Question #1 of 47

The component of the return on a futures position that results from interest earned on U.S. Treasury bills deposited to establish the position is called the:

A) collateral yield.

B) roll yield.

C) current yield.

Explanation

Collateral yield is the return earned on the collateral posted to satisfy margin requirements. In most cases, the collateral posted will be U.S. Treasury Bills, in which case the collateral yield is the T-bill yield.

(Study Session 19, Module 58.2, LOS 58.f)

Question #2 of 47

An example of a relative value hedge fund strategy is:

A) merger arbitrage.

B) market neutral.

C) convertible arbitrage.

Explanation

Relative value strategies include convertible arbitrage fixed income, asset-backed fixed income, general fixed income, volatility, and multi-strategy. Market neutral is an equity hedge strategy. Merger arbitrage is an event driven strategy.

(Study Session 19, Module 58.2, LOS 58.d)

www.ombookcentre.in

Question #3 of 47

Investments in infrastructure assets that will be constructed in the future are *most accurately* described as:

A) brownfield infrastructure investments.

B) openfield infrastructure investments.

C) greenfield infrastructure investments.

Explanation

Greenfield investments are infrastructure assets to be built. Brownfield investments are infrastructure assets that already exist.

(Study Session 19, Module 58.2, LOS 58.d)

Question #4 of 47

An equity hedge fund strategy that focuses primarily on exploiting overvalued securities is *best* described as a(n):

A) fundamental value strategy.

B) short bias strategy.

C) event driven strategy.

Explanation

Equity hedge funds with a short bias attempt to profit from short positions in equities they believe to be overvalued. These funds may hold long equity positions but typically have net short exposure to the market. An event driven strategy focuses on companies involved in mergers, in financial distress, or in other special situations. A fundamental value strategy attempts to identify undervalued equities.

(Study Session 19, Module 58.2, LOS 58.d)

Question #5 of 47

Springfield Fund of Funds invests in two hedge funds, DXS and REF funds. Springfield initially invested $50.0 million in DXS and $100.0 million in REF. After one year, DXS and REF were valued at $55.5 million and $104.5 million, respectively, net of both hedge fund management fees and incentive fees. Springfield Fund of Funds charges 1.0% management fee based on assets under management at the beginning of the year and a 10.0% incentive fee independent of management fees. The annual net return for Springfield Fund of Funds is *closest to*:

A) 6.0%.

B) 5.5%.

C) 5.0%.

Explanation

Management fee = $150.0 × 1.0% = $1.5 million

Net value at end of year after hedge fund fees = $55.5 + $104.5 = $160.0 million

Incentive fee = ($160.0 – $150.0) × 10% = $1.0 million

Total fees = $1.5 + $1.0 = $2.5 million

Net of fees: $160.0 – $2.5 = $157.5 million

Net return = ($157.5 / $150.0) – 1 = 5.0%

(Study Session 19, Module 58.2, LOS 58.e)

Question #6 of 47

For an investment with negatively skewed returns, the *most appropriate* of the following risk measures is:

A) Sortino ratio.

B) shortfall risk.

C) value at risk.

www.ombookcentre.in

Explanation

The Sortino ratio uses downside deviation, and therefore will capture the effects of negative skewness better than measures that use standard deviation. Value at risk (VaR) is a downside risk measure that estimates the potential loss from outcomes in the left tail of the distribution of returns but uses standard deviation, as does shortfall risk.

(Study Session 19, Module 58.2, LOS 58.g)

Question #7 of 47

A portfolio manager who adds commodities to a portfolio of traditional investments is *most likely* seeking to:

A) decrease portfolio variance only.

B) increase expected returns only.

C) both increase expected returns and decrease portfolio variance.

Explanation

Unlike most alternative investments, expected returns on commodities are typically less than expected returns on traditional investments. However, because their returns typically have a low correlation with returns on traditional investments, adding commodities to a portfolio of traditional investments can decrease portfolio variance.

(Study Session 19, Module 58.1, LOS 58.c)

www.ombookcentre.in

Question #8 of 47

A British hedge fund has a value of £100 million at the beginning of the year. The fund charges a 2% management fee based on assets under management at the end of the year and a 20% incentive fee with a soft hurdle rate of LIBOR + 2.5%. Incentive fees are calculated net of management fees. If the relevant LIBOR rate is 2.5% and the fund's value at the end of the year before fees is £120 million, the net return to investors is *closest to*:

A) 14.1%.

