Canadian Securities Course (CSC) Level 2 Practice Exam (Sample)

Study Guide

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Questions

1. Which statement accurately describes mutual funds in the text provided?

A. Offer tax advantages over mutual funds of ETFs

B. Trade at different NAVPS

C. Have higher embedded fees compared to ETFs

D. Trade on the primary market only

2. What strategy involves exploiting inefficiencies or arbitrage in hedge funds?

A. Event driven - unique events such as merger.

B. Relative value - buy in one market sell in another.

C. Directional - movement of market.

D. Hedge funds specialize in long-term growth strategies.

3. Which statement accurately describes mutual fund structures involving a corporation?

A. Trust - open end, given in units

B. Corporation - given shares usually in government

C. Trust deed - establish objectives, policies, and restrictions

D. Corporation - holdings may diversify portfolio, earnings interest, dividends, or capital gains

4. What is the main concern related to concentration risk in ETFs?

A. Low liquidity

B. High diversification

C. Low correlation

D. Small number of holdings making up a disproportionate amount of the overall ETF value

5. What are the categories of risks related to investing in ETFs?

A. ETF specific risk and liquidity risk

B. General investing risk and market risk

C. Market risk and ETF derivative specific risk

D. ETF specific risk and ETF derivative specific risk

6. What are some risks associated with Mortgage Backed Securities?

A. Interest rate risk

B. Credit risk

C. Inflation Risk

D. Market risk

7. What effect does rolling over contracts have on Futures-based Commodity exchange traded funds?

A. Results in a roll yield gain

B. Causes a decrease in management expenses

C. Results in a roll yield loss

D. Increases leverage ratio

8. When is it advised to use a limit order for protection in ETF trading?

A. During the first and last 15 minutes of trading

B. When the underlying asset is halted

C. For large trades executed all at once

D. When the market is closed

9. What is a disadvantage of Fee-Based Accounts?

A. Limited number of trades

B. Lower costs for clients

C. Greater transparency

D. No potential for neglect

10. What characterizes small to mid-cap equity funds in terms of their volatility, dividend issuance, and market ranking?

A. High risk, high dividends, top 100 companies

B. Low risk, high dividends, smaller companies

C. High risk, no dividends, top 100 companies

D. High risk, no dividends, smaller companies

Answers

1. C
2. B
3. D
4. D
5. D
6. A
7. C
8. C
9. A
10. D

Explanations

1. Which statement accurately describes mutual funds in the text provided?

A. Offer tax advantages over mutual funds of ETFs

B. Trade at different NAVPS

C. Have higher embedded fees compared to ETFs

D. Trade on the primary market only

The statement that accurately describes mutual funds is that they have higher embedded fees compared to ETFs. Mutual funds typically charge higher management fees than exchange-traded funds (ETFs), due to the active management style of many mutual funds, as well as additional costs associated with marketing and servicing. These fees can impact overall returns for investors over time. In contrast, the other statements do not hold true. For example, mutual funds and ETFs may offer varying tax implications depending on the specific fund structure and individual investment situations, but it is not accurate to categorically state that mutual funds offer tax advantages over ETFs. Furthermore, while mutual funds are priced at their net asset value per share (NAVPS) at the end of the trading day, ETFs trade throughout the day at market prices that can differ from their NAVPS due to supply and demand dynamics. Lastly, while mutual funds are primarily bought and sold through the fund company or intermediaries, therefore only trading on the primary market, ETFs are traded on the secondary market through various stock exchanges, offering more liquidity and real-time pricing.

2. What strategy involves exploiting inefficiencies or arbitrage in hedge funds?

A. Event driven - unique events such as merger.

B. Relative value - buy in one market sell in another.

C. Directional - movement of market.

D. Hedge funds specialize in long-term growth strategies.

The correct answer is B. Relative value strategy involves buying securities that are perceived to be undervalued and selling securities that are perceived to be overvalued, with the intention of profiting from the price movements of these securities in relation to each other. This strategy exploits pricing inefficiencies in the market and is commonly used in hedge funds to generate returns. Option A, event-driven strategy, involves capitalizing on unique events such as mergers, acquisitions, or other corporate events. Option C, directional strategy, focuses on predicting the general movement of the market or specific securities. Option D, the statement about hedge funds specializing in long-term growth strategies is not accurate as hedge funds use a variety of strategies, including both short-term and long-term approaches.

3. Which statement accurately describes mutual fund structures involving a corporation?

- A. Trust - open end, given in units
- B. Corporation - given shares usually in government
- C. Trust deed - establish objectives, policies, and restrictions
- D. Corporation - holdings may diversify portfolio, earnings interest, dividends, or capital gains

The correct statement is that in a mutual fund structure involving a corporation, holdings may diversify the portfolio and the earnings can come in different forms such as interest, dividends, or capital gains. This reflects the nature of corporate mutual funds, which are established as separate legal entities. They can invest in a wide array of assets, such as stocks and bonds, to achieve diversification. Earnings generated from these investments can manifest as interest income, dividend payouts from equities, or capital gains realized when investments are sold for profit. This highlights the flexibility and benefits of a corporate structure in managing investments, which can lead to potentially higher returns for shareholders. Regarding other statements, while trusts do operate under specific guidelines and may deal in units, they do not accurately describe a corporate structure. Similarly, although a trust deed outlines the objectives and policies of a trust fund, it does not pertain to mutual funds organized as corporations. The reference to shares being given usually in government doesn't correctly characterize the nature of corporate mutual funds, which typically involve shares of the corporation itself, not specifically government-related assets.

