim soft-dollar compliance must follow the mandatory provisions, but can forgo some of the recommended provisions. If research only benefits some clients, it is acceptable to use just their brokerage to pay for it. The Standards do not require sending research to clients. (Study Session 1, LOS 3.b)

Question #21 of 42

Question ID: 461216

When Jones produced the research report on Sunrise Technologies before it went public, she violated:

- ✗ **A)** **Standard V(B): Communication with Clients and Prospective Clients by leaving relevant facts out of the report, but not Standard III(A): Loyalty, Prudence, and Care because the CEO cannot pass his fiduciary duty on to her.**
- ✓ **B)** Standard V(A): Diligence and Reasonable Basis because her research report was not thorough, and Standard I(B): Independence and Objectivity because of her obedience to her CEO.
- ✗ **C)** Standard I(B): Independence and Objectivity because of her obedience to her CEO, and Standard II(A): Material Nonpublic Information because of Karloff's involvement.

Explanation

Jones' research was not thorough, and her report did leave out salient facts. Thus, she violated Standards V(A) and V(B). Her objectivity was certainly in question, so she violated Standard I(B). She also has a fiduciary duty to the clients regardless of what the boss says, so she violated Standard III(A). No nonpublic information was used in this report, so Standard II(A) was not violated. (Study Session 1, LOS 2.a,b)

Question #22 of 42

Question ID: 412533

An analyst receives a research report from a colleague. The colleague's report has an elaborate table with performance data on publicly traded stocks. The colleague says the data in the table consists of measures provided by Standard & Poor's. The analyst finds the table a useful reference for a report she is writing. She uses several pieces of data from the table. The analyst is potentially in violation of:

- ✗ **A)** **Standard I(C), Misrepresentation, concerning the use of the work of others.**
- ✓ **B)** Standard V(A), Diligence and Reasonable Basis, if she does not first verify the data in the table is accurate.
- ✗ **C)** no particular standard because this is appropriate activity.

Explanation

Since the data in the table supposedly comes from Standard & Poor's, a recognized data source, the analyst does not have to cite the source of the data. However, the analyst needs to use reasonable care and verify that the data is accurate by going back to the source. Had the analyst printed the table prepared by her colleague without acknowledgement, the analyst would have violated Standard I(C), Misrepresentation.

Question #23 of 42

Question ID: 461222

Four months ago Lance Tuipuloto, CFA, analyzed three equity securities for Janet Scadden. However, Scadden decided to invest in bonds instead. Tuipuloto now wants to destroy the records from the stock analysis. Is this action in compliance with Standard V(C)?

- ✗ **A)** **Yes. Tuipuloto does not need to keep the records because his advice was not followed.**
- ✓ **B)** No.
- ✗ **C)** Yes. Tuipuloto only needs to keep the records for 90 days.

Explanation

According to Standard V(C), Record Retention, the files should be not be destroyed. The CFA Institute recommends keeping all records for at least 7 years.

Question #24 of 42

Question ID: 412549

In the preparation of a research report, a CFA Institute member may emphasize certain matters, touch briefly on others, and omit some altogether:

- ✓ **A)** **provided that the analyst has a reasonable basis for his or her actions.**
- ✗ **B)** under no circumstances.
- ✗ **C)** provided that the analyst both has a reasonable basis and is unconstrained by the Mosaic theory.

Explanation

According to Standard V(B), the analyst must use reasonable judgment in identifying relevant factors when communicating with clients and prospects . The Mosaic theory does not apply here.

Question #25 of 42

Question ID: 461221

Ten years ago Lance Tuipuloto, CFA, met with Horace and Nichole Scadden to discuss potential investments, but these prospects never became clients. Tuipuloto now wants to destroy the records from the meeting with the prospective clients. Is this action in compliance with Standard V(C)?

✓ **A)** **Yes; A sufficient number of years have passed since the meeting.**

✗ **B)** No.

