

The following Sample Paper consists of 39 question items. They span over the "Exam 3 - Investment Planning (IP)" and the "Module: Introduction to Financial Planning". The actual Question Paper would consist of 77 items of total 150 marks out of which Introduction to Financial Planning items would be 17 items of 30 marks, thus representing 20% of marks in each of Exam 1, 2, 3 & 4. This Sample Paper is representative of the revised and restructured Exam effective from 1st February, 2013 as regards distribution and pattern of question items in respective Sections and their defined difficulty level. For more details, refer to the Revised Syllabus and Topic List. Suggested solutions to 3-mark and 4-mark problems are as per Working Notes alongside. The Assessment Year considered is AY2013-14 and the relevant question would thus be suitable for exam effective from 1st February 2013.

Exam 3 - Investment Planning (IP)

Attempted Answers Are Checked and Displayed In Blue Color.

Correct Answers are Displayed in Red Color after each Question.

SECTION - I

1 Bond prices are less sensitive to changes in the interest rates when the bonds have _____.

[1 Mark]

- (a) small coupons and long maturity
- (b) small coupons and short maturity
- (c) large coupons and long maturity
- (d) large coupons and short maturity
- (e) Not Attempted

Correct Answer : large coupons and short maturity

2 The deviation of an ETF's value from the value of its underlying asset is known as ____.

[1 Mark]

- (a) standard error
- (b) variance
- (c) standard deviation
- (d) tracking error
- (e) Not Attempted

Correct Answer : tracking error

3 This is not a described category under FPSB India's Financial Planner Competency Profile to discuss the competent performance of a CFP professional.

[1 Mark]

- (a) Financial Planning Body of Knowledge
- (b) Financial Planner Professional Skills
- (c) Financial Planner Code of Ethics and Professional Responsibility
- (d) Financial Planner Abilities
- (e) Not Attempted

Correct Answer : Financial Planner Code of Ethics and Professional Responsibility

4 Monitoring Volume of trading in a stock is an important aspect of technical analysis because _____.

[1 Mark]

- (a) it confirms the trend in price movement and the pattern formation
- (b) it indicates the stock's potential to
- (c) it indicates delivery position in the stock
- (d) it indicates value at risk in the stock
- (e) Not Attempted

Correct Answer : it confirms the trend in price movement and the pattern formation

5

The system of trading on margin is practiced in futures markets to ____.

[1 Mark]

- (a) make futures contracts more readily tradable
- (b) reduce the risk of default on contracts
- (c) allow people to make higher profits
- (d) reduce the ticket size for participation
- (e) Not Attempted

Correct Answer : reduce the risk of default on contracts

6

Which of the following correctly defines a CFP professional's working out the financial goals of a client?

[2 Marks]

- (a) The CFP professional analyzes the financial information submitted by the clients and formulates short term and long term financial goals
- (b) The CFP professional assists the client in clarifying and prioritizing short and long-term realistic financial goals with respect to the current situation
- (c) The CFP professional seeks all information about financial transactions and assets in order to structure financial goals of the client
- (d) The CFP professional discusses the merits of financial goals and selects only the achievable goals
- (e) Not Attempted

Correct Answer : The CFP professional assists the client in clarifying and prioritizing short and long-term realistic financial goals with respect to the current situation

7

A logarithmic price scale is different from a linear price scale in that ____.

[2 Marks]

- (a) the distance between the numbers on the scale increases in exact proportion to the increase in the price of the underlying asset
- (b) the distance between the numbers on the scale decreases as the price of the underlying asset increases
- (c) the distance between the numbers on the scale multiplies in proportion to the price of the underlying asset increases
- (d) the distance between the numbers on the scale increases as the price of the underlying asset decreases
- (e) Not Attempted

Correct Answer : the distance between the numbers on the scale decreases as the price of the underlying asset increases

8

Ex-mark, commonly known as R-Squared in Statistics, in mutual funds is defined as ____.

