

## STUDY HINTS FOR THE LEVEL I CFA EXAM

The Level I CFA exam is a multiple choice test consisting of 240 multiple choice questions, half of which will be given in the morning session and half of which will be in the afternoon session. Expect that all topics will be covered in both the morning and afternoon, similar to the question format found in the three practice examinations that are in the *Stalla Seminars Practice Exams*.

**Read the exam rules on page 10-11 of the CFA Level I Study Guide provided by AIMR.** Specifically, note that only two brands of calculators are permitted for the exam: the HP 12 C and the TI BAI Plus. Answers will be recorded by darkening the ovals on the answer sheets provided at the exam. **No. 2 or HB pencils with attached erasers must be used to record the answers.** Erasers not attached to the pencils will not be permitted on the exam. It is suggested that you bring several approved pencils to the exam since none will be provided at the examination centers.

The Level I exam is expected to cover most of the general principles that comprise the reading assignments. As a guide for last minute preparation, we suggest that you review the following material:

### **Ethics (15% of exam):**

Review the basic requirements of each of the Standards of Professional Conduct, focusing on the required conduct and compliance procedures for each standard. Pay less attention to minute details such as the material on L1:19-28. Do expect a few questions on the rules of procedure, especially the sections written in bold italics on pages L1:45-46 and L1-49, as well as the requirements of the GIPS in bold italics (L1:45-61). The Homework questions in *Stalla Review for the CFA Exam* (including the three Practice Exams) should provide enough practice in the type of questions that will appear on the exam.

### **Quantitative Methods (12% of exam):**

The Quantitative Methods portions of the exam will include Time Value of, Descriptive Statistics, Probability, Statistical Analyses such as Hypothesis Testing, Regression and Correlation. Know how to do all of the various types of problems covered in Time Value of Money Money (L1: 63-103). Working problems is your best form of study preparation in this area. Some problems might be complicated involving one or more time sequences.

Descriptive Statistics (L1: 104-134) is likely to be covered completely on the exam. However, do not worry about complex equations like skewness and kurtosis. Most of the material in this section will be very basic.

The hardest material in probability is Bayesian analysis. Fortunately, there is only likely to be one question on it. If you find the material difficult, guess and move on. Do not waste valuable time trying to perform calculations that you find incomprehensible. If the principles of counting is covered, it is likely to be limited to combinations and permutations.

The uniform and binomial distributions are not likely to be worth many points on the exam. However, the normal curve will be emphasized. Study pages L2: 33-45 thoroughly. Also, sampling, confidence intervals and hypothesis testing will likely be covered by several questions (L2: 50-68 and L3: 1-33). Detailed mathematics may not be necessary, but know the meaning and interpretation of terms such as level of significance, Type I and Type II error, p-value, and so forth. Do not worry about detailed formulas on testing the difference between two means (pooled variances, etc.). No one can be expected to remember extremely complex formulas.

Regression and correlation analysis (L3: 34-64) will be the source of several questions. Again, the meaning and interpretation of terms such as regression coefficient, correlation coefficient, coefficient of determination, dependent and independent variable, standard error of estimate, confidence interval, prediction interval and significance testing are important. Do not worry too much about long, complicated equations. Stick to the equations that are boxed, short, and important, and you should be all right.

### **Economics (10% of the exam):**

The Economics section of the exam will consist of approximately 24 questions. They will divide up into approximately 6 questions in each of the following categories: macroeconomics (L4: 1-51), Money and Banking and Expectations (L4: 52-83) microeconomics (Lesson 5), International Trade and Foreign Currency and Balance of Payments (Lesson 6).

In macroeconomics, cause and effect relationships are important, not explaining theories or drawing graphs. Know the simple expenditure multiplier, but otherwise ignore the details of Keynesian economics. Virtually all of the Money and Banking section is important. You are probably going to be required to perform calculations in this area. Monetarist theory is important, including the equation of exchange and the quantity theory of money. Understand the effects of monetary policy in the short run, and the long run both when it is anticipated and unanticipated.. The adaptive expectations and rational expectations models are important.

All of International Trade Theory is important (L6: 1-11). Expect some questions on those pages. Foreign Currency (L6: 12-44) topics are likely to be emphasized on the exam: Currency quotations and conversions, cross exchange rate calculations, forward discount and premium calculations, triangular arbitrage, purchasing power parity, balance of payments relationships, and covered interest arbitrage are likely to be heavily emphasized.

### **Financial Statement Analysis (20% of the exam):**

Historically, the Financial Statement Analysis section of the Level I exam has been the most difficult portion of the test. There will be approximately 48 questions in this area, half in the morning and half in the afternoon. Most of the questions will likely be concentrated in a relatively few blocks:

1. Financial ratios (which will likely include the DuPont model that is discussed on pages L12-48 of *Stalla Review for the CFA Exam*). There may be several questions in this area. Most of the financial ratios are discussed on pages L7: 17-38
2. Inventories (L8: 1-18)
3. Accounting for Fixed Assets (L8: 19-39)
4. Leases (L9: 1-8). Do not study the details on Leases from the point of view of lessors (L9: 9-15).
5. Accounting for Equity Capital (L10: 1-8)
6. Computing Earnings per Share (L10: 9-16).
7. Cash Flow (L10: 20-31).

