

Certified Private Wealth Professional  
(CPWP)

Module 1 Examination

Paper 1

# Financial Instruments

證券及投資學會

## Published by:

Hong Kong Securities and Investment Institute

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**Question 1**

Which **ONE** of the following statements regarding asset-backed securities (“ABSs”) is **INCORRECT**?

- A ABSs are bonds secured by a pool of assets.
- B Collateralised debt obligations are a form of ABS.
- C ABSs generally provide better yields than high-yield bonds.
- D ABSs allow financial institutions to securitise illiquid assets.

**Question 2**

Which of the following statements regarding foreign exchange (“FX”) market are **CORRECT**?

- I Most FX products are traded via over-the-counter (“OTC”).
  - II OTC FX market operates for 24 hours of each business day.
  - III Most OTC FX products are traded via electronic trading platforms.
  - IV Dealers in OTC FX market mostly provide market participants two-way quotes of the exchange rate.
- 
- A I and III only
  - B II and IV only
  - C I, II and III only
  - D I, II, III and IV

**Question 3**

Which **ONE** of the following is **NOT** a feature of an interest-rate swap (fixed-for-floating)?

- A It is traded over-the-counter.
- B Floating rate receiver pays a fixed interest payment at a predetermined fixed rate on the notional principal.
- C The two parties exchange the principal and specify how to calculate the interest payments.
- D The payments are netted and normally settled in arrears.

**Question 4**

Which **ONE** of the following statements regarding capital protected structured products is **INCORRECT**?

- A Capital protected products are primarily designed for risk-averse investors.
- B Invested capital is protected up to a certain level at maturity.
- C Counterparty risk is mitigated.
- D Zero-coupon bonds are often used to provide the guaranteed return component of a capital protected product.

**Question 5**

Which **ONE** of the following stock investment is Sharia-compliant?

- A Buying stocks of an alcohol producer.
- B Buying stocks and hedging the risk with related stock futures.
- C Short-sell a stock.
- D Buying stocks with an interest-bearing loan offered by a third party against the shares as collateral.

**Question 6**

Which **ONE** of the following statements regarding hedge funds is **CORRECT**?

- A Hedge funds generate a better performance than traditional investment funds.
- B Performance fee is only applicable to hedge funds.
- C Hedge funds are generally allowed to use leverage and derivatives.
- D The objective of hedge funds tends to outperform the benchmark.

**Question 7**

The annual report of an investment fund includes an auditor's report. If the opinion of an auditor is qualified, which of the following statement is/are **CORRECT**?

- I The auditor usually concludes that the financial statements give "a true and fair view".
  - II The auditor usually concludes that the financial statements are prepared in conformity with the applicable financial reporting framework and present an appropriate picture of the investment fund's operating performance and financial position.
  - III The auditor suggests that the information provided in the financial statements is limited in scope or inaccurate.
  - IV The auditor's opinion may indicate a warning signal on the financial statements.
- 
- A I only
  - B IV only
  - C I and II only
  - D III and IV only

**Question 8**

You have invested \$10 million in a 3-year inflation-linked bond ("ILB") paying interest annually at 3% per annum. Suppose there is a 3% inflation rate, the ILB principal on the interest payment day will:

- A be adjusted upward.
- B be adjusted downward.
- C remain unchanged.
- D be redetermined by the issuer.

**Question 9**

Which **ONE** of the following statements regarding active bond management strategies is **INCORRECT**?

- A To hold short-dated bonds and short-sell long-dated bonds when short yields are expected to fall and long yields are expected to rise.
- B To buy underpriced bonds and sell overpriced bonds if all the bonds belong to the same credit quality or credit ratings.
- C To hold less bonds with high duration if market interest rate is expected to drop.
- D To select bonds after detailed credit analysis on their issuers.

**Question 10**

Which **ONE** of the following statements regarding the coupon payment of a convertible bond is **CORRECT**?

- A It may pay higher coupons than a straight bond with identical characteristics.
- B It may pay lower coupons than a straight bond with identical characteristics.
- C Its coupon payment is the same as a straight bond with identical characteristics.
- D There is not enough information to compare it with the coupon payment of a straight bond with identical characteristics.

**Question 11**

A 5-year bond with face value of HKD1,000 and a yield of 3%. A coupon of HKD30 paid annually. The bond is traded at:

- A a discount.
- B a premium.
- C par.
- D There is insufficient information to determine.