B) 16.5%.

C) 17.6%.

Explanation

Management fee = £120.0 × 2.0% = £2.4 million.

Gross value at end of year (given) = £120.0 million.

Gross return = (£120.0 / £100.0) – 1 = 20.0%. The soft hurdle rate of 2.5% + 2.5% = 5.0% was exceeded.

Incentive fee = (£120.0 – £100.0 – £2.4) × 20% = £3.52 million.

Total fee = £2.40 + £3.52 = £5.92 million.

Net of fee: £120.00 – £5.92 = £114.08 million.

Net return = (£114.08 / £100.00) – 1 = 14.1%.

(Study Session 19, Module 58.2, LOS 58.e)

Question #9 of 47

A Hong Kong hedge fund was valued at HK$400 million last year. At year's end the value before fees was HK$480 million. The fund charges 2 and 20. Management fees are calculated on end-of-year values. Incentive fees are independent of management fees and calculated using no hurdle rate. The previous year the fund's net return was 2.5%. The annualized return for the last two years is *closest to*:

A) 8.1%.

B) 13.6%.

C) 7.9%.

Explanation

Management fee is HK$480 million × 0.02 = HK$9.6 million.

Incentive fee is (HK$480 million – HK$400 million) × 0.20 = HK$16.0 million.

Total fee is HK$9.6 million + HK$16.0 million = HK$25.6 million.

Net of fee: HK$480.0 – HK$25.6 = HK$454.4 million

Net return: (HK$454.4 / HK$400.00) – 1 = 13.6%

Two year annualized return is $(1.136 \times 1.025)^{1/2} - 1 = 7.9\%$

(Study Session 19, Module 58.2, LOS 58.e)

www.ombookcentre.in

Question #10 of 47

If a commodity's convenience yield is close to zero, the futures market for that commodity is *most likely*:

A) in contango.

B) in backwardation.

C) at fair value.

Explanation

Futures price ≈ Spot price (1 + risk-free rate) + storage costs – convenience yield. If the convenience yield is close to zero, it is likely that the futures price exceeds the spot price, i.e., the market for the commodity is in contango.

(Study Session 19, Module 58.2, LOS 58.d)

Question #11 of 47

In a 2-and-20 hedge fund fee structure, the "2" refers to a hedge fund's

A) incentive fee.

B) redemption fee.

C) management fee.

Explanation

"2-and-20" denotes a 2% management fee and a 20% incentive fee.

(Study Session 19, Module 58.2, LOS 58.e)

Question #12 of 47

Bulldog Fund is a hedge fund with a value of £100 million at the beginning of the year. Bulldog Fund charges 1.5% management fee based on assets under management at the end of the year and a 25% incentive fee with no hurdle rate. Incentive fees are calculated independent of management fees. The fund's value at the end of year before fees is £120 million. Compared to a 2 and 20 fee structure, Bulldog Fund's total fees for the year are:

A) higher.

B) the same.

C) lower.

Explanation

	1.5% Management Fee, 25% Incentive Fee	2% Management Fee, 20% Incentive Fee
Management fee	£120 × 1.5% = £1.8 million	£120 × 2% = £2.4 million
Incentive fee	(£120 − £100) × 25% = £5.0 million	(£120 − £100) × 20% = £4.0 million
Total fees	£1.8 + £5.0 = $pound; 6.8 million	£2.4 + £4.0 = $pound; 6.4 million

(Study Session 19, Module 58.2, LOS 58.e)

www.ombookcentre.in

Question #13 of 47

Under which approach to valuing real estate properties is an analyst *most likely* to estimate a capitalization rate?

A) Income approach.

B) Cost approach.

C) Comparable sales approach.

Explanation

The income approach estimates values by calculating the present value of expected future cash flows from property ownership or by dividing the net operating income (NOI) for a property by a capitalization rate. The comparable sales approach estimates a property value based on recent sales of similar properties. The cost approach is based on the estimated cost to replace an existing property.

(Study Session 19, Module 58.1, LOS 58.f)

Question #14 of 47

Real estate and private equity *most likely* share which of the following characteristics?

