Question #1 of 15

Question ID: 1576518

The typical trade used by a merger arbitrage fund is:

A) short position in acquirer, long position in firm being acquired.

B) long position in acquirer, short position in firm being acquired.

C) short positions in both the acquirer and the firm being acquired.

Explanation

Merger arbitrage funds typically short the stock of the acquirer and buy the stock of the firm being acquired.

(Module 83.1, LOS 83.a)

Question #2 of 15

Question ID: 1576520

An equity hedge fund strategy that focuses primarily on exploiting overvalued securities is *best* described as a(n):

A) fundamental value strategy.

B) event driven strategy.

C) short bias strategy.

Explanation

Equity hedge funds with a short bias attempt to profit from short positions in equities they believe to be overvalued. These funds may hold long equity positions but typically have net short exposure to the market. An event driven strategy focuses on companies involved in mergers, in financial distress, or in other special situations. A fundamental value strategy attempts to identify undervalued equities.

(Module 83.1, LOS 83.a)

Question #3 of 15

Question ID: 1577199

A hedge fund that employs a fundamental growth strategy using equity securities is *most likely* to seek out shares of companies that are:

A) either undervalued or overvalued.

B) growing revenues and earnings rapidly.

C) undervalued only.

Explanation

Fundamental growth refers to investing in companies that are experiencing high growth and for which the fund managers anticipate significant capital appreciation. (Module 83.1, LOS 83.a)

Question #4 of 15

Question ID: 1578001

Which hedge fund strategy is *least likely* to have a long bias?

A) Convertible bond arbitrage.

B) Fundamental long/short.

C) Distressed event-driven.

Explanation

Convertible bond arbitrage aims to be market neutral to exploit mispricing an underlying bond and its embedded call option. Fundamental long/short is an equity hedge fund strategy that takes long positions in undervalued companies and short stocks or an index to reduce risk, typically maintaining a long bias. Distressed/restructuring is an event-driven strategy that tends to be long biased; it invests in discounted debt in companies in or near bankruptcy.

(Module 83.1, LOS 83.a)

Question #5 of 15

Question ID: 1577999

The performance of a hedge fund is *most* appropriately evaluated:

A) on a risk-adjusted return basis.

B) against an equity market index.

C) against a strategy-specific benchmark.

Explanation

Because hedge funds pursue strategies that generate high risk-adjusted returns due to market inefficiency or market volatility, their performance is often evaluated on a risk-adjusted return basis, rather than against benchmarks. Strategies that hedge funds use make them difficult to measure against traditional benchmarks. While hedge fund indexes are available, index performance data may be overstated due to survivorship and backfill bias.

(Module 83.1, LOS 83.a)

Question #6 of 15

Question ID: 1576521

An example of a relative value hedge fund strategy is:

A) merger arbitrage. ✗

B) market neutral. ✗

C) convertible arbitrage. ✓

Explanation

Relative value strategies include convertible arbitrage fixed income, asset-backed fixed income, general fixed income, volatility, and multi-strategy. Market neutral is an equity hedge strategy. Merger arbitrage is an event driven strategy.

(Module 83.1, LOS 83.a)

Question #7 of 15

Question ID: 1578004

What is the *least likely* reason an institutional investor would use a separately managed account for a hedge fund investment?

A) Efficient capital allocation. ✗

B) Higher manager motivation. ✓

C) Enhanced investor control. ✗

Explanation

Benefits of an SMA structure include more customizable portfolio, investor-specific investment mandates, better transparency, efficient capital allocation, higher liquidity, enhanced investor control, and lower fees. Drawbacks include operational complexity, higher governance oversight, and less manager incentive, which could be mitigated through the incentive fee's structure.

(Module 83.1, LOS 83.b)

Question #8 of 15

Question ID: 1576519

The period of time within which a hedge fund must fulfill a redemption request is the:

A) lockup period.

B) notice period.

C) withdrawal period.