**Question 12**

Which **ONE** of the following is a liquidity ratio for financial statement analysis?

- A Cash ratio
- B Inventory turnover
- C Interest coverage
- D Debt ratio

**Question 13**

Suppose that the central bank of a country needs to take action to raise the value of its currency against the US dollars. Which **ONE** of the following is the **MOST APPROPRIATE** action?

- A Buy the US dollars against the domestic currency to increase the local money supply.
- B Sell the US dollars against the domestic currency to increase the local money supply.
- C Sell the US dollars against the domestic currency to reduce the local money supply.
- D Buy the US dollars against the domestic currency to reduce the local money supply.

**Question 14**

Which of the following statements regarding carry trade are **CORRECT**?

- I It occurs when an investor borrows US dollar to buy gold futures contracts.
- II It occurs when an investor borrows a currency of low interest rate, converts it into another currency of high interest rate and lends out that other currency.
- III It is usually done on a margin basis with huge leverage and so it is very risky.
- IV It is sometimes known as triangular arbitrage.

- A I and IV only
- B II and III only
- C I, II and III only
- D II, III and IV only

**Question 15**

Which **ONE** of the following factors influences the exchange rate in the long run?

- A Hot money
- B Carry trades
- C Foreign investment
- D Economic and political news

**Question 16**

Which of the following statements regarding warrants and options are **CORRECT**?

- I Warrants are options linked to credit risk.
  - II Put warrants are put options in nature.
  - III Warrants tend to be longer dated than options.
  - IV Warrants are typically traded on a stock exchange alongside the relevant stock rather than on a derivatives exchange.
- 
- A I and II only
  - B I and III only
  - C II, III and IV only
  - D I, II, III and IV



**Question 17**

Which **ONE** of the following statements regarding put-call parity is **CORRECT**?

- A If the put-call parity does not hold, arbitrage opportunity will not exist.
- B The put-call parity indicates that a covered call strategy has a payoff similar to that of a short call strategy.
- C The put-call parity is related to triangular arbitrage.
- D A call option and a put option with the same underlying asset, strike price and maturity have a pricing relationship.

**Question 18**

Which **ONE** of the following is **NOT** a category of structured products in the European Structured Investment Products Association categorisation system?

- A Capital protection
- B Yield enhancement
- C Substitution
- D Leverage

**Question 19**

Which of the following risks will structured products involve?

- I Market risk
  - II Issuer default risk
  - III Foreign exchange risk
  - IV Liquidity risk
- 
- A I and II only
  - B III and IV only
  - C I, II and IV only
  - D I, II, III and IV

**Question 20**

Which **ONE** of the following statements regarding private equity ("PE") is **INCORRECT**?

- A PE has been observed as having a higher risk than public equity.
- B Secondary market for PE is limited.
- C It is challenging to measure performance of PE due to lack of objective performance data.
- D Seed investors are one of the key investors in PE funds.

**Question 21**

Which **ONE** of the following statements regarding characteristics of commodities as alternative investments is **INCORRECT**?

- A They generally produce no income and thus only provide spot return.
- B Their holding cost is always expensive.
- C They tend to have high correlations with traditional asset classes.
- D Their values tend to be strongly correlated to inflation or economic shock.

**Question 22**

Which of the following statements regarding convertible bond are **CORRECT**?

- I Convertible bonds allow the bondholders to convert the bonds into new ordinary shares of the bond issuer based on a specified conversion price.
  - II Converting convertible bonds into shares may have a dilution effect on current shareholders.
  - III Convertible bonds are issued as subordinated bonds by bond issuers.
  - IV Convertible bonds can be broken down into a straight bond component and a stock call option component.
- 
- A I and II only
  - B III and IV only
  - C I, II and IV only
  - D I, II, III and IV

**Question 23**

You have the following information for a fund:

Initial charge: 3.5%

Total expense ratio: 2.1%

Expected gross return per annum: 5.0%

From an investor's point of view, what is the time required for this investment to reach the theoretical break-even point (i.e. net of all fees)?

- A It is not expected that the investment will break even ever.
- B The investment is expected to break even within one year.
- C The investment is expected to break even after one year.
- D It is not possible to make a statement without knowing more about the transaction costs.

**Question 24**

Which of the following components should be shown on a factsheet of a fund?

- I Investment strategy
- II Fee structure
- III Historical performance
- IV Risk measures

- A I and III only
- B II and IV only
- C I, II and IV only
- D I, II, III and IV

**Question 25**

Which **ONE** of the following statements regarding exchange-traded funds (“ETFs”) is **CORRECT**?