✗ **C)** Yes; the prospects never became clients.

Explanation

According to Standard V(C), Record Retention, the files may be destroyed. The CFA Institute recommends keeping all records for at least 7 years. Given that more than 7 years have passed since Tuipuloto's meeting with the Scaddens, it is not against Standard V(C) to get rid of the records from that meeting.

Question #26 of 42

Question ID: 412530

Several years ago, Hilton and Ross, a full service investment firm, managed the initial public offering of eCom, Inc. Now, eCom wants Hilton and Ross to underwrite its secondary public offering. A senior manager at Hilton and Ross asks Brent Whitman, CFA, one of its equity analysts, to write a favorable research report on eCom to help make the underwriting a success. Whitman conducts a thorough analysis of eCom and concludes that the company has serious problems that do not suggest a favorable financial outlook. Nevertheless, Whitman writes a favorable report because he is fearful of losing his job. Hilton and Ross publicly distribute a report that only contains a buy recommendation and a brief description of the basic characteristics of eCom. Whitman has violated:

✗ **A)** **Standard I(B) Independence and Objectivity, only.**

✓ **B)** Both Standard I(B) Independence and Objectivity and Standard V(A) Diligence and Reasonable Basis.

✗ **C)** Standard V(A) Diligence and Reasonable Basis only.

Explanation

Whitman violated Standard V(A) Diligence and Reasonable Basis because he did not have a reasonable and adequate basis for issuing a favorable recommendation. Whitman violated Standard I(B) Independence and Objectivity because he did not act independently in issuing his recommendation but instead was influenced by senior management at Hilton and Ross.

Question #27 of 42

Question ID: 412544

Nicole Wise, CFA, is an analyst at Chicago Securities. She attends a meeting with management of one of the companies that she covers. During the meeting, management expresses great optimism about the company's recent acquisition of a new business. Wise is excited about these prospects and issues a research report that states that the company is about to achieve significant success with the new acquisition. Wise has:

✗ **A)** **violated CFA Institute Standards of Professional Conduct because she did not check the accuracy of the statements that management made.**

✗ **B)** not violated CFA Institute Standards of Professional Conduct because she had reasonable reason to believe that the statements in her report were true.

✓ **C)** violated CFA Institute Standards of Professional Conduct because she misrepresented the optimism by turning it to certainty.

Explanation

Standard V(B), Communication with Clients and Prospective Clients. Members must distinguish between fact and opinion in the presentation of a research report or investment recommendation. Wise violated the standard because she misrepresented management's enthusiasm by turning it into certainty.

Question #28 of 42

Question ID: 412556

An analyst finds a stock with historical returns that are not correlated with interest rate changes. The analyst writes a report for his clients that have large allocations in fixed-income instruments and emphasizes the observed lack of correlation. He feels the stock would be of little value to investors whose portfolios are comprised primarily of equities. The clients with allocations of fixed income instruments are the only clients to see the report. According to Standard V(B), Communication with Clients and Prospective Clients, the analyst has:

✗ **A)** **violated the article in the Standard concerning facts and opinions.**

✗ **B)** violated the Standard concerning fair dealings with all clients.

✓ **C)** not violated the Standard.

Explanation

Recommending a stock whose return is uncorrelated with interest rate changes is appropriate for the clients described in the problem. Emphasizing the lack of correlation is appropriate as long as the analyst makes no guarantees concerning the relationship in the future. Reporting historical correlation is a presentation of fact, and is not in violation. The analyst is free to show the report only to investors for whom the investment is appropriate.

Question #29 of 42

Question ID: 461220

An analyst has constructed an investment policy statement (IPS) and a portfolio for a new client, Susan Stevens. He has also provided written guidelines on the processes used to make investment management decisions. Six month later, Stevens questions the analyst about several portfolio holdings. Although the analyst cannot remember his reasoning for recommending specific securities, and cannot find supporting documents, he assures her that the recommendations were made within the limits of her IPS and the firm's stated processes for making investment management decisions. Stevens is not satisfied by this response, but leaves the portfolio unchanged. The analyst has *most likely* violated:

✗ **A)** **Standard III(C) Suitability.**

✗ **B)** Standard V(B) Communications with Clients and Prospective Clients.

