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QUESTION 1

An analyst makes the following two statements about the assumptions underlying the use of the efficient frontier to construct an optimal portfolio of assets.

Statement 1: Investors believe all investments are represented by a probability distribution of expected returns.

Statement 2: Investors base investment decisions solely on the expected risk of the investment-Determine whether each statement correctly describes one of the assumptions.

- A. Only Statement 1 is correct.
- B. Only Statement 2 is correct.
- C. Both Statement 1 and 2 are correct.

Correct Answer: A

QUESTION 2

Which of the following is/are TRUE?

- I. Losses due to union strike at a plant are classified as extraordinary items.
 - II. Unusual and infrequent items appear as part of income from continuing operations.
 - III. Gains from debt retirement are classified as extraordinary items.
 - IV. The loss from the sale of a portion of business segment is included in income from continuing operations.
- A. II and III
 - B. I and IV
 - C. I and II
 - D. III and IV

Correct Answer: D

Extraordinary items are those items which are unusual in nature and infrequent in occurrence. Extraordinary items appear segregated from the income from continuing operations on the Income Statement. Therefore, II is false. III is true under current GAAP. Losses due to a strike or the sale of a portion of a business segment are considered unusual but not infrequent and hence, do not qualify as extraordinary items.

QUESTION 3

When estimating change in sales for a market series, change in sales is regressed against change in _____.

- A. Earnings
- B. Nominal GNP
- C. None of these answers
- D. Revenues

Correct Answer: B

Regressing change in sales with change in GNP basically to find a relationship between GNP and sales, so that GNP growth rate can be used to estimate future sales changes.

QUESTION 4

Holding income constant, if consumers and investors decide to spend more on goods and services, then

- A. additional spending will require increased borrowing (or less saving), which will drive up the real rate of interest.
- B. producers will expand output without increasing prices to accommodate the stronger demand.
- C. additional spending will increase the supply of loanable funds, which will reduce the real interest rate and thereby trigger additional spending.
- D. the economy's long-run capacity (LRAS) will expand to accommodate the stronger demand.

Correct Answer: A

Strong aggregate demand will put pressure on the market for loanable funds and will result in higher interest rates (as the demand for funds increases). This will cause aggregate demand to contract from its heightened state. This adjustment represents one of the economy's self-correcting mechanisms.

QUESTION 5

The following financial data on CashCow, Inc. have been taken from its financial statements for 1996:

- a.
Dividends paid \$25,000
- b.
Sale of land \$64,000
- c.
Inventory purchases \$29,000
- d.
Purchase of a warehouse \$208,000

e.

Bonds issued \$90,000

f.

Dividends received from investments \$17,000

g.

Interest paid on bonds \$2,400

h.

Salaries paid \$107,400

i.

Cash collection from customers \$28,400

j.

Loss on land sale \$18,000

k.

Beginning cash balance \$312,000

In the above question, the investing cash flow is _____.

A. -\$208,000

B. -\$126,000

C. -\$144,000

D. -\$162,000

Correct Answer: C

Items b and d are the investing cash flows. Note that item j is a non-cash event.

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