- A ETFs are type of closed-ended funds.
- B Regulations generally require that an ETF must keep its tracking error at 2% or below of the fund’s underlying assets.
- C ETFs are mostly traded at a discount from their net asset value.
- D ETFs can be created by physically purchasing the underlying assets or synthetically using the derivatives of the underlying assets.

**Question 26**

Which of the following discussion areas are appropriate for private wealth managers in the selling process of risky investment products, such as accumulators?

- I Maximum exposure versus customer's net worth assessment.
  - II Product explanation and product risk disclosure.
  - III Margin requirement and how it is calculated.
  - IV Margin call and close out procedures.
- 
- A I and II only
  - B III and IV only
  - C I, II and III only
  - D I, II, III and IV

**Question 27**

Which **ONE** of the following is **NOT INCLUDED** in the principle of the 5Cs in making lending decisions?

- A Character
- B Capital
- C Complexity
- D Collateral

**Question 28**

Which **ONE** of the following statements regarding lending value ("LV") in lending and leveraging is **CORRECT**?

- A LV is also known as loan-to-value ratio.
- B LV is always equal to market value of assets pledged.
- C LV will decrease when market value increases.
- D LV will be lower if the collateral is highly concentrated.

**Question 29**

Mr Wong is holding Stock C (current market price \$3.60) in his portfolio and anticipates that the price of Stock C will remain stable in the coming 3 months. Which of the following option strategies relating to Stock C will be suitable for Mr Wong to profit on this expected scenario?

- A Buy a call option with a strike price of \$7.00.
- B Write a call with a strike price of \$3.60 and write a put with a strike price of \$3.60.
- C Write a call with a strike price of \$7.60 and buy a put with a strike price of \$3.60.
- D Buy a call with a strike price of \$1.80 and buy a put with a strike price of \$5.00.

**Question 30**

The following is some information about 4 stocks being traded on the Hong Kong stock market.

| Stock | Portfolio Weight | Current Market Price | Historical Volatility <sup>^</sup> | Implied Volatility <sup>#</sup> |
|-------|------------------|----------------------|------------------------------------|---------------------------------|
| A     | 25%              | 15.00                | 30%                                | 20%                             |
| B     | 25%              | 80.20                | 25%                                | 25%                             |
| C     | 25%              | 3.60                 | 12%                                | 15%                             |
| D     | 25%              | 8.00                 | 15%                                | 20%                             |

<sup>^</sup> based on 90-day annualised volatility

<sup>#</sup> based on average implied volatility of at-the-money calls and puts

Mr Wong is managing a portfolio of these 4 stocks and anticipates that Stocks A, B and D will rise quickly in the coming 3 months. He expects to do some leveraging and buy more stocks. Which of the following statements regarding leveraging are **CORRECT**?

- I Leveraging will increase expected volatility of Mr Wong's equity portfolio.
  - II Leveraging tends to assure a better alpha in investment performance.
  - III Leveraging will increase the risk and the expected return of Mr Wong's portfolio.
  - IV Leveraging can be done by borrowing money to buy more stocks or by buying equity futures contracts of the 3 stocks.
- A II and IV only
  - B I, II and III only
  - C I, III and IV only
  - D II, III and IV only

**Question 31**

Which **ONE** of the following statements regarding portfolio rebalancing is **INCORRECT**?

- A Rebalancing manages the unsystematic risk exposure of the portfolio and brings it back to the desired level.
- B Rebalancing mechanism should be documented in the investment policy statement.
- C Rebalancing mechanism should be integrated with the risk management process.
- D Rebalancing prevents actual asset class weights from drifting away from permitted weighting.

**Question 32**

Which **ONE** of the following statements regarding systematic risk and/or unsystematic risk is **CORRECT**?

- A Systematic risk decreases as more individual assets of different categories are combined.
- B Unsystematic risk decreases as more individual assets of different categories are combined.
- C Unsystematic risk is also known as market risk.
- D Systematic risk is specific to a particular asset, company or industry.

**Question 33**

A portfolio has lagged behind its benchmark performance by about 2%. An analysis has shown that the underperformance was due to overweighting in the agriculture sector. Which step of the portfolio management process should this analysis belong to?

- A Performance attribution
- B Portfolio adjustment
- C Immunisation
- D Portfolio selection

**Question 34**

Which of the following items could be specified in an investment policy statement?

