Reading 3-V: Standards of Professional Conduct & Guidance: Investment Analysis, Recommendations, and Actions

Question #1 of 36

Question ID: 412553

An analyst who routinely purges the files that support his research and recommendations:

A) is acting in accordance to Standard III(E), Preservation of Confidentiality.

B) is acting in accordance to Standard IV(A), Loyalty to Employer.

C) may be violating Standard V(C), Record Retention.

Question #2 of 36

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 total risk to return only.

B) the relationship of the historical beta and return only.

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

Question #3 of 36

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

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

C) Standard I(B) Independence and Objectivity, only.

Question #4 of 36

Question ID: 485749

Ted Riczek, CFA, is an independent investment advisor. Riczek often makes investment recommendations to clients based on research from several third-party sources. The Code and Standards most likely require Riczek to:

A) make a reasonable effort to verify that the third-party research is sound.

B) perform his own research rather than relying on third-party research.

C) disclose to his clients the sources of any third-party research that supports his recommendations.

Question #5 of 36

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) not violated the Code and Standards in her report.

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

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

Question #6 of 36

Question ID: 412555

Robert Hamilton, a CFA candidate, is preparing a research report on Pets-R-Us for public distribution. Hamilton's preliminary report contains unfavorable earnings forecasts for the next four quarters. As part of his analysis, Hamilton met with Linda Brisson, the president of Pets-R-Us, and asked her to review the preliminary report for factual inaccuracies. Brisson revised Hamilton's earnings forecasts so that the quarterly earnings showed an upward trend and resulted in positive earnings by the fourth quarter. Hamilton included the revised earnings figures in his report without further review. Although the final report included the basic characteristics of Pets-R-Us, it emphasized certain areas such as projected quarterly earnings but only briefly touched on others. According to CFA Institute Standards of Professional Conduct on research reports, Hamilton:

A) violated the Standard because the report did not give similar attention to all areas but instead emphasized quarterly earnings at the expense of other areas.

B) did not violate the Standard.

C) violated the Standard because he did not thoroughly review and analyze any information provided by Brisson.

Question #7 of 36

Question ID: 412531

An analyst notices that for most years that a given class of assets has an abnormally high rate of return, the asset class often has an abnormally low rate of return the next year. Based upon this information, according to Standard V(A), Diligence and Reasonable Basis, the analyst can recommend:

A) neither of these choices.

B) an increased allocation of Treasury bills (T-bills) for all portfolios of assets that have increased dramatically in the previous year.

C) short selling assets that have had a good previous year to all clients.

Question #8 of 36

Question ID: 738660

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, based on his clear recollection of supporting documentation he compiled at his previous employer. He publishes the reports and obtains several new clients. Hurst is *most likely*:

A) not in violation of any Standard.

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

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

Question #9 of 36

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) have a reasonable and adequate basis for the recommendation.

B) do both of these.

C) support a recommendation with appropriate research and investigation.

Question #10 of 36

Question ID: 412551

In preparing research reports, which of the following is *least likely* required or recommended by the Code and Standards?

A) Maintain copies of materials that were relied on in preparing the research report.

B) Send all reports to the firm's legal counsel to ensure compliance with securities laws.

C) Attribute paraphrases and summaries of material prepared by others.

Question #11 of 36

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.

Question #12 of 36

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

C) complied with the Standard.

Question #13 of 36

Question ID: 412558

Bertrand Greene, CFA, is preparing a report on Blanding, Inc. Blanding's earnings have increased in each of the last six years by an average of 11.8%. Based on his analysis, Greene projects that Blanding's earnings will increase by 12.5% in each of the next two years. Greene will violate the Code and Standards if he states:

A) "Blanding's earnings have been compounding at approximately 11.8% annually."

B) "Blanding's earnings will grow at 12.5% annually in each of the next two years."

C) "I expect Blanding's earnings growth to increase to 12.5% annually in the next two years."

Question #14 of 36

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 did not violate the Standards.

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

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

Question #15 of 36

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 transmit his report by computer on the Internet.

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

Question #16 of 36

Question ID: 725791

According to CFA Institute Standards of Professional Conduct, members are *least likely* required to:

A) make diligent efforts to determine whether third party research relied on is sound.

B) distribute a detailed research report to clients with any recommendation.

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

Question #17 of 36

Question ID: 412557

An analyst belongs to a nationally recognized charitable organization, which requires dues for membership. The analyst has worked out a deal that he provides money management advice in lieu of paying dues. For this arrangement to comply with the standards, the analyst needs consent from:

A) both his supervisor in the organization and his regular place of work.