✓ **C)** Standard V(C) Record Retention.

Explanation

Standard V(C) Record Retention requires analysts to develop and maintain "...records to support their investment analysis, recommendations...with clients and prospective clients." The analyst is unable to explain why securities were added to the portfolio; this is a violation of Standard V(C).

Question #30 of 42

Question ID: 412545

Roger Halpert, CFA, prepares a company research report in which he recommends a strong "buy." He has been careful to ensure that his report complies with the CFA Institute Standard on research reports. According to CFA Institute Standards of Professional Conduct, which of the following statements about how Halpert can communicate the report is *most correct*?

✗ **A)** **Halpert can make his report in person.**

✓ **B)** Halpert can make his report in person, by telephone, or by computer on the Internet.

✗ **C)** Halpert can transmit his report by computer on the Internet.

Explanation

A report can be made via any means of communication, including in-person recommendation, telephone conversation, media broadcast, and transmission by computer such as on the Internet.

Question #31 of 42

Question ID: 412554

Janet Coleman, a CFA Institute member, is an analyst at a regional brokerage firm. She is preparing a research report on Standard Power and Light. Due to deregulation, utility companies face increased competition. During the past year, three of the five utility companies in her region have cut their dividends by 50%, on average, to provide more internal funds for investment purposes. In a discussion with Standard's chief executive officer, Coleman learned that Standard expects to have a record amount of capital expenditures during the next year. Although Standard subsequently issued a press release about its capital expenditure plans, it did not make any public statements about a change in dividend policy. Coleman reasons that the management of Standard will be under pressure to cut its dividends within the next year to remain competitive. Coleman issues a research report in which she states:

"We expect Standard Power and Light will experience an initial decrease of $3 a share in its stock price when it cuts its dividend from $2 to $1 a share by the second quarter. We expect that Standard will strengthen its competitive position by using more internally generated funds to finance its investment opportunities. If investors buy the stock now at around $50 a share, their total return should be at least 20% on the stock."

Based on CFA Institute Standards of Professional Conduct, which of the following statements about Coleman's actions is CORRECT?

✓ **A)** **Coleman violated the Standards because she failed to separate opinion from fact in her research report.**

✗ **B)** Coleman did not violate the Standards.

✗ **C)** Coleman violated the Standards because she used material inside information.

Explanation

Coleman's statement that Standard will cut its dividend from $2 to $1 a share is an opinion, not a fact. She should distinguish between facts and opinions in research reports.

Question #32 of 42

Question ID: 412535

In the process of recommending an investment, in order to comply with Standard V(A), Diligence and Reasonable Basis, a CFA Institute member must:

✗ **A)** **support a recommendation with appropriate research and investigation.**

✗ **B)** have a reasonable and adequate basis for the recommendation.

✓ **C)** do both of these.

Explanation

Both of these are explicitly required by Standard V(A).

Question #33 of 42

Question ID: 412529

Wes Smith, CFA, works for Advisors, Inc. In order to remain in compliance with Standard V(A), Diligence and Reasonable Basis, Smith may recommend a security in which of the following situations?

✓ **A)** **Advisors' research department recommends a stock.**

✗ **B)** For either of the reasons listed here.

✗ **C)** Smith reads a favorable review of the security in a widely read periodical.

Explanation

Smith will be in violation if he acts solely on the basis of what he read in the periodical. Use of information within the firm can be relied upon unless the Smith has reason to believe the source lacks a sound basis.