[2 Marks]

- (a) the measure of dispersion from the risk free rate of return for the period
- (b) the annual recurring costs as a percentage of the net assets of the scheme
- (c) the extent to which the return of a mutual fund scheme is explained by a particular financial market
- (d) the volatility of return from its chosen benchmark index
- (e) Not Attempted

Correct Answer : the extent to which the return of a mutual fund scheme is explained by a particular financial market

SECTION - II

1 Human mind frequently makes random judgmental errors. This trait may be dealt with by programming individual decision process. This Characteristic is used in ____.

[1 Mark]

- (a) averaging
- (b) arbitraging
- (c) Systematic Investment Plan
- (d) hedging
- (e) Not Attempted

Correct Answer : Systematic Investment Plan

2 Choose the instrument from the following which does not have reinvestment risk:

- (a) Short term bonds
- (b) Corporate Bonds with Call option
- (c) Zero coupon bonds
- (d) Government securities
- (e) Not Attempted

Correct Answer : Zero coupon bonds

3 Which of the following is not a fiscal policy measure?

[1 Mark]

- (a) Reducing Cash Reserve Ratio
- (b) Increasing taxes
- (c) Reducing subsidies
- (d) Reducing Government borrowing
- (e) Not Attempted

Correct Answer : Reducing Cash Reserve Ratio

4 Which of the following best describes the cost of foregone income that results from making an economic decision to use funds to purchase a piece of capital equipments?

[1 Mark]

- (a) Fixed cost
- (b) Cost of capital
- (c) Marginal cost
- (d) Opportunity cost
- (e) Not Attempted

Correct Answer : Opportunity cost

5 Mr. A invested in tradable bonds of a corporate paying annual coupon of 10.5%. The tenure of the bonds is 9 years and he desires to hold them till maturity. What would be the impact of declining interest rates on his cash flows during this tenure?

[2 Marks]

- (a) The coupon rate would vary with the same margin as the originally contracted 10.5% is from the Repo rate
- (b) He would stand to receive larger than contracted coupon payments proportionate to the appreciation in bond prices in secondary market
- (c) He would receive lower than contracted coupon payments proportionate to the decline in interest rates
- (d) No impact, as he has no intention to sell the bonds and coupon payments would not be impacted by declining interest rates
- (e) Not Attempted

Correct Answer : No impact, as he has no intention to sell the bonds and coupon payments would not be impacted by declining interest rates

6

A businessman wants to achieve the goal of marriage of his daughter after 10 years. The funds required would be Rs. 25 lakh at then costs. He wants to invest monthly for the goal. You suggest an asset allocation strategy where he should invest monthly in equity and debt in ratio 65:35 for 9 years, and shift the entire accumulated amount in these funds to liquid fund in the last year. If the returns expected from equity, debt and liquid funds in this period are 12 % p.a., 9 % p.a. and 5 % p.a., respectively, what approximate amount per month is required to be allocated to equity and debt schemes?

[3 Marks]

- (a) Rs. 12,679 & Rs. 8,453
 (b) Rs. 9,485 & Rs. 6,323
 (c) Rs. 8,601 & Rs. 4,631
 (d) Rs. 12,075 & Rs. 8,050
 (e) Not Attempted

Correct Answer : Rs. 8,601 & Rs. 4,631

7

Your client started investing Rs. 12,000 per month a year ago in an asset allocation of 30:70 in equity and debt to achieve a goal in 6 years from now by accumulating Rs. 10 lakh. You realize that he would be requiring Rs. 15 lakh for the same goal. You expect equity and debt to give returns of 11.75% p.a. and 8.25% p.a., respectively in the entire period of investment. You assess changing asset allocation to 65:35 in equity and debt by investing Rs. 2,000 additional per month to see how closer he can reach to his goal. You find that _____.

[3 Marks]

- (a) Approximate surplus of Rs. 2,13,707
 (b) Approximate shortfall of Rs. 1,68,091
 (c) Approximate surplus of Rs. 6,47,691
 (d) Approximate surplus of Rs. 1,47,691
 (e) Not Attempted

Correct Answer : Approximate surplus of Rs. 1,47,691

8

An individual has recently purchased a house worth Rs. 40 lakh for self-occupation by availing housing loan of Rs. 28 lakh at 9.25% p.a. rate of interest. The tenure of loan is 18 years. He has Rs. 12 lakh financial assets at present. He is expected to save annually Rs. 2 lakh which he invests on a quarterly basis beginning a quarter from now in an instrument which is expected to provide return of 9% p.a. What would be his net worth five years from now? The value of the house which is for consumption purposes is not considered in the net worth so arrived.