Explanation

A notice period, typically 30 to 90 days, is the amount of time a fund has after receiving notice of a redemption request to fulfill the redemption request. A lockup period is a minimum length of time before an investor may redeem shares or make withdrawals.

(Module 83.1, LOS 83.a)

Question #9 of 15

Question ID: 1578005

What is an example of selection bias when creating a hedge fund index?

A) A fund reporting for the first time because it performs well.

B) Inconsistent allocation of individual funds to a peer group.

C) A fund being removed from an index because they stopped reporting.

Explanation

Selection bias occurs when individual funds are inconsistently allocated to an index for a particular strategy. Removing a fund from an index because the fund stopped reporting performance is likely to introduce survivorship bias. Including a fund that starts reporting because it has successful performance to report is likely to introduce backfill bias.

(Module 83.1, LOS 83.c)

Question #10 of 15

Question ID: 1578002

A hedge fund is *most likely* to be structured as a:

A) corporation.

B) limited partnership.

C) trust.

Explanation

Hedge funds are typically structured as a limited partnership or limited liability company, with the general partner or managing member serving as the fund manager.

(Module 83.1, LOS 83.b)

Question #11 of 15

Question ID: 1578003

The terms of a hedge fund are *least likely* to be stated in a:

A) private placement memorandum.

B) partnership agreement.

C) side letter.

Explanation

A side letter addresses terms for a specific investor (not for the fund in general) and can supersede the terms of the fund's offering documents. The primary fund documents that lay out a hedge fund's operational framework include the private placement memorandum, partnership agreement, or the articles of incorporation.

(Module 83.1, LOS 83.b)

Question #12 of 15

Question ID: 1577200

The notice period for a hedge fund is *best* described as the period following:

A) a request for redemption of shares, within which the fund must fulfill the request.

B) an investment in the fund, during which the investor is not permitted to redeem shares.

C) the opening of the fund to investors, before the fund is closed to new investors.

Explanation

The notice period is the time within which a hedge fund must fulfill a request for redemption of shares. The period during which investors may not redeem shares is called a lockup period. (Module 83.1, LOS 83.a)

Question #13 of 15

Question ID: 1578000

Which statement about hedge funds is the *most* accurate? Hedge funds are:

A) privately held and available to qualified or accredited investors.

B) highly regulated and limited in strategies they may pursue.

C) lower risk than private equity because they invest mostly in liquid assets.

Explanation

Hedge funds are pooled investment vehicles that are generally available to investors that meet high suitability requirements (e.g., institutional or accredited investors). Hedge funds are lightly regulated and can pursue a wide variety of strategies. Hedge funds tend to invest mostly in liquid debt and equity assets, but they also use leverage and derivatives, which can result in a different risk and return profile than the underlying assets, making it critical for managers to manage the fund's risk exposure.

(Module 83.1, LOS 83.a)

Question #14 of 15

Question ID: 1578006

Which type of biases in a hedge fund index are *most likely* to overestimate performance?

A) Backfill bias and survivorship bias.

B) Selection bias and survivorship bias.

C) Backfill bias and selection bias.

Explanation

Survivorship bias eliminates funds that no longer report, meaning that unsuccessful funds that have stopped reporting are not represented in the index performance. Backfill bias includes new funds after they have successful performance to report. As a result, survivorship and backfill bias can lead to overestimating performance. Selection bias is likely to result in a misallocation of funds to an index for a particular strategy but is less likely to result in an overestimation of performance compared to survivorship and backfill bias.

(Module 83.1, LOS 83.c)

Question #15 of 15

Question ID: 1578007

When comparing the performance of several hedge funds, the fund with the *best* risk-adjusted annual performance is the one with the:

A) highest alpha.

B) lowest standard deviation.

C) highest coefficient of variation.

Explanation

The coefficient of variation can measure returns adjusted for the relative level of risk. The higher the co-efficient of variation, the greater the return of the same level of risk. Standard deviation is a measure of risk, and alpha is a measure of return.

(Module 83.1, LOS 83.c)