Question #1 of 21

Question ID: 1576026

The CFO of Premlow Insurance Co. wants to ensure that her investment portfolio aligns with the company's claims history and obligations as they come due. She will *most likely* invest in which types of fixed-income securities?

A) Short-term, high-yield securities.

B) Long-term, investment-grade securities.

C) Intermediate-term, risk-free securities.

Explanation

Insurance companies have to ensure that they have the funds needed to pay claims as they come due. Investment-grade securities are deemed the safest by rating agencies, and while the yields are relatively low, they do provide a stable stream of income. Long-term investments align with the reality that claims are ongoing for insurance companies.

(Module 51.1, LOS 51.a)

Question #2 of 21

Question ID: 1576037

The ask price posted by a dealer on an older, relatively illiquid bond is quoted at $1,065 per bond. The bid price posted by the dealer on that same bond will *most likely* be:

A) 7 basis points higher.

B) 15 basis points lower.

C) 4 basis points lower.

Explanation

For an older, less liquid bond traded on the secondary market, the spread between the bid (lower) and the ask (higher) will be greater than it would be for newer, more liquid bonds, often with a spread of up to 1020 basis points. Newer, more liquid bonds may have a spread of less than a basis point.

(Module 51.1, LOS 51.c)

Question #3 of 21

Question ID: 1576030

An analyst who evaluates both fixed-income and equity indices will find that the turnover for the former relative to the latter will be:

A) lower.

B) higher.

C) equivalent.

Explanation

Bonds have maturity dates (unlike equities), and new bonds are issued regularly relative to equities. So, the turnover (removal and replacement of constituents) is higher for fixed-income indices versus equity indices.

(Module 51.1, LOS 51.b)

Question #4 of 21

Question ID: 1576453

Fixed income classifications by issuer *most likely* include:

A) Financial sector bonds.

B) Floating-rate bonds.

C) Money market securities.

Explanation

Corporate bonds are frequently classified by issuer as financial or non-financial. Floating-rate bonds are a classification by coupon structure. Money market securities are a classification by original maturities.

(Module 51.1, LOS 51.a)

Question #5 of 21

Question ID: 1576035

Ridgeland Company wishes to issue its first bond, which will only be available to high-net-worth investors. The underwriter used by Ridgeland has guaranteed the bond issue price. Which of the following *best* describes this bond issuance?

A) A public offering, underwritten offering.

B) A shelf registration, best-efforts offering.

C) A private placement, debut issuer.

Explanation

Because this bond is only available to specific investors, it is considered a private placement rather than a public offering. An issuer that is offering its first-ever bond is referred to as a debut issuer. In this case, because the underwriter has guaranteed the bond issue price, it will be an "underwritten offering" (not best-efforts offering). A shelf registration allows bonds to be issued over time, and there is no indication that this is the intention here.

(Module 51.1, LOS 51.c)

Question #6 of 21

Question ID: 1576034

A company's CFO looks to add more debt to the company's capital structure over a period of several years. She will *most likely* use which type of primary market transaction?

A) Shelf registration.

B) Underwritten offering.

C) Best-efforts offering.

Explanation

Through a shelf registration, a bond issue is registered in aggregate with securities regulators. The bonds are then issued over a period of time, dependent upon when the issuer needs to raise the funds. This will accommodate the CFO's desire to add debt over a period of years. Best-efforts offerings are when intermediaries do not guarantee the issue price. In an underwritten offering, financial intermediaries guarantee the bond issue.

(Module 51.1, LOS 51.c)

Question #7 of 21

Question ID: 1576024

A fixed-income investor is interested in high-yield bonds and is willing to take on the risk associated with non-investment-grade securities. Which of the following credit ratings will *most likely* be associated with the bonds in his portfolio?

A) An S&P rating of BBB–.

B) An S&P rating of BB+.

C) A Moody’s rating of Baa2.

Explanation

Investment-grade bonds are the safest investments, aside from "default risk free," which means they will have the lowest yields. S&P ratings ranging from AAA to BBB– are investment grade, as are Moody's ratings ranging from Aaa to Baa3. An S&P rating of BB+ is considered non-investment grade and will carry greater risk. Because this investor is interested in high-yield bonds and is willing to take on more risk, BB+ is the most likely rating found in his portfolio.