[3 Marks]

- (a) Rs. 2.83 lakh
 (b) Rs. 18.82 lakh
 (c) Rs. 6.68 lakh
 (d) Rs. 7.36 lakh
 (e) Not Attempted

Correct Answer : Rs. 6.68 lakh

9

Your client starts investing immediately for 10 years annually Rs. 60,000 in the ratio of 80:20 in equity and debt products. You expects return from equity and debt to be 11.75% p.a. and 8.25% p.a. during this period. To protect the wealth, he rebalances the portfolio in 40:60 ratio of equity and debt after 10 years and invests in the same ratio annually Rs. 60,000 for the next 5 years. The return expected from equity and debt in this period subsides to 9% p.a. and 7% p.a., respectively. What rate of return is expected on his total investments? How would this return fare when seen from average inflation of 6% during the entire period?

[4 Marks]

- (a) 6.96% p.a.; real return of 0.91% p.a.
 (b) 7.57% p.a.; real return of 1.48% p.a.
 (c) 7.24% p.a.; real return of 1.17% p.a.
 (d) 9.52% p.a.; real return of 3.32% p.a.
 (e) Not Attempted

Correct Answer : 9.52% p.a.; real return of 3.32% p.a.

SECTION - III

1 Other things equal, diversification is most effective when classes of securities included in portfolio have _____.

[1 Mark]

- (a) negatively correlated returns
- (b) positively correlated returns
- (c) high returns
- (d) uncorrelated returns
- (e) **Not Attempted**

Correct Answer : **negatively correlated returns**

2 Money has time value. This fact derives its significance from several conditions. Choose the one from the following which does not correspond:

[1 Mark]

- (a) Cost of foregoing present consumption.
- (b) Possibility of increase in tax rates over time.
- (c) Reduction in the purchasing power over time.
- (d) Ability to buy assets which generate income over time.
- (e) **Not Attempted**

Correct Answer : **Possibility of increase in tax rates over time.**

3 The average inflation over the last three years is 8.5 % p.a. You invested Rs. 1 lakh in a security 3 years ago which you have redeemed for Rs. 1.3 lakh. What real return have you obtained from investment?

[2 Marks]

- (a) 1.50% p.a.
- (b) 1.38% p.a.
- (c) 0.59% p.a.
- (d) 2.27% p.a.
- (e) **Not Attempted**

Correct Answer : **0.59% p.a.**

4 Mr. A's portfolio consists of two stocks A and B in which he has invested Rs. 75,000 and Rs. 67,000, respectively. Stock A has beta of 1.4 and stock B has beta of 0.80. The return expected from the market in current scenario is 12% while the return on Treasury bonds is 7%. What is the expected return from the portfolio?

[3 Marks]

- (a) 11.17%.
- (b) 12.58%.
- (c) 14%.
- (d) 10.4%.
- (e) **Not Attempted**

Correct Answer : **12.58%.**

5 For an investment product guaranteeing a fixed cash flow of Rs. 4 lakh per annum for 20 years beginning four years from the date of investment, what price should be fixed if the same can be invested in financial instruments which can yield 8.25 % p.a. for the four years and 7.5% p.a. for the remaining period of the product?

[3 Marks]

- (a) Rs. 31,92,437
- (b) Rs. 27,84,712
- (c) Rs. 29,80,260
- (d) Rs. 41,97,230
- (e) **Not Attempted**

Correct Answer : **Rs. 31,92,437**

6

A 15-year, 9% corporate bond with Face Value Rs. 1,000 and interest payable semi-annually matures after 6 years. The bond is available at a yield to maturity of 7%. If the record date for the last coupon has just passed, at what value 50 bonds of the corporate are likely to be quoted in the market?