A) Biases in historical returns on indexes.

B) Low management fees.

C) Commonly traded on an exchange.

Explanation

Private equity index returns may exhibit survivorship bias and backfill bias, while some real estate index returns may exhibit sample selection bias. Neither asset class is considered to have low management fees. Private equity is not typically traded on an exchange.

(Study Session 19, Module 58.1, LOS 58.f)

Question #15 of 47

Compared to traditional investments, alternative investments are *most likely* to be more:

A) leveraged.

B) transparent.

C) liquid.

Explanation

Alternative investments tend to use more leverage and are typically less liquid and less transparent than traditional investments.

(Study Session 19, Module 58.1, LOS 58.a)

www.ombookcentre.in

Question #16 of 47

Which of the following will result from futures prices for a particular commodity being in contango?

A) Positive current yield.

B) Negative roll yield.

C) Negative collateral yield.

Explanation

A positive roll yield results from a backwardated market, whereas a negative yield is produced in a contango market. In backwardated (contango) markets, futures prices are lower (higher) than spot prices.

(Study Session 19, Module 58.2, LOS 58.f)

Question #17 of 47

A Canadian hedge fund has a value of C$100 million at the beginning of the year. The fund charges a 2% management fee based on assets under management at the beginning of the year and a 20% incentive fee with a 10% hard hurdle rate. Incentive fees are calculated net of management fees. The value at the end of the year before fees is C$112 million. The net return to investors is *closest to*:

A) 8%.

B) 10%.

C) 9%.

Explanation

Management Fee: C$100.0 × 2.0% = C$2.0 million

Gross value at end of year (given) = C$112.0 million

Incentive fee = [(C$112.0 – C$100.0 – C$2.0 – (C$100.0 × 10.0%)] × 20% = C$0

Total fee = C$2.0 million

Net of fee: C$112.0 – C$2.0 = C$110.0 million

Net return = (C$110.0 / C$100.0) – 1 =10.0%

(Study Session 19, Module 58.2, LOS 58.e)

Question #18 of 47

A due diligence factor that is common to analyzing real estate investment trusts, hedge funds, and private equity is (are):

A) variability of manager performance.

B) dividend distribution requirement.

C) drawdown procedures.

Explanation

All of these classifications of alternative investments share variability of manager performance as a due diligence factor. Drawdown procedures are primarily a due diligence factor for analyzing private equity. Dividend distribution requirement is specific to REITs.

(Study Session 19, Module 58.2, LOS 58.g)

Question #19 of 47

Compared to a traditional mutual fund, a hedge fund is *more likely* to feature:

A) higher fees.

B) lower leverage.

C) higher liquidity.

Explanation

www.ombookcentre.in

A hedge fund typically is more likely to use leverage, is less liquid, and charges higher fees than a traditional mutual fund.

(Study Session 19, Module 58.1, LOS 58.a)

Question #20 of 47

Which of the following alternative investments is *least likely* classified as investing in commodities?

A) Direct ownership of a natural gas distribution pipeline. ✓

B) Managed futures fund specializing in livestock. ✗

C) Common shares of a copper mining firm. ✗

Explanation

Utility assets such as natural gas distribution pipelines are best classified as infrastructure investments. Managed futures funds and common shares of commodity producers are among the methods for investing in commodities.

(Study Session 19, Module 58.1, LOS 58.b)

www.ombookcentre.in

Question #21 of 47

The difference between a hedge fund's trading net asset value and its accounting net asset value is that:

A) accounting NAV tends to be higher because of estimated liabilities. ✗

B) trading NAV tends to be lower because of illiquid assets. ✓

C) accounting NAV tends to be lower because of model prices. ✗

Explanation

Trading NAV adjusts accounting NAV downward to account for illiquidity of a hedge fund's investments, such as positions that are large relative to trading volume.

(Study Session 19, Module 58.2, LOS 58.f)

Question #22 of 47

A form of direct investment in mortgages is:

A) whole loans. ✓

B) mortgage real estate investment trusts. ✗

C) commercial mortgage-backed securities. ✗

Explanation

Whole loans (i.e., commercial property mortgages) are considered direct investments. Commercial mortgage-backed securities (CMBS) and mortgage REITs are indirect investments.