(Module 51.1, LOS 51.a)

Question #8 of 21

Question ID: 1576038

Jacob Sands, CFA, is an investment advisor working with a client who would like to incorporate more fixed income into his investment portfolio. The client already has a significant amount of funds allocated to relatively safe investments and has asked Sands about adding distressed debt to his portfolio. Sands will *most likely* describe these investments as having a:

A) medium credit rating, high risk, low yield.

B) high credit rating, low risk, low yield.

C) low credit rating, high risk, high yield.

Explanation

Distressed debt is the debt of an issuer that is either in bankruptcy already or is expected to be there in the near future. This debt (and the issuer themselves) will likely carry a low credit rating, and because of the financial state they are in, these bonds are considered high risk. Because investors will naturally expect to earn high returns on higher risk investments, the yields will be high—if the issuer makes the interest and principal payments as they come due!

(Module 51.1, LOS 51.c)

Question #9 of 21

Question ID: 1576029

Dave Kats, CFA, recommends the inclusion of a bond fund to his client. In determining the appropriate index benchmark for the fund, Kats will look for an index that matches the exposure of the bond fund in which of the following specific areas?

A) Volatility.

B) Duration.

C) Credit quality.

Explanation

An index used as a benchmark for a bond fund should match the exposure of the fund in terms of credit quality, sector focus, and maturity. Duration and volatility are not specifically identified as exposures that need to be matched by an index fund benchmark.

(Module 51.1, LOS 51.b)

Question #10 of 21

Question ID: 1576027

An investor who wishes to purchase asset-backed commercial paper (ABCP) will be choosing an investment that is considered:

A) intermediate term and default free.

B) long term and high yield.

C) short term and investment grade.

Explanation

ABCP is commercial paper that has a maturity of less than a year (thereby making it short term) and collateralized by financial assets, such as receivables. Regular commercial paper is only eligible to be issued by high credit rating corporations, and ABCP is even more secure because it is collateralized. The high ratings make it investment grade, so it would not be high yield (associated with non-investment grade). It would not, however, be default free.

(Module 51.1, LOS 51.a)

Question #11 of 21

Question ID: 1576032

An analyst is likely to see a fixed-income index focused on which of the following characteristics?

A) Geography.

B) Correlation to equity.

C) Coupon rate ranges.

Explanation

If a fixed-income index uses a narrower focus, the focus may be on geography, credit quality, sector, or maturity. Coupon rate ranges and equity correlations are unlikely to be a focus in the development of a fixed-income index.

(Module 51.1, LOS 51.b)

Question #12 of 21

Question ID: 1576033

In explaining aggregate bond indices to her client, Ashley James references the Bloomberg Barclays Aggregate Index. Which of the following characteristics described by James to her client is *most accurate*?

A) Highly rated, high-yield, and unrated bond issuances are all included.

B) There is no minimum size for bonds in the index.

C) Bonds included come from many sectors and currencies.

Explanation

An aggregate index like the Bloomberg Barclays Aggregate Index will include a broad selection of bonds from many sectors and currencies (the Bloomberg Barclays Aggregate Index has bonds across 28 currencies). There are minimum size thresholds for bonds to be included in the index, and high-yield and unrated bond issuances are excluded.

(Module 51.1, LOS 51.b)

Question #13 of 21

Question ID: 1576454

A purchase of a new bond issue by a single investor is *most accurately* described as a(n):

A) private placement.

B) underwritten offering.

C) grey market transaction.

Explanation

In a private placement, an entire bond issue is sold to a single investor or a small group of investors, rather than being offered to the public.

(Module 51.1, LOS 51.c)

Question #14 of 21

Question ID: 1576031

An investor is working with his financial planner to incorporate more fixed-income investments into his portfolio. One of the investor's questions centers on bond tracker funds and whether they use sampling to mirror a fixed-income index construction. The planner's response will *most likely* be that the tracker fund:

A) uses sampling to minimize transaction complexity.