[3 Marks]

- (a) Rs. 55,593
- (b) Rs. 56,321
- (c) Rs. 54,767
- (d) Rs. 54,832
- (e) Not Attempted

Correct Answer : Rs. 54,832

7

You manage a Rs. 10,00,000 portfolio. You are expecting to receive an additional Rs. 6,50,000 from a new client. The existing portfolio has a required return of 10.25 percent. The risk-free rate is 5 percent and the return on the market is 9.5 percent. If you want required return on the new portfolio to be 11 percent, what should be the average beta for the new stocks added to the portfolio?

[4 Marks]

- (a) 1.25
- (b) 1.59
- (c) 1.76
- (d) 1.47
- (e) Not Attempted

Correct Answer : 1.59

8

Mr. A purchased a flat worth Rs. 50 lakh in January 2007 by availing a housing loan of Rs. 35 lakh for tenure 15 years at the rate of 9% p.a. The value of his flat as in January 2013 has appreciated to Rs. 90 lakh. What approximate value of home equity can he consider in his flat towards his unencumbered interest after also setting aside 15% of the appreciation value towards taxes and other costs to be discharged on selling the unit?

[4 Marks]

- (a) Rs. 49 lakh
- (b) Rs. 74.56 lakh
- (c) Rs. 57.79 lakh
- (d) Rs. 63.79 lakh
- (e) Not Attempted

Correct Answer : Rs. 57.79 lakh

9

A stock of face value Rs. 10 is currently priced at Rs. 175. The company paid a dividend of 125% in the previous fiscal year and the absolute amount of dividend is expected to grow by on an average 5% year-on-year. It has a beta of 0.8. You expect the market to give a return of 12% while the risk-free rate is 5%. You find out the extent of undervaluation or overvaluation of the stock by dividend discount method, and state that _____.

[4 Marks]

- (a) the company's stock is undervalued by 38%
- (b) the company's stock is overvalued by 56%
- (c) the company's stock is undervalued by 153%
- (d) the company's stock is undervalued by 25%
- (e) Not Attempted

Correct Answer : the company's stock is undervalued by 25%

SECTION - IV

1 The Value investing strategy is _____.

[1 Mark]

- (a) investing in stocks that are below their intrinsic value
- (b) investing in stocks that trade at very high Price Earning multiple
- (c) investing in stocks that trade significantly above their Price Book Value ratio
- (d) investing in stocks that are trading at below their peer companies in the sector
- (e) Not Attempted

Correct Answer : investing in stocks that are below their intrinsic value

2 An approach that increases the proportion of funds in stocks when the stock market is expected to rise, and increases cash when the stock market is expected to fall is _____.

[1 Mark]

- (a) liquidity expectation timing
- (b) portfolio optimization
- (c) strategic asset allocation
- (d) tactical asset allocation
- (e) Not Attempted

Correct Answer : tactical asset allocation

3 Which of the following is an infringing use of CFP marks to describe an individual eligible to use them?

[1 Mark]

- (a) CFP certificant
- (b) CFP expert
- (c) CFP professional
- (d) CFP practitioner
- (e) Not Attempted

Correct Answer : CFP expert

4 Which of the following does not correspond to the principle of "Professionalism" under Financial Planner Code of Ethics and Professional Responsibility?

[2 Marks]

- (a) Enhancing and maintaining the profession's public image and its ability to serve the public interest
- (b) Complying with appropriate rules, regulations and professional requirements
- (c) Behaving with dignity and showing courtesy to clients, fellow professionals and business associates
- (d) Appearing in executive attire, using latest gadgets of communication, fine dining skills, etc.
- (e) Not Attempted

Correct Answer : Appearing in executive attire, using latest gadgets of communication, fine dining skills, etc.

5 The efficient market hypothesis which contradicts the market timing approach says that _____.

[2 Marks]

- (a) It is impossible to time the market as historical data is hard to get
- (b) It is impossible to time the market due to trends that it shows
- (c) It is impossible to time the market as market behavior is random
- (d) It is impossible to time the market as there is efficiency in settlement
- (e) Not Attempted

Correct Answer : It is impossible to time the market as market behavior is random

6

Your client Mr A. has his Rs. 50 lakh portfolio in three asset classes as on 1st April 2009 comprised of Equity and Debt each in 35 % allocation with the rest of the portfolio invested in Gold ETF. Over the period upto 1st January 2013, Gold has given a total return of 90 % in the portfolio whereas equity and debt have returned 11% and 15%, respectively. You rebalance the portfolio today and change its allocation to 60% in equity with the other two classes equally sharing the balance. What should be the transfer of money amongst asset classes.

