



INSTITUTE OF ACTUARIAL
& QUANTITATIVE STUDIES

Subject: Introduction to Derivatives &
Financial Market

Chapter: Alternative Investment 1 & 2
(Unit 4)

Category: Practice Question

1. Which of the following is *least likely* to be considered an alternative investment?
 - A. Real estate
 - B. Commodities
 - C. Long-only equity funds
2. Private equity funds are *most likely* to use:
 - A. merger arbitrage strategies.
 - B. leveraged buyouts.
 - C. market-neutral strategies.
3. An investor is seeking an investment that can take long and short positions, may use multi-strategies, and historically exhibits low correlation with a traditional investment portfolio. The investor's goals will be *best* satisfied with an investment in:
 - A. real estate.
 - B. a hedge fund.
 - C. a private equity fund.
4. Relative to traditional investments, alternative investments are *least likely* to be characterized by:
 - A. high levels of transparency.
 - B. limited historical return data.
 - C. significant restrictions on redemptions.
5. Alternative investment funds are typically managed:
 - A. actively.
 - B. to generate positive beta return.
 - C. assuming that markets are efficient.
6. Compared with traditional investments, alternative investments are *more likely* to have:
 - A. greater use of leverage.
 - B. long-only positions in liquid assets.
 - C. more transparent and reliable risk and return data.

7. An investor is most likely to consider adding alternative investments to a traditional investment portfolio because:
- A. of their historically higher returns.
 - B. of their historically lower standard deviation of returns.
 - C. their inclusion is expected to reduce the portfolio's Sharpe ratio.
8. The potential benefits of allocating a portion of a portfolio to alternative investments include:
- A. ease of manager selection.
 - B. improvement in portfolio risk–return.
 - C. accessible and reliable measures of risk and return.
9. An investor may prefer a single hedge fund to a fund of funds if he seeks:
- A. due diligence expertise.
 - B. better redemption terms.
 - C. a less complex fee structure.
10. Hedge funds are similar to private equity funds in that both:
- A. are typically structured as partnerships.
 - B. assess management fees based on assets under management.
 - C. do not earn an incentive fee until the initial investment is repaid.
11. An investor seeks a current income stream as a component of total return, and desires an investment that historically has low correlation with other asset classes. The investment *most likely* to achieve the investor's goals is:
- A. timberland.
 - B. collectibles.
 - C. commodities.

12. Both event-driven and macro hedge fund strategies use:
- A. long-short positions.
 - B. a top-down approach.
 - C. long-term market cycles.
13. Hedge fund losses are *most likely* to be magnified by a:
- A. margin call.
 - B. lockup period.
 - C. redemption notice period.
14. The first stage of financing at which a venture capital fund *most likely* invests is the:
- A. seed stage.
 - B. mezzanine stage.
 - C. angel investing stage.
15. What is the most significant drawback of a repeat sales index to measure returns to real estate?
- A. Sample selection bias
 - B. Understatement of volatility
 - C. Reliance on subjective appraisals
16. Compared with direct investment in infrastructure, publicly traded infrastructure securities are characterized by:
- A. higher concentration risk.
 - B. more-transparent governance.
 - C. greater control over the infrastructure assets.
17. An equity hedge fund following a fundamental growth strategy uses fundamental analysis to identify companies that are *most likely* to:
- A. be undervalued.
 - B. be either undervalued or overvalued.
 - C. experience high growth and capital appreciation.

18. Which of the following is most likely to be available when conducting hedge fund due diligence?
- A. The benchmark used by the fund
 - B. Information on systems risk management
 - C. Details of investment strategies and processes
19. A private equity fund desiring to realize an immediate and complete cash exit from a portfolio company is *most likely* to pursue a(n):
- A. IPO.
 - B. trade sale.
 - C. recapitalization.
20. As the loan-to-value ratio increases for a real estate investment, risk *most likely* increases for:
- A. debt investors only.
 - B. equity investors only.
 - C. both debt and equity investors.
21. Which of the following forms of infrastructure investments is the most liquid?
- A. An unlisted infrastructure mutual fund
 - B. A direct investment in a greenfield project
 - C. An exchange-traded master limited partnership (MLP)
22. An investor chooses to invest in a brownfield rather than a greenfield infrastructure project. The investor is *most likely* motivated by:
- A. growth opportunities.
 - B. predictable cash flows.
 - C. higher expected returns.
23. The privatization of an existing hospital is best described as:
- A. a greenfield investment.
 - B. a brownfield investment.
 - C. an economic infrastructure investment.