Question #34 of 42

Question ID: 461202

An analyst receives a report from his research department that summarizes and interprets a recent speech from the chairman of the U.S. Federal Reserve. The summary says that the chairman thinks inflation is under control. Based upon this summary, the analyst says in his next newsletter that inflation is under control. This is a violation of:

✗ **A)** **none of the Standards listed here.**

✗ **B)** Standard V(A), Diligence and Reasonable Basis, only.

✓ **C)** Standard V(A), Diligence and Reasonable Basis, and Standard V(B), Communication with Clients and Prospective Clients.

Explanation

The analyst should verify that the research department has interpreted the chairman's speech correctly. The analyst must make it clear that the statement concerning inflation is only an opinion. No one knows if that is true or not at any point in time. Based upon the given information, we cannot say that the analyst is violating only one standard. The analyst may also be violating plagiarism in accordance with Standard I(C), Misrepresentation. Hence, the answer citing the two standards and not limiting violations to just those two standards is the best answer.

Question #35 of 42

Question ID: 412550

Joni Black, CFA, works for a portfolio management firm. Black is a partner of the firm and is primarily responsible for managing several large pension plans. Black has just finished a research report in which she recommends Zeta Corporation as a "Strong Buy." Her rating is based on solid management in a growing and expanding industry. She just handed the report to the marketing department of the firm for immediate dissemination. Upon returning to her desk she notices a news flash by CNN reporting that management for Zeta Corporation is retiring. Black wishes she did not recommend Zeta Corporation as a "Strong Buy," but believes the corporation is still a good investment regardless of the management. What course of action for Black is *best*? Black:

✗ **A)** **may send out the report as written as long as a follow up is disseminated within a reasonable amount of time reflecting the changes in management.**

✓ **B)** should revise the recommendation based on this new information.

✗ **C)** should report the new information to her immediate supervisor so that they can determine whether or not the marketing department should send out the report as written.

Explanation

This question is related to Standard V(B) which states that CFA Institute members should use reasonable judgment regarding the inclusion or exclusion of relevant factors in research reports. The change in management was a relevant factor and must be disclosed before dissemination.

Question #36 of 42

Question ID: 412541

The following scenarios refer to recommendations made by two analysts.

- Jean King, CFA, is a quantitative analyst at Quantlogic, Inc. King uses computer-generated screens to differentiate value and growth stocks based on accounting numbers such as sales, cash flow, earnings, and book value. Based on her analysis of all domestically traded stocks in the U.S. over the past year, King concludes that value stocks as a class have underperformed growth stocks over that period. Using only this analysis, she recommends that account executives at Quantlogic sell all value stocks from the portfolios for which they have discretionary authority to trade and replace these stocks with growth stocks.
- James Capelli, CFA, is a fundamental analyst at Wheaton Capital Management, which focuses on regional stocks. His analysis of Branson Wireless includes the investment's basic characteristics such as information about historical earnings, ownership of assets, outstanding contracts, and other business factors. In addition to conducting both a general industry analysis and a company financial analysis, Capelli interviews key executives at Branson. Based on his analysis, he concludes that the company's future prospects are strong and issues a "buy" recommendation.

According to CFA Institute Standards of Professional Conduct, did King and Capelli have a reasonable and adequate basis for making their recommendations?

✓ **A)** **Capelli has a reasonable basis for his recommendation, but King does not.**

✗ **B)** Both King and Capelli have a reasonable basis for their recommendations.

✗ **C)** King has a reasonable basis for his recommendation, but Capelli does not.

Explanation

Capelli appears to have exercised diligence and thoroughness in making his recommendation. King's recommendation is not based on thorough quantitative work because the period used in her study is only one year. Also, her recommendation does not consider the client's specific needs and circumstances.

Question #37 of 42

Question ID: 412547

Bob Hatfield, CFA, has his own money management firm with two clients. The accounts of the two clients are equal in value. It is Hatfield's opinion that interest rates will fall in the near future. Based upon this, Hatfield begins increasing the bond allocation of each portfolio. In order to comply with Standard V(B), Communication with Clients and Prospective Clients, the analyst needs to:

✗ **A)** **make sure that the change is identical for both clients.**

✗ **B)** perform both of these functions.