B) his supervisor in his regular place of work only.

C) his supervisor in the organization only.

Question #18 of 36

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

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

Question #19 of 36

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 and the prohibition against plagiarism.

B) violated none of the Standards.

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

Question #20 of 36

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) may generally exclude more basic facts.

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

C) will definitely include more basic facts.

Question #21 of 36

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

C) Both King and Capelli have a reasonable basis for their recommendations.

Question #22 of 36

Question ID: 412528

Susan Tigra, CFA, is a portfolio co-manager for the Sandia Energy pension fund. Sandra Bulow, a research analyst under Tigra's supervision, creates a new trading model and immediately begins to trade. Susan stops Bulow from trading, but notes that the firm has no guidelines for testing new models. Tigra should *most likely*:

A) encourage her firm to develop detailed, written guidance that establishes minimum levels of testing for all computer-based models as required by Standard III(C) "Suitability."

B) encourage her firm to develop detailed, written guidance that establishes minimum levels of testing for all computer-based models as recommended by Standard V(A) "Diligence and Reasonable Basis."

C) report Bulow to the firm's compliance department for violation of Standard V(A) "Diligence and Reasonable Basis."

Question #23 of 36

Question ID: 412543

Don Wilson and Nadine Chavis, both CFA charterholders, are investment advisors at Uptown Securities. Wilson recommends that one of his clients buy Alpha Company based on research conducted by Uptown. Chavis recommends that one of her clients sell Alpha Company based on research conducted by another brokerage firm for general distribution. Both recommendations are consistent with each client's investment objectives and within the context of their entire portfolios. Neither Wilson nor Chavis has reason to suspect that any information contained in the research reports from these two sources is inaccurate or inadequately supported. According to Standard V(A) Diligence and Reasonable Basis, do Wilson and Chavis have a reasonable basis for making their investment recommendations?

A) Both of these advisors have a reasonable basis for their recommendations.

B) Only one of these advisors has a reasonable basis for his or her recommendation.

C) Neither of these advisors has a reasonable basis for their recommendations.

Question #24 of 36

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 misrepresented the optimism by turning it to certainty.

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

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

Question #25 of 36

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) not violated the Standard.

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

C) violated the article in the Standard concerning facts and opinions.

Question #26 of 36

Question ID: 412538

Peggy Green, CFA, is a research analyst following Brown Co. All the information she has gathered suggests the stock should be rated a weak "hold." During a recent lunch, Green overheard another analyst say that the stock should be rated a "buy." Green returns to her office and issues a "buy" recommendation. Green:

A) violated CFA Institute Standards of Professional Conduct because she did not seek approval of the change from her firm's compliance director.

B) has violated CFA Institute Standards of Professional Conduct because she failed to distinguish between fact and opinion.

C) has violated CFA Institute Standards of Professional Conduct because she did not have a reasonable and adequate basis for making this recommendation.

Question #27 of 36

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.

Question #28 of 36

Question ID: 412540

A client calls his money manager and asks the manager to liquidate a large portion of his assets under management for an emergency. The manager warns the client of the risk of selling many assets quickly but says that he will try to get the client the best possible price. This is a violation of:

A) none of the Standards listed here.

B) Standard III(C), Suitability.

C) Standard V(A), Diligence and Reasonable Basis.

Question #29 of 36

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

C) not a violation of any Standard.

Question #30 of 36

Question ID: 412562

Ethyl Redd recently joined Bloomington Investments as a research analyst. After spending an afternoon looking through the research team's archives, Redd is not sure Bloomington maintains the records that support the team's analysis and recommendations for the minimum 7-year period called for by Standard V(C), Record Retention. What is Redd's *most* appropriate course of action?

A) Keep her own copies of the relevant records and maintain them at home for a minimum 7-year holding period.

B) Decline to participate in any new research until she can verify that the firm is in compliance with the Standard.

C) Review the firm's record retention procedures with her supervisor or compliance officer to ensure that they comply with the Standard, or suggest ways to bring them into compliance.

Question #31 of 36

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 not having a reasonable basis for making the purchase of Datagen.

B) violated the Standards by improper use of inside information.

C) violated the Standards by using the recommendation of another brokerage firm in his report.

Question #32 of 36

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.

Question #33 of 36

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.

Question #34 of 36

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

C) perform both of these functions.

Question #35 of 36

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

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

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

Question #36 of 36

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) should revise the recommendation based on this new information.

B) 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.

C) 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.