- I Customer's investment objectives and constraints
  - II Investment strategy
  - III Metrics for risk measurement and evaluation
  - IV Strategic asset allocation and rebalance mechanism
- 
- A I and II only
  - B II and III only
  - C I, III and IV only
  - D I, II, III and IV

**Question 35**

Which **ONE** of the following risks is classified as systematic risk?

- A Risk of poor corporate performance.
- B Risk raised by changes of tax regime.
- C Exposure of the company due to its exporting activities.
- D Risk raised by failure of internal control.

**Question 36**

Most private wealth management institutions will undertake credit risk assessment for each customer, which **ONE** of the following components is **NOT** included in expected loss?

- A Margin call ratio
- B Probability of default
- C Loss given default percentage
- D Exposure at default



**Question 37**

In monitoring a customer's collateral position, it is noted that the loan-to-value ratio has just exceeded the margin call ratio, what action in general the customer has to take in this status?

- A No action is required.
- B The customer will be required to take urgent action within a week to re-establish OK-status.
- C The customer will be required to take immediate remedial action within one or two days to re-establish OK-status, otherwise the collateral may be sold.
- D The customer will be required to take remedial action within a month to re-establish OK-status.

**Question 38**

What is the maximum amount that may be borrowed under a Lombard facility in absolute value terms?

- A Market value
- B Lending value
- C Advance ratio
- D Margin call ratio

**Question 39**

The following are the key credit documents, **EXCEPT**:

- A Deed of charge
- B Personal guarantee
- C Personal net worth statement
- D Audited report

**Question 40**

Which **ONE** of the following measures is the key performance measurement for passively managed portfolio?

- A Tracking error
- B Jensen's measure
- C Appraisal ratio
- D Sharpe ratio

**Question 41**

Which of the following statements regarding normal distribution are **CORRECT**?

- I It is a bell-shaped distribution.
  - II The total area above the mean is 0.5.
  - III The mid-point of the distribution is the arithmetic mean.
  - IV 68% of all possible values lie within 1 variance of the mean.
- 
- A I and III only
  - B II and IV only
  - C I, II and III only
  - D I, II, III and IV

**Question 42**

In relation to the efficient market hypothesis, if securities prices reflect all historical market information and all publicly available information, then the market will be identified as:

- A weak form efficient.
- B semi-strong form efficient.
- C strong form efficient.
- D inefficient.

**Question 43**

Which **ONE** of the following statements regarding strategic asset allocation (“SAA”) is **INCORRECT**?

- A SAA is the long-term asset mix that considered appropriate to meet a customer’s return objectives whilst remaining within his risk tolerance.
- B Portfolio rebalancing is aimed to in line with the SAA.
- C SAA involves the anticipation of the economic cycle leading to the idea of rotation by asset class.
- D Available investment universe is a prerequisite to determine the SAA of the initial portfolio.

**Question 44**

An active manager holds the view that the global economy will grow and inflation will increase. He then reduces the weight of bonds and allocates the asset to equities in the short term. He is said to use the strategy of:

- A sector rotation.
- B strategic asset allocation.
- C tactical asset allocation.
- D portfolio tilting.

**Question 45**

Under the portfolio theory, the diversification effect will be the greatest when the average correlation of the returns among the individual assets in a portfolio is:

- A -1
- B 0
- C 1
- D 1.5

## Answers

| Question No. | Answers |
|--------------|---------|
| 1            | C       |
| 2            | D       |
| 3            | C       |
| 4            | C       |
| 5            | B       |
| 6            | C       |
| 7            | D       |
| 8            | A       |
| 9            | C       |
| 10           | B       |
| 11           | C       |
| 12           | A       |
| 13           | C       |
| 14           | B       |
| 15           | C       |
| 16           | C       |
| 17           | D       |
| 18           | C       |
| 19           | D       |
| 20           | D       |
| 21           | C       |
| 22           | C       |
| 23           | C       |
| 24           | D       |
| 25           | D       |
| 26           | D       |
| 27           | C       |
| 28           | D       |
| 29           | B       |
| 30           | C       |
| 31           | A       |
| 32           | B       |
| 33           | A       |
| 34           | D       |
| 35           | B       |
| 36           | A       |
| 37           | B       |
| 38           | B       |
| 39           | D       |
| 40           | A       |
| 41           | C       |
| 42           | B       |
| 43           | C       |
| 44           | C       |
| 45           | A       |