The other topics in Financial Statement Analysis will all be covered with 1-2 questions each, but the "fire power" will be concentrated in the above 7 areas.

### **Corporate Finance (10% of the exam):**

The Corporate Finance questions may be difficult. Know how to determine the cost of the various components of capital (L11: 5-8) and how to perform WACC calculations (L11: 14-17). In addition, the material on ranking capital projects will likely be covered, including linear interpolation to obtain payback and discounted payback periods (L11: 18-25). You will likely have to perform a NPV calculation, but the IRR and MIIR calculations are very unlikely. Understand how to calculate operating cash flow (L11: 29-32) for a project and how to make a capital budgeting decision based on the NPV approach (L11-33). Optimum capital structures including the MM model (L11: 44-55) will likely be the source of several questions, as will signaling theory and the optimum dividend policy (L11: 56-63).

### **Equity Investments (7% of the exam)**

Make sure you know how to perform basic dividend discount model calculations, especially the constant growth dividend discount model (L12: 36). The formula for internal growth rate (L12: 47) is also important, as is the DuPont model. Expect about one or two questions on technical analysis (L12: 79-84). Most of the other questions (especially questions covering pages L12: 59-78) mostly will be of a "trivial pursuit" nature. If you read the Lesson 12 section and can do the examples, you should not find this portion of the exam too difficult.

### **Global Markets and Instruments (2% of the exam)**

Expect four or five global questions from the material covered on L12: 85-91 and L16: 32-34.

### **Derivatives (5% of the exam)**

There will only be a few questions on Futures. Most will be the trivial pursuit variety, concerning definitions of terms (long/short, initial margin, variation margin, maintenance margin, mark-to-market, the role of the clearinghouse, methods of settlement, and so forth). However, know how to calculate how much a contract price has to increase or decrease before a margin call will occur (L15-10).

Most of the derivative questions will probably be related to Options. A few questions might require knowledge of some definitions (call, put, in-the-money, out-of-the-money, and so forth). Most questions, however, should center around strategies that employ options. Therefore, the material covered on pages L15: 20-31 is very important. If you do the Homework problems covered in the *Stalla Review for the CFA Exam and Practice Exams*, you should have little problem with the options questions on the exam itself.

There are only going to be a few questions on swaps. Most of them are expected to be definitions of terms (tenor, settlement, notional amount, and so forth). You may have to determine one cash flow for an interest rate swap as in the example on page L15: 34-35.

### **Debt Investments (11% of the exam)**

In Fixed Income, expect most of the questions to be on the material covered on pages L13: 44-65 and L14: 1-46 with only a few "trivial pursuit" type questions being based on pages L13: 1-43. You should expect to have to calculate the value of a bond, certain bond yields, the duration and convexity of a bond, spot rates and forward rates (particularly the latter). If you can do these calculations and have read the rest of the material once, the fixed income questions should not be too difficult.

### **Alternative Investments (3% of the exam):**

Real Estate, Investment Companies, and Venture Capital should be a simple portion of the exam. Expect one question on the material covered on L15: 44-46, probably on the determinants of real estate value and three questions on valuating real estate

Expect only one or two questions on Investment Companies (trivial pursuit) and one or two definitions in Venture Capital.

### **Portfolio Management (5% of exam):**

Portfolio management can be broken down into Conventional Portfolio Management (L16: 1-10) and Modern Portfolio Theory (L16: 11-30). The Global Portfolio

Management material will be included in the Global Markets and Instruments section of the test.

The questions on conventional portfolio management topics should not be very difficult. Know the two objectives and five constraints (L16: 2-5), the phases of an individual's investment life cycle (L16: 8-10) and how the two objectives and five constraints should be applied to various types of portfolios (summarized in the table on L16-10) and you should be all right.

The modern portfolio theory questions may involve calculations. Specifically, know the formulas on L16: 11-12 and understand beta (L16: 18-21). Know the CAPM, the CML model (L16-22) and the SML model (L16: 23-24). However, you do not need to know the derivations of these models. The arbitrage pricing model might have one or two questions related to it, but they are likely to be on the material found on L16-31.

### **Psyche Yourself for the Exam**

Before taking the exam, read the Hints on Taking the CFA Exam section (L16: 35-42). This contains a lot of useful hints in answering multiple choice questions. It also provides you with other useful ideas about preparations to be made just prior to the test day. Read these hints about 10 days before taking the exam itself and follow the advice on exam day!

About a week before the exam, start getting yourself into a mental state in which passing the exam is not such an all-encompassing goal as it seems today. This will relax you and reduce the tendency to panic on exam day. A calm and relaxed attitude is the best mental approach to taking the exam itself. So, about two weeks before the exam, keep saying to yourself:

- I am prepared.
- I will do my best.
- If my best is not good enough, so be it.

Good Luck!