Chapter 2: The Asset Allocation Decision

1. With regard to **direct and indirect investing**, choose the **INCORRECT** statement.
   a. Direct investing refers to the purchase of securities directly in one’s brokerage account
   b. Indirect investing refers to the purchase of investment companies, thereby letting the intermediary do the investing on behalf of the investment company owners
   c. Direct investing must be done by every investor since it is not possible to invest only indirectly
   d. Many investors do both direct and indirect investing

1. All but one of the following is reason for investing:
   a. income
   b. appreciation
   c. saving
   d. excitement

2. Investing involves taking ______ with the expectation of _______.
   a. risk; return
   b. saving; consumption
   c. funds from consumption; return
   d. high returns; high current consumption

2. In the **portfolio management process**, which of the following is step #1?
   a. monitoring of market conditions
   b. formulation of appropriate investment strategies
   c. identify and evaluate an investor’s objectives, constraints, and preferences
   d. adjust the portfolio as appropriate

3. Investment horizon is the:
   A) diversity of a portfolio.
   B) allocation of assets.
   C) amount of liquidity in a portfolio.
   D) planned life of an investment.
   E) time until a stock matures.

4. Which of the following is not an investor constraint?
   A) Investment management
   B) Resources
   C) Investment horizon
   D) Liquidity
   E) Taxes

5. ______ is buying and selling in anticipation of the overall direction of the market.
   A) Market timing
   B) Market making
   C) Liquidity
   D) Asset allocation
   E) Investing
6. The distribution of an investment across broad asset classes is known as _________.
   A) market timing
   B) hypothecation
   C) investment protocol
   D) asset allocation
   E) security selection

7. ________ refers to the selection of assets within a particular class of investments.
   A) market timing
   B) hypothecation
   C) investment protocol
   D) asset allocation
   E) security selection

8. ______ portfolio management calls for holding diversified portfolios without spending effort or resources attempting to prove investment performance through security analysis.
   a) Active
   b) Idiotic
   c) Passive
   d) None of the above

11 Security selection refers to ______
   a) choosing specific securities within each asset-class
   b) deciding how much to invest in each asset-class
   c) deciding how much to invest in the market portfolio versus the riskless asset
   d) none of the above

12. You analyze the market and attempt to pick the best-performing sectors and then buy stocks that you feel will perform the best on those sectors. You have a(n) _______ asset allocation and a(n) _______ security selection.
   A) active; active
   B) active; passive
   C) passive; passive
   D) passive; active
   E) none of the above

13. An individual investor's time horizon is most important to developing the investor's:
   a. investment goals.
   b. investment objective.
   c. investment constraints.
   d. liquidity needs.
6. Which of the following, in the investment policy statement, is not a constraint or preference?
   a. liquidity
   b. risk
   c. time horizon
   d. unique circumstances

10. With regard to asset allocation, choose the INCORRECT statement:
   a. the asset allocation decision involves deciding the percentage of investable funds to be placed in stocks, bonds, and cash equivalents
   b. differences in asset allocation will be the key factor over time causing differences in portfolio performance
   c. it is the second most important decision made by investors in the portfolio management process, security selection being the most important
   d. how asset allocation decisions are made by investors remains a subject that is not fully understood.

14. Which type of investor is most concerned about individual state regulations?
   a. Pension plans.
   b. Individuals.
   c. Endowments.
   d. Insurance companies.

15. ----------- shifts the weights of securities in the portfolio to take advantage of areas that are expected to do relatively better than other areas.
   a. Portfolio management
   b. Market timing
   c. Momentum strategy
   d. Sector rotation

16. All of the following represent requirements for conducting effective sector rotation, EXCEPT
   a. an accurate assessment of current economic conditions.
   b. a knowledge and understanding of the phases of the business cycle.
   c. an understanding of the political environment.
   d. expertise in technical analysis.

4. The life cycle approach for individual investors has four phases—which of the following is not one of these phases?
   a. The consolidation phase
   b. the accumulation phase
   c. The spending phase
   d. The capital preservation phase.

17. If security markets are totally efficient, the best common stock strategy to take is:
   a. an asset allocation approach.
   b. the modern portfolio theory.
   c. an active strategy.
   d. a passive strategy.
18. Passive common stock strategies attempt to minimize:
   a. capital losses.
   b. transactions costs and time spent on the portfolio.
   c. market risk.
   d. company and industry risk.

19. Which of the following statements regarding a buy and hold strategy are true?
   a. There are no selection choices to be made under this strategy.
   b. This strategy is applicable only to large portfolios.
   c. There is no reinvestment decision to make under this strategy.
   d. This strategy produces lower transactions and search costs.

20. Which of the following statements about the required rate of return is FALSE?
The required rate of return is
   a. also known as the discount rate.
   b. the sum of the risk-free rate and the market's rate of return.
   c. the minimum return expected relative to the risk of a security.
   d. the sum of the risk-free rate of return and the risk premium.

21. The choice between following an active or a passive investment strategy
    generally depends on all of the following factors, EXCEPT the
    a. amount of investment involved.
    b. investor's expertise.
    c. investor's belief in market efficiency.
    d. availability of time.

22. Key steps in the dynamic process of portfolio management are:
    I. Specification of investor objectives, constraints, and preferences.
    II. Asset allocation, portfolio optimization, security selection, implementation
        and execution.
    III. Development of capital market expectations.
    IV. Measurement of portfolio performance.
The order of these steps in the process is:
   a. I, II, III, IV.
   b. I, III, II, IV.
   c. I, IV, III, II.
   d. III, I, IV, II.

23. Which of the following statements reflects the importance of the asset allocation
    decision to the investment process? The asset allocation decision:
   a. helps the investor decide on realistic investment goals.
   b. identifies the specific securities to include in a portfolio.
   c. determines most of the portfolio’s returns and volatility over time.
   d. creates a standard by which to establish an appropriate investment horizon.
24. Which of the following factors affect the correlation coefficients among asset prices in different national capital markets?
   I. Technological specialization.
   II. Cultural and sociological differences.
   III. Independent fiscal and monetary policies.
   IV. Regulations imposed by national governments.
   a. I and IV only.
   b. II and III only.
   c. I, III and IV only.
   d. I, II, III and IV.
   (CFA Level 1 Sample Exam, 1999, #88)

25. Which of the following reasons for investing is likely to be associated with a young investor's pension fund investments?
   a. income
   b. income and appreciation
   c. appreciation
   d. the excitement of investing