(Study Session 19, Modules 58.1, LOS 58.d)

Question #23 of 47

Which of the following *best* describes why adding a commodities index position to a portfolio of stocks and bonds may be beneficial? Commodities index positions:

A) benefit from commodity markets oscillating between contango and backwardation.

B) are positively correlated with stock and bond prices.

C) serve as a hedge against inflation.

Explanation

The correlation between commodity futures and inflation is positive, while the correlation between inflation and stocks and bonds is negative. Therefore, declining stock and bond prices due to high inflation can be offset by the rising prices of commodities that occur during times of high inflation. While it is possible for commodity futures markets to change between backwardation and contango, this alone is not a reason to add a commodities position to a traditional portfolio.

(Study Session 19, Module 58.2, LOS 58.d)

www.ombookcentre.in

Question #24 of 47

The yield from an investment in commodities that results from a difference between the spot price and a futures price is the:

A) roll yield.

B) convenience yield.

C) collateral yield.

Explanation

Roll yield is the yield return due to a difference between the spot price and futures price, or a difference between two futures prices with different expiration dates, and results from futures prices converging to the spot price as futures contracts approach their expiration dates. Roll yield may be positive or negative.

(Study Session 19, Module 58.2, LOS 58.f)

Question #25 of 47

For a given set of underlying real estate properties, the type of real estate index that is *most likely* to have the lowest standard deviation is a(n):

A) REIT trading price index.

B) appraisal index.

C) repeat sales index.

Explanation

Appraisal index returns are based on estimates of property values. Because estimating values tends to introduce smoothing into returns data, appraisal index returns are likely to have lower standard deviations than index returns based on repeat sales or trading prices of REIT shares.

(Study Session 19, Module 58.1, LOS 58.f)

Question #26 of 47

A private equity provision that requires managers to return any periodic incentive fees resulting in investors receiving less than 80% of profits is a:

A) high water mark.

B) clawback.

C) drawdown.

Explanation

A clawback provision requires the manager to return any periodic incentive fees to investors that would result in investors receiving less than 80% of the profits generated by portfolio investments as a whole.

(Study Session 19, Modules 58.1, LOS 58.d)

Question #27 of 47

In the valuation of a real estate investment trust (REIT), subtracting the REIT's liabilities from the value of its real estate assets and dividing by the number of shares outstanding provides an estimate of the REIT's:

A) adjusted funds from operations.

B) free cash flow per share.

C) net asset value.

Explanation

An asset-based approach to valuing a REIT is to estimate its net asset value as the difference between the value of the REIT's real estate assets and its liabilities, divided by the number of shares outstanding.

(Study Session 19, Module 58.1, LOS 58.f)

Question #28 of 47

The formative stage of venture capital investing when capital is furnished for market research and product development is *best* characterized as the:

A) early stage.

B) seed stage.

C) angel investing stage.

Explanation

www.ombookcentre.in

In the seed stage of venture capital investing, capital is furnished for product development, marketing, and market research. The angel investing stage is when investment funds are used for business plans and assessing market potential. The early stage refers to investments made to fund initial commercial production and sales.

(Study Session 19, Modules 58.1, LOS 58.d)

Question #29 of 47

An additional risk of direct investment in real estate, which is not typically a significant risk in a portfolio of traditional investments, is:

A) market risk. ✗

B) counterparty risk. ✗

C) liquidity risk. ✓

Explanation

Direct investment in real estate involves liquidity risk because large sums may be invested for long periods before a sale of the property can take place. Market risk exists for both traditional portfolio and real estate investments. Counterparty risk applies mainly to derivative contracts that require a payment from a counterparty, such as swaps and forwards.

(Study Session 19, Module 58.1, LOS 58.a)

www.ombookcentre.in

Question #30 of 47

The typical trade used by a merger arbitrage fund is:

A) long position in acquirer, short position in firm being acquired. ✗

B) short positions in both the acquirer and the firm being acquired. ✗

C) short position in acquirer, long position in firm being acquired. ✓

Explanation

Merger arbitrage funds typically short the stock of the acquirer and buy the stock of the firm being acquired.

