

86**BASICS OF PORTFOLIO
PLANNING AND CONSTRUCTION**

1. Categories of investment constraints in an investment policy statement least likely include:
 - (A) liquidity needs.
 - (B) tax concerns.
 - (C) risk tolerance.

2. A portfolio manager who believes equity securities are overvalued in the short term reduces the weight of equities in her portfolio to 35% from its longer-term target weight of 40%. This decision is best described as an example of:
 - (A) rebalancing.
 - (B) strategic asset allocation.
 - (C) tactical asset allocation.

3. Which of the following is not necessarily included in an investment policy statement?
 - (A) An investment strategy based on the investor's objectives and constraints.
 - (B) Procedures to update the IPS when circumstances change.
 - (C) A benchmark against which to judge performance.

4. All of the following affect an investor's risk tolerance EXCEPT:
 - (A) family situation.
 - (B) tax bracket.
 - (C) years of experience with investing in the markets.

5. Which of the following statements is most accurate about integrating ESG considerations into portfolio planning and construction?
 - (A) Integrating ESG considerations into portfolio planning and construction is likely to decrease portfolio returns.
 - (B) Investors who engage in active ownership to pursue their ESG considerations should vote their shares themselves rather than delegating share voting to an investment manager.
 - (C) A broad market index is an inappropriate benchmark for a portfolio that uses negative screening to address the investor's ESG concerns.

6. If an investor's ability to bear risk is low and willingness to bear risk is high, an investment manager should most appropriately consider the investor's overall financial risk tolerance to be
- (A) low.
 - (B) moderate.
 - (C) high.
7. Which of the following statements about risk is NOT correct? Generally, greater:
- (A) existing wealth allows for greater risk.
 - (B) insurance coverage allows for greater risk.
 - (C) spending needs allows for greater risk.
8. An endowment is required by statute to pay out a minimum percentage of its asset value each period to its beneficiaries. This investment constraint is best classified as:
- (A) legal and regulatory.
 - (B) liquidity.
 - (C) unique circumstances.
9. Which of the following statements about the importance of risk and return in the investment objective is least accurate?
- (A) The return objective may be stated in dollar amounts even if the risk objective is stated in percentages
 - (B) Expressing investment goals in terms of risk is more appropriate than expressing goals in terms of return
 - (C) The investor's risk tolerance is likely to determine what level of return will be feasible.
10. Davis Samuel, CFA, is meeting with one of his portfolio management clients, Joseph Pope, to discuss Pope's investment constraints. Samuel has established that:
- Pope plans to retire from his job as a bond salesman in 17 years, after which this portfolio will be his primary source of income.
 - Pope has sufficient cash available that he will not need this portfolio to generate cash outflows until he retires.
 - Pope, as a registered securities representative, is required to have Samuel send a copy of his account statements to the compliance officer at Pope's employer.
 - Pope opposes certain policies of the government of Lower Pannonia and does not wish to own any securities of companies that do business with its regime.
- To complete his assessment of Pope's investment constraints, Samuel still needs to inquire about Pope's:

- (A) tax concerns.
 - (B) unique circumstances.
 - (C) liquidity needs.
11. Which of the following is NOT a rationale for the importance of the policy statement in investing? It:
- (A) forces investors to understand their needs and constraints.
 - (B) helps investors understand the risks and costs of investing.
 - (C) identifies specific stocks the investor may wish to purchase.
12. Based on a questionnaire about investment risk, an advisor concludes that an investor's risk tolerance is high, but based on an analysis of the client's income needs and time horizon, he concludes the investor's risk tolerance is low. The most appropriate action for the advisor is to
- (A) emphasize stocks over bonds.
 - (B) emphasize bonds over stocks.
 - (C) educate the client about investment risk and re-administer the questionnaire.
13. Which of the following portfolio constraints in the Investment Policy Statement of a local college's endowment most likely belongs in the "unique circumstances" category? The endowment is
- (A) exempt from taxes.
 - (B) subject to oversight by a regulatory authority.
 - (C) unwilling to invest in companies that sell weapons.
14. When developing the strategic asset allocation in an IPS, the correlations of returns:
- (A) among asset classes should be relatively high.
 - (B) within an asset class should be relatively high.
 - (C) within an asset class should be relatively low.
15. A firm that invests the majority of a portfolio to track a benchmark index, and uses active investment strategies for the remaining portion, is said to be using:
- (A) a core-satellite approach.
 - (B) risk budgeting.
 - (C) strategic asset allocation
16. Which of the following should least likely be included as a constraint in an investment policy statement (IPS)?
- (A) How funds are spent after being withdrawn from the portfolio.
 - (B) Any unique needs or preferences an investor may have.
 - (C) Constraints put on investment activities by regulatory agencies.