24. A hedge fund invests primarily in distressed debt. Quoted market prices are available for the underlying holdings but they trade infrequently. Which of the following will the hedge fund *most likely* use in calculating net asset value for trading purposes?
- A. Average quotes
 - B. Average quotes adjusted for liquidity
 - C. Bid prices for short positions and ask prices for long positions
25. Angel investing capital is typically provided in which stage of financing?
- A. Later-stage.
 - B. Formative-stage.
 - C. Mezzanine-stage.
26. If a commodity's forward curve is in contango, the component of a commodities futures return *most likely* to reflect this is:
- A. spot prices.
 - B. the roll yield.
 - C. the collateral yield.
27. United Capital is a hedge fund with \$250 million of initial capital. United charges a 2% management fee based on assets under management at year end, and a 20% incentive fee based on returns in excess of an 8% hurdle rate. In its first year, United appreciates 16%. Assume management fees are calculated using end-of-period valuation. The investor's net return assuming the performance fee is calculated net of the management fee is *closest* to:
- A. 11.58%.
 - B. 12.54%.
 - C. 12.80%.

28. Capricorn Fund of Funds invests GBP 100 million in each of Alpha Hedge Fund and ABC Hedge Fund. Capricorn FOF has a “1 and 10” fee structure. Management fees and incentive fees are calculated independently at the end of each year. After one year, net of their respective management and incentive fees, the investment in Alpha is valued at GBP80 million and the investment in ABC is valued at GBP140 million. The annual return to an investor in Capricorn, net of fees assessed at the fund of funds level, is *closest* to:
- A. 7.9%.
 - B. 8.0%.
 - C. 8.1%.

29. The following information applies to Rotunda Advisors, a hedge fund:

- \$288 million in assets under management (AUM) as of prior year-end
- 2% management fee (based on year-end AUM)
- 20% incentive fee calculated:
 - net of management fee
 - using a 5% soft hurdle rate
 - using a high-water mark (high-water mark is \$357 million)
- Current year fund return is 25%

The total fee earned by Rotunda in the current year is *closest* to:

- A. \$7.20 million.
- B. \$20.16 million.
- C. \$21.60 million.

30. A hedge fund has the following fee structure:

Annual management fee based on year-end AUM	2%
Incentive fee	20%
Hurdle rate before incentive fee collection starts	4%
Current high-water mark	\$610 million

The fund has a value of \$583.1 million at the beginning of the year. After one year, it has a value of \$642 million before fees. The net return to an investor for this year is *closest* to:

- A. 6.72%.
- B. 6.80%.
- C. 7.64%.

31. Ash Lawn Partners, a fund of hedge funds, has the following fee structure:

- 2/20 underlying fund fees with incentive fees calculated independently
- Ash Lawn fees are calculated net of all underlying fund fees
- 1% management fee (based on year-end market value)
- 10% incentive fee calculated net of management fee
- The fund and all underlying funds have no hurdle rate or high-water mark fee conditions:

In the latest year, Ash Lawn's fund value increased from \$100 million to \$133 million before deduction of management and incentive fees of the fund or underlying funds. Based on the information provided, the total fee earned by *all* funds in the aggregate is *closest* to:

- A. \$11.85 million.
- B. \$12.75 million.
- C. \$12.87 million.

32. Risks in infrastructure investing are *most likely* greatest when the project involves:

- A. construction of infrastructure assets.
- B. investment in existing infrastructure assets.
- C. investing in assets that will be leased back to a government.

33. An investor in a private equity fund is concerned that the general partner can receive incentive fees in excess of the agreed-on incentive fees by making distributions over time based on profits earned rather than making distributions only at exit from investments of the fund. Which of the following is most likely to protect the investor from the general partner receiving excess fees?
- A. A high hurdle rate
 - B. A clawback provision
 - C. A lower capital commitment
34. Until the committed capital is fully drawn down and invested, the management fee for a private equity fund is based on:
- A. invested capital.
 - B. committed capital.
 - C. assets under management.
35. A private equity fund is estimating the value of a privately held company that is financed with both debt and equity, is generating positive revenues, and has negative EBITDA. The private equity fund is *most likely* able to estimate the company's equity value using:
- A. net income multiples.
 - B. market value of its assets.
 - C. expected free cash flow to equity and cost of equity.
36. An analyst wanting to assess the downside risk of an alternative investment is *least likely* to use the investment's:
- A. Sortino ratio.
 - B. value at risk (VaR).
 - C. standard deviation of returns.
37. An effective risk management process used by alternative investment funds *most likely* includes:
- A. in-house valuations.
 - B. internal custody of assets.
 - C. segregation of risk and investment process duties.