

Questions 97 through 110 relate to Fixed Income Investments

97. Which of the following structures inherently contains a cap rate?
- A. Floating-rate security with a reference rate equal to the U.S. Treasury security
 - B. Inverse floater with reference rate equal to the U.S. Treasury security
 - C. Inflation-indexed bonds
98. In which of the following financing arrangements, the purchased security is *most likely* placed as a collateral?
- A. Margin buying
 - B. Repo agreement
 - C. Futures contract
99. Which of the following securities is *most likely* to have the lowest duration?
- A. Zero-coupon bond
 - B. Fixed coupon bond
 - C. Floating-rate bond
100. Which of the following statements is *most* accurate about duration?
- A. Duration is a precise measure.
 - B. Duration is not affected by the presence of embedded options in the bond.
 - C. Duration is an approximate measure.
101. Which of the following bond features is *most likely* to have an inverse relationship with the duration of a callable fixed-rate coupon bond?
- A. Maturity
 - B. Coupon rate
 - C. Maturity and coupon rate
102. Which of the following is *least likely* to be an event risk?
- A. Industrial accidents
 - B. Management buyouts
 - C. Bond-rating downgrade

103. Jamaima Charles, CFA, made the following statements about the yield volatility at a local seminar:

Statement 1: “Yield volatility is positively related to the value of the put option and negatively related to the value of a puttable bond.”

Statement 2: “Yield volatility is negatively related to the value of the call option and positively related to the value of a callable bond.”

Charles is *most likely* correct with respect to:

- A. Statement 1 only.
- B. Statement 2 only.
- C. none of the statements.

104. Which of the following is *least likely* to be an interest rate tool available to the Fed?

- A. Buying and selling of Treasury securities in open market.
- B. Increasing or decreasing the bank reserve requirements.
- C. Increasing or decreasing long-term discount rates, which banks use to borrow funds from the Fed.

105. Adam Bratt, CFA, made the following statements at a board meeting:

Statement 1: “The shape of the yield curve is independent of the term structure theories and can take any shape.”

Statement 2: “If the yield curve is inverted according to the pure expectations theory, then at the same time the yield curve can be upward sloping according to the liquidity preference theory.”

Bratt is *most likely* correct with respect to:

- A. Statement 1 only.
- B. Statement 2 only.
- C. both of the statements.

106. Which of the following is *most* accurate about the preferred habitat theory?

- A. The preferred habitat theory is a weaker version of the market segmentation theory.
- B. There is no link between the preferred habitat theory and the market segmentation theory.
- C. The preferred habitat theory is a stronger version of the market segmentation theory.

107. Which one of the following statements about debentures is *least likely* correct?

- A. Debentures are not backed by any collateral.
- B. The government-sponsored entities are not allowed to issue debentures.
- C. Debentures are not required to pay coupons.

108. Which of the following is *least likely* to be a motivation behind the creation of a collateralized mortgage obligation (CMO) security?

- A. Creating a pool of securities with different maturities.
- B. To enhance the credit rating of the CMO tranche.
- C. Redistribution of the pool's prepayment risk.

109. Jack William, CFA, is exploiting an arbitrage opportunity using a two-year 7% Treasury note with a current market value of \$1,025. William has also collected the following data related to the current spot-rate curve presented in Exhibit I.

Exhibit I

Term	Spot rates*
6 months	4.0%
12 months	4.5%
18 months	5.0%
24 months	5.5%

* expressed as semi-annual yield to maturity

The arbitrage profit that can be earned by William is *closest* to:

- A. \$3.68, and the appropriate strategy would be to buy the bond and sell the STRIPS.
- B. \$3.68, and the appropriate strategy would be to sell the bond and buy the STRIPS.
- C. \$3.86, and the appropriate strategy would be to buy the bond and sell the STRIPS.

110. Which of the following statements is *least likely* correct?

- A. The reinvestment risk will be higher for a short-term bond with higher coupons than a short-term bond with lower coupons.
- B. The reinvestment risk will be higher for a long-term bond with higher coupons than a long-term bond with lower coupons.
- C. A noncallable zero-coupon bond has the highest reinvestment risk, as the yield to maturity of the bond is locked at the time the bond is purchased.