17. Which of the following would least likely be considered a minimum requirement of an IPS? A(n):
- (A) benchmark portfolio.
 - (B) investment strategy based on client circumstances and constraints.
 - (C) target return figure.
18. Which of the following asset class specifications is most appropriate for asset allocation purposes?
- (A) Emerging markets.
 - (B) Consumer discretionary.
 - (C) Domestic bonds.
19. An investment manager is most likely to be engaging in tactical asset allocation if she:
- (A) allocates more than the targeted 10% to emerging market bonds because the sector appears to be undervalued
 - (B) allocates 5% to cash, 20% to fixed income, and 75% to equities based on the investor's long-time horizon and high-risk tolerance.
 - (C) increases the allocation to tax-free bonds because the investor's effective tax rate has increased.
20. Brian Nebrik, CFA, meets with a new investment management client. They compose a statement that defines each of their responsibilities concerning this account and choose a benchmark index with which to evaluate the account's performance. Which of these items should be included in the client's Investment Policy Statement (IPS)?
- (A) Both of these items.
 - (B) Only one of these items.
 - (C) Neither of these items.
21. Which of the following factors is least likely to affect an investor's risk tolerance?
- (A) Number of dependent family members.
 - (B) Level of inflation in the economy.
 - (C) Level of insurance coverage.
22. An investment manager has constructed an efficient frontier based on a client's investable asset classes. The strategic asset allocation for the client should be the asset allocation of one of these efficient portfolios, selected based on:
- (A) the relative valuations of the investable asset classes.
 - (B) a risk budgeting process.
 - (C) the client's investment objectives and constraints.

23. When performing strategic asset allocation, properly defined and specified asset classes should:
- (A) approximate the investor's total investable universe as a group.
 - (B) each contain assets that have a broad range of risk and expected return.
 - (C) have high returns correlations with other asset classes.
24. Which of the following statements about investment constraints is least accurate?
- (A) Diversification efforts can increase tax liability.
 - (B) Investors concerned about time horizon are not likely to worry about liquidity.
 - (C) Unwillingness to invest in gambling stocks is a constraint.
25. Which of the following statements about risk and return is least accurate?
- (A) Return objectives may be stated in absolute terms.
 - (B) Risk and return may be considered on a mutually exclusive basis.
 - (C) Specifying investment objectives only in terms of return may expose an investor to inappropriately high levels of risk.
26. While assessing an investor's risk tolerance, a financial adviser is least likely to ask which of the following questions?
- (A) "How much insurance coverage do you have?"
 - (B) "Is your home life stable?"
 - (C) "What rate of investment return do you expect?"
27. The major components of a typical investment policy statement (IPS) least likely include:
- (A) the investment manager's compensation.
 - (B) duties and responsibilities of the investment manager.
 - (C) investment objectives.
28. A return objective is said to be relative if the objective is:
- (A) based on a benchmark index or portfolio.
 - (B) stated in terms of probability.
 - (C) compared to a specific numerical outcome.
29. Which of the following statements is NOT consistent with the assumption that individuals are risk averse with their investment portfolios?
- (A) Higher betas are associated with higher expected returns.
 - (B) Many individuals purchase lottery tickets.
 - (C) There is a positive relationship between expected returns and expected risk

30. An individual investor specifies to her investment advisor that her portfolio must produce a minimum amount of cash each period. This investment constraint is best classified as:
- (A) legal and regulatory.
 - (B) liquidity.
 - (C) unique circumstances.
31. Which of the following is least likely to be considered a constraint when preparing an investment policy statement?
- (A) Liquidity needs.
 - (B) Risk tolerance.
 - (C) Tax concerns
32. When preparing a strategic asset allocation, how should asset classes be defined with respect to the correlations of returns among the securities in each asset class?
- (A) Low correlation within asset classes and high correlation between asset classes.
 - (B) High correlation within asset classes and low correlation between asset classes.
 - (C) Low correlation within asset classes and low correlation between asset classes.