(Study Session 19, Module 58.2, LOS 58.d)

Question #31 of 47

Return and risk data on alternative investments may be affected by backfill bias if:

A) a firm's historical returns are included when it is added to an index. ✓

B) data only include currently existing firms. ✗

C) the incorrect distribution is used to model volatility. ✗

Explanation

Backfill bias refers to bias introduced by including the previous performance data for firms added to a benchmark index.

(Study Session 19, Module 58.1, LOS 58.c)

Question #32 of 47

An investor made an investment in a hedge fund at the beginning of the year, when the NAV after fees was €80 million. The NAV after fees for Year 1 was €75 million. For Year 2, the end-of-year value before fees is €90 million. The fund has a 2 and 20 fee structure. Management fees are paid independently of incentive fees and are calculated on end-of-year values. Incentive fees are calculated using a high water mark and a soft hurdle rate of 2%. Total fees paid for Year 2 are:

A) €3.8 million. ✓

B) €4.4 million. ✗

C) €5.8 million. ✗

Explanation

Management fee = €90 million × 0.02 = €1.8 million.

Gross return = (€90 / €75) – 1 = 20.0%. The soft hurdle rate was exceeded.

Because of the high water mark, incentive fees are paid only on the increase in NAV above the previous year-end NAV after fees of €80 million.

Incentive fee = (€90 million – €80 million) × 0.20 = €2.0 million.

Total fee: €1.8 million + €2.0 million = €3.8 million.

Note that the new high water mark is €90 million – €3.8 million = €86.2 million.

(Study Session 19, Module 58.2, LOS 58.e)

www.ombookcentre.in

Question #33 of 47

For which of the following investments is an investor *most likely* to require the greatest liquidity premium?

A) Commodity futures. ✗

B) Private equity funds. ✓

C) Real estate investment trusts. ✗

Explanation

Private equity funds tend to have lockup periods; investors will require liquidity premiums as compensation. REITs and commodity futures are exchange-traded instruments and much more liquid than private equity funds.

(Study Session 19, Module 58.2, LOS 58.g)

Question #34 of 47

Social infrastructure assets *most likely* include:

A) health care facilities.

B) broadcasting towers.

C) waste treatment plants.

Explanation

Health care facilities are categorized as social infrastructure. Waste treatment plants are utility infrastructure. Broadcasting towers are communications infrastructure.

(Study Session 19, Module 58.2, LOS 58.d)

Question #35 of 47

A hedge fund that charges an incentive fee on all profits, but only if the fund's rate of return exceeds a stated benchmark, is said to have a:

A) soft hurdle rate.

B) hard hurdle rate.

C) high water mark.

Explanation

With a soft hurdle rate, a hedge fund charges an incentive fee on all profits, but only if the fund's rate of return exceeds a stated benchmark. With a hard hurdle rate, a hedge fund charges an incentive fee only on the portion of returns that exceed a stated benchmark. With a high water mark, a fund's value must exceed its highest previous value before the fund may charge an incentive fee.

(Study Session 19, Module 58.2, LOS 58.e)

www.ombookcentre.in

Question #36 of 47

Categories of alternative investments *least likely* include:

A) hedge funds.

B) currencies.

C) real estate.

Explanation

Categories of alternative investments include hedge funds, private equity, real estate, commodities, and other non-traditional assets such as collectibles or patents.

(Study Session 19, Module 58.1, LOS 58.b)

Question #37 of 47

The most prevalent type of private equity fund is:

A) distressed securities funds.

B) venture capital funds.

C) leveraged buyout funds.

Explanation

Leveraged buyout funds comprise the majority of private equity investment funds.

(Study Session 19, Modules 58.1, LOS 58.d)

Question #38 of 47

Victrix is a hedge fund that has a 3-and-15 fee structure. Compared to hedge funds with 2-and-20 fee structures, Victrix charges higher:

A) incentive fees.

B) load fees.

C) management fees.

Explanation

Hedge fund fee structures indicate management fees as a percentage of assets under management and incentive fees as a percentage of gains in value. A 3-and-15 fee structure means a fund charges a 3% management fee and a 15% incentive fee. Sales load is typically associated with mutual funds and is not indicated by hedge fund fee structures.

(Study Session 19, Module 58.2, LOS 58.e)

www.ombookcentre.in

Question #39 of 47

A portfolio manager who adds hedge funds to a portfolio of traditional securities is *most likely* seeking to:

A) both increase expected returns and decrease portfolio variance.