B) does not use sampling because that is more prevalent in equity index tracker funds.

C) does not use sampling because the universe of fixed-income constituents is low relative to equity.

Explanation

A bond tracker fund will use sampling techniques because fixed-income indices have many more constituents than equity indices, and sampling will keep the transaction complexity reasonable.

(Module 51.1, LOS 51.b)

Question #15 of 21

Question ID: 1576025

The Federal Reserve Bank of the United States sells Treasury securities to try and slow economic growth and reduce the money supply. The maturities of these securities are *most likely* to fall in a range of:

A) more than 10 years.

B) 1 year to 10 years.

C) less than 1 year.

Explanation

The Federal Reserve Bank is a central bank, and the monetary policy tool it is using to reduce the money supply is the sale of intermediate-term (1 to 10-year) Treasury notes.

(Module 51.1, LOS 51.a)

Question #16 of 21

Question ID: 1577192

The bid-ask spread for a bond *most likely* conveys information about:

A) its liquidity, but not its credit quality.

B) both its liquidity and its credit quality.

C) its credit quality, but not its liquidity.

Explanation

Bond dealers' bid-ask spreads depend primarily on the liquidity of an issue. Spreads are narrower for highly liquid issues and wider for less liquid issues. Credit quality and liquidity are both reflected in yield spreads.

(Module 51.1, LOS 51.c)

Question #17 of 21

Question ID: 1577971

Aggregate bond indexes are *most likely* to:

A) have less turnover than broad equity indexes.

B) have large weights in sovereign bonds.

C) include all bond sectors in a single currency.

Explanation

Aggregate indexes contain a broad selection of bonds across sectors and currencies. Because sovereign governments are the largest issuers of bonds, they typically have the largest weight in broad bond indexes. Because bonds mature, they must be replaced in indexes more frequently than equities.

(Module 51.1, LOS 51.b)

Question #18 of 21

Question ID: 1576036

Jane Reeves manages the travel schedule for the analysts and principals of the Overwater Underwriters (OU) Company. The schedule includes several roadshows over the next three months on behalf of Lakecot, Inc., a company that hired OU to bring its debt issuance to the marketplace. Lakecot's debt is *best* described as a:

A) debut issue.

B) shelf issue.

C) repeat issue.

Explanation

Debut issues are new and often require a significant amount of time for underwriters to market the issuance to investors through roadshows. A shelf registration is used for a bond that will be issued over a period of time rather than all at once. A repeat issue will not typically require months of roadshows and marketing efforts to investors.

(Module 51.1, LOS 51.c)

Question #19 of 21

Question ID: 1576028

An analyst has been tasked by his boss to review several bonds from issuers that used to carry investment-grade ratings, but have recently been downgraded to below investment grade. The bonds in this analyst's portfolio are *best* described as:

A) fallen angels. ✓

B) high to low yields. ✗

C) risk for cash investments. ✗

Explanation

Fallen angels is the term for bonds associated with issuers that previously held investment-grade ratings, that have since been downgraded to below investment grade. Neither of the other terms are used to describe these bonds. Yields would increase as the bond is downgraded to below investment grade.

(Module 51.1, LOS 51.a)

Question #20 of 21

Question ID: 1576455

Which type of issuer is *most likely* to issue bonds by auction?

A) Corporate. ✗

B) Municipal. ✗

C) Sovereign. ✓

Explanation

Many national governments use auctions to issue sovereign bonds. Corporate bonds are typically issued in an underwriting or private placement process while municipal bonds are typically issued in a negotiated or underwritten process.

(Module 51.1, LOS 51.c)

Question #21 of 21

Question ID: 1576456

A bond is quoted at 96.25 bid and 96.75 ask. Based only on this information, this bond is *most likely*:

A) a corporate bond.

B) non-investment grade.

C) relatively illiquid.

Explanation

The spread between the bid and ask prices is one-half percent of par, which most likely reflects an illiquid market for this bond. Bonds with liquid secondary markets typically have bid-ask spreads of approximately 10 to 12 basis points.

(Module 51.1, LOS 51.c)