[3 Marks]

- (a) Shift from Equity to Debt Rs. 1,52,962 and shift from Gold ETF to Equity Rs. 6,66,762
(b) Shift from Debt to Equity Rs. 2,10,000 and shift from Debt to Gold ETF Rs. 1,05,000.
(c) Shift from Debt to Equity Rs. 6,51,500 and shift from Gold ETF to Equity Rs. 14,89,99
(d) Shift from Debt to Equity Rs. 9,01,176 and shift from Gold ETF to Equity Rs. 15,69,288
(e) Not Attempted

Correct Answer : Shift from Debt to Equity Rs. 6,51,500 and shift from Gold ETF to Equity Rs. 14,89,100

7

You are evaluating the rankings based on Treynor Ratio of three funds A, B and C . The average returns obtained from funds A, B and C have been 16%, 19% and 14%, respectively against the market return of 13%. The standard deviations of fund returns have been 17, 22 and 16, respectively versus the market return standard deviation of 15. If the beta reported of these funds is 1.2, 1.4 and 1.1, respectively and the risk-free rate of return is 5.5%, what are your rankings in the order of best to worst?

[4 Marks]

- (a) B,A,C
(b) A,B,C
(c) C,B,A
(d) A,C,B
(e) Not Attempted

Correct Answer : B,A,C

SECTION - V

1 A mutual fund in India is constituted in the form of _____.

[1 Mark]

- (a) a public trust formed under the Principles of Mutuality
(b) an investment company according to special amendment to the Banking Regulation Act, 1949
(c) a public trust created under the Indian Trusts Act, 1882
(d) a public company incorporated under The Companies Act, 1956
(e) Not Attempted

Correct Answer : a public trust created under the Indian Trusts Act, 1882

2

The following entities assist in the initial sale of securities in the primary market:

[1 Mark]

- (a) Brokerages
(b) Stock exchanges
(c) Issue Underwriters
(d) Merchant Bankers
(e) Not Attempted

Correct Answer : merchant Bankers

3



Under the Investment Adviser Regulations, 2013 notified by SEBI, which of the following has not been considered as one of the eligibility criteria for investment advisers?

[1 Mark]

- (a) Registration with financial product manufacturers
- (b) Capital Adequacy requirement
- (c) Infrastructure
- (d) Eligible Qualification and Certification
- (e) Not Attempted

Correct Answer : Registration with financial product manufacturers

4

Which of the following cannot be categorized under Fiduciary Responsibility of a financial planner towards his/her client?

[1 Mark]

- (a) Disclose all material facts
- (b) Get the best returns on client's investments
- (c) Serve the client's best interest
- (d) Act in utmost good faith
- (e) Not Attempted

Correct Answer : Get the best returns on client's investments

5



Which of the following is not prescribed for an entity to act as bank under the Banking Regulation Act, 1949?

[2 Marks]

- (a) Use of at least one word bank, banking, banking company in its name
- (b) Restriction on granting loan to person interested in management of the bank
- (c) Prohibition to form subsidiary company for certain purposes
- (d) Restriction on business of certain kinds such as trading of goods etc.
- (e) Not Attempted

Correct Answer : Prohibition to form subsidiary company for certain purposes

6



Green Shoe Option means_____.

[2 Marks]

- (a) An option to offer their shares by the existing shareholders of a company which comes out with public issue of shares.
- (b) Allotment on a firm basis a certain quota of shares in a public issue by an issuing company to Qualified Institutional Buyers (QIBs).
- (c) Allotment on a firm basis a certain quota of shares in a public issue by an issuing company to Indian and Multilateral Development Financial Institutions and MFIs
- (d) An option reserved with the issuing company to allocate shares in excess of the shares included in the public issue.
- (e) Not Attempted

Correct Answer : An option reserved with the issuing company to allocate shares in excess of the shares included in the public issue.