B) decrease portfolio variance only.

C) increase expected returns only.

Explanation

For a portfolio of traditional securities, adding alternative investments such as hedge funds can potentially increase the portfolio's expected returns, because these investments often have higher expected returns than traditional investments, and decrease portfolio variance, because returns on these investments are less than perfectly correlated with returns on traditional investments.

(Study Session 19, Module 58.1, LOS 58.c)

Question #40 of 47

The period of time within which a hedge fund must fulfill a redemption request is the:

A) withdrawal period.

B) lockup period.

C) notice period.

Explanation

A notice period, typically 30 to 90 days, is the amount of time a fund has after receiving notice of a redemption request to fulfill the redemption request. A lockup period is a minimum length of time before an investor may redeem shares or make withdrawals.

(Study Session 19, Module 58.2, LOS 58.d)

Question #41 of 47

Historical data on returns of real estate are *most likely* to exhibit:

A) overstated correlations with other asset classes.

B) downward-biased Sharpe measures.

C) smoothing.

Explanation

Appraisal methods used to value real estste tend to produce smoothed return patterns that understate standard deviations of returns. This causes Sharpe ratios to be biased upward. Methods used to construct real estate indexes tend to understate the correlation of real estate returns with other asset classes (and thus overstate its diversification benefits).

(Study Session 19, Module 58.1, LOS 58.f)

www.ombookcentre.in

Question #42 of 47

Kettering Incorporated is a successful manufacturer of technology hardware. Kettering is seeking capital to finance additional growth that will position the company for an initial public offering. This stage of financing is *most accurately* described as:

A) mezzanine financing.

B) early-stage financing.

C) angel investing.

Explanation

Mezzanine stage capital prepares a company for and IPO. Angel investing and early-stage financing describe venture capital in a company's formative stages.

(Study Session 19, Module 58.1, LOS 58.f)

Question #43 of 47

Alternative investments *most likely* have which of the following characteristics compared to traditional investments?

A) Higher levels of regulation and transparency.

B) Unique legal structures and tax treatments.

C) Lower leverage and higher liquidity.

Explanation

Compared to traditional investments, alternative investments have unique legal issues and tax treatments that are related to their legal structure and registrations. They often have lower levels of regulation and are less transparent than traditional asset classes. Alternative investments often employ high levels of leverage in illiquid markets.

(Study Session 19, Module 58.1, LOS 58.a)

Question #44 of 47

Funds that invest in the equity of companies, primarily by using debt financing, are *best* characterized as:

A) real estate investment trusts.

B) private equity funds.

C) hedge funds.

Explanation

Leveraged buyout (LBO) funds, a type of private equity fund, use borrowed money to purchase equity in established companies.

(Study Session 19, Module 58.1, LOS 58.b)

www.ombookcentre.in

Question #45 of 47

With respect to risk management for alternative investments, counterparty and liquidity risk are introduced as additional considerations by the use of:

A) derivatives.

B) foreign currencies.

C) lock-up periods.

Explanation

Use of derivatives introduces operational, financial, counterparty, and liquidity risk.

(Study Session 19, Module 58.2, LOS 58.g)

Question #46 of 47

To which of the following categories of alternative investments is an investor *most likely* to gain exposure through derivatives?

A) Private equity.

B) Commodities.

C) Hedge funds.

Explanation

For many commodities, liquid markets exist in derivatives such as futures contracts. Derivatives are less likely to be available on hedge funds or private equity.

(Study Session 19, Module 58.1, LOS 58.b)

Question #47 of 47

A hedge fund strategy that takes positions in shares of firms undergoing restructuring or acquisition is an:

A) equity hedge strategy.

B) event driven strategy.

C) macro strategy.

Explanation

Event-driven strategies include merger arbitrage, distressed/restructuring, and special situations strategies that involve long or short positions in common equity, preferred equity, or debt of a specific corporation. Macro strategies are based on global economic trends and events, and may involve long or short positions in equities, fixed income, currencies, or commodities. Equity hedge strategies seek to profit from long and short positions in publicly traded equities and derivatives with equities as their underlying assets, but are not based on events such as restructuring or acquisition.

(Study Session 19, Module 58.2, LOS 58.d)

www.ombookcentre.in