✓ **C)** inform the clients of the change and tell them it is based upon an opinion and not a fact.

Explanation

According to Standard V(B), the analyst must inform the clients of the change and tell them it is based upon an opinion and not a fact. Making an identical change in two portfolios may be a violation of this standard if the needs of the clients are not identical.

Question #38 of 42

Question ID: 412542

A financial analyst and CFA Institute member sends a preliminary research report on a company to his supervisor. The supervisor approves the report, but then the analyst receives news that causes him to revise downward the earnings estimate of the company. The analyst resubmits the report to the supervisor with the new earnings estimate. The analyst soon finds out that the supervisor plans to release the first version of the report with the first earnings estimate without a reasonable and adequate basis. In response to this the analyst must:

✗ **A)** **both insist that a follow up report be issued and take up the issue with regulatory authorities.**

✗ **B)** only insist that the first report be followed up by a revision.

✓ **C)** insist that the supervisor change the earnings forecast or remove his (the analyst's) name from the report.

Explanation

According to Standard V(A), Diligence and Reasonable Basis, the analyst must exercise diligence, independence, and thoroughness when performing investment analysis, making a recommendation, or taking investment action. The analyst should document the difference in opinion including any request to remove his or her name from the report.

Question #39 of 42

Question ID: 412548

An analyst has several groups of clients who are categorized according to their specific needs. Compared to research reports distributed to all of the clients, reports for a specific group:

✗ **A)** **will definitely include more basic facts.**

✓ **B)** may generally exclude more basic facts.

✗ **C)** will not be allowed because it violates the Standard III(B), Fair Dealing.

Explanation

According to Standard V(B), an analyst can use reasonable judgment regarding the exclusion of some facts and should include more basic facts for reports to wider audiences. The key issue is that analysts should tailor their reports to the intended audience.

Question #40 of 42

Question ID: 412546

An analyst finds a stock that has had a low beta given its historical return, but its total risk has been commensurate with its return. When writing a research report about the stock for clients with well-diversified portfolios, according to Standard V(B), Communication with Clients and Prospective Clients, the analyst needs to mention:

✓ **A)** **the relationship of the historical beta and return only.**

✗ **B)** the relationship of the historical total risk to return only.

✗ **C)** both the historical beta and total risk and return.

Explanation

Using reasonable judgment, an analyst may exclude certain factors from research reports. Since the report will be delivered to clients with well-diversified portfolios, total risk is not as important as beta. Given that the total risk has been only commensurate with historical return, furthermore, then the analyst is not negligent by not mentioning it.

Question #41 of 42

Question ID: 412560

Lee Hurst, CFA, is an equity research analyst who has recently left a large firm to start independent practice. He is able to re-create several of his previous recommendation reports from memory, based on sources obtained at his previous employer. He publishes the reports and obtains several new clients. Hurst is *most likely*:

✗ **A)** **in violation of Standard V(A) "Diligent and Reasonable Basis."**

✓ **B)** in violation of Standard V(C) "Record Retention."

✗ **C)** not in violation of any Standard.

Explanation

Hurst is most likely in violation of Standard V(C) "Record Retention" because the supporting documentation is unavailable. He needs to recreate the supporting records based on information gathered through public sources or the covered company.

Question #42 of 42

Question ID: 412561

According to CFA Institute Standards of Professional Conduct, members should do all of the following to meet the compliance procedures for having a reasonable basis for recommendations, EXCEPT:

✗ **A)** **analyze the investment's basic characteristics before recommending a specific investment to a broad client group.**

✓ **B)** distribute a detailed, written research report to clients with each recommendation.

✗ **C)** analyze the client's investment needs.

Explanation

Standard V(C), Record Retention, requires that members maintain appropriate records to support the reasonableness of such recommendations or actions, but they are not required to distribute a research report with each recommendation.