4. What is the main concern related to concentration risk in ETFs?

- A. Low liquidity
- B. High diversification
- C. Low correlation
- D. Small number of holdings making up a disproportionate amount of the overall ETF value

The main concern related to concentration risk in ETFs arises from a small number of holdings that may make up a disproportionate amount of the overall fund's value. This means that if a few assets are heavily weighted in the ETF, their performance can significantly impact the overall performance of the fund. In essence, if those concentrated holdings perform poorly, the entire ETF could suffer substantial losses, leading to a higher level of risk for investors. Concentration risk contrasts with a well-diversified portfolio, where the impact of any single holding is minimized. Therefore, an ETF that has significant weight in just a few securities is considered to carry greater concentration risk, as it may not provide the level of diversification that many investors seek when using ETFs as part of their investment strategy. Other options, such as low liquidity, high diversification, and low correlation, might highlight different aspects of risk or characteristics of an ETF, but they do not specifically address the primary issue of concentration risk, which is fundamentally about the uneven distribution of value across the ETF's holdings.

5. What are the categories of risks related to investing in ETFs?

A. ETF specific risk and liquidity risk

B. General investing risk and market risk

C. Market risk and ETF derivative specific risk

D. ETF specific risk and ETF derivative specific risk

The correct answer highlights two significant types of risks associated with investing in exchange-traded funds (ETFs). ETF specific risk refers to factors that can affect an individual ETF, such as the performance of the underlying assets, the fund's management, and the specific sector or market in which the ETF operates. This type of risk is unique to each ETF, meaning that while one ETF may perform well, another may not due to its specific holdings or strategy. The second part, ETF derivative specific risk, pertains to risks associated with the use of derivatives within certain ETFs. Some ETFs may use options or futures to enhance returns or to hedge risks; however, these instruments can introduce additional complexity and risks, such as leverage risk and the potential for significant losses if the derivatives do not perform as expected. This combination of ETF specific risks and derivative risks provides a comprehensive view of the unique challenges that investors face when dealing with ETFs. Understanding these risks is crucial for making informed investment decisions.

6. What are some risks associated with Mortgage Backed Securities?

A. Interest rate risk

B. Credit risk

C. Inflation Risk

D. Market risk

Mortgage Backed Securities (MBS) indeed carry various risks, and interest rate risk is a significant concern. This risk arises from the possibility that changes in interest rates can affect the value of the MBS. When interest rates rise, the market value of existing MBS typically declines because newer issues may offer higher returns. Conversely, lower interest rates can increase the attractiveness of existing MBS, but they also encourage homeowners to refinance, which can lead to prepayment risk. This introduces uncertainty for investors regarding the duration of cash flows and can reduce overall returns. While credit risk, inflation risk, and market risk are relevant in other contexts, they are not as closely associated with MBS as interest rate risk. Credit risk pertains to the potential for homeowners to default on their loans, impacting the cash flow to MBS investors. Inflation risk relates to the risk that inflation may erode the purchasing power of the cash flows from the MBS. Market risk refers to the risk of losses due to changes in market prices or values. Each of these risks is important to consider, but interest rate risk is particularly integral to the valuation and performance of Mortgage Backed Securities.

7. What effect does rolling over contracts have on Futures-based Commodity exchange traded funds?

A. Results in a roll yield gain

B. Causes a decrease in management expenses

C. Results in a roll yield loss

D. Increases leverage ratio

Rolling over contracts in futures-based commodity exchange-traded funds (ETFs) typically leads to a roll yield loss. This occurs because rolling over contracts involves selling expiring futures contracts and buying new ones with later expiration dates. If the market is in contango, where futures prices are higher than the spot price, this rollover results in selling low and buying high, leading to a loss in the roll yield. This phenomenon can have a significant impact on overall returns for investors in these funds, particularly if the fund frequently rolls over contracts. By understanding this mechanism, investors can better assess the potential performance of futures-based commodity ETFs based on market conditions. In contrast, the other options discussed do not accurately reflect the typical outcomes associated with the rollover of futures contracts.

8. When is it advised to use a limit order for protection in ETF trading?

A. During the first and last 15 minutes of trading

B. When the underlying asset is halted

C. For large trades executed all at once

D. When the market is closed

Using a limit order for protection when trading ETFs is particularly advisable for large trades executed all at once. This strategy allows traders to set a specific price at which they are willing to buy or sell their ETF shares, thereby preventing unwanted fluctuations in price that can occur in volatile markets. When executing large trades, the risk of the market moving against you increases significantly. A limit order helps mitigate this risk by ensuring that the transaction only occurs at the predetermined price, which can help avoid a potential adverse market impact that might arise from executing a market order. In the context of the other options, while the first and last 15 minutes of trading can be volatile due to lower liquidity, and trading is not possible when the market is closed, those scenarios aren't directly related to the protection provided by limit orders for large trades. Additionally, a halt in trading indicates that significant issues may be affecting the asset, making it less relevant to the use of limit orders for protection specifically aimed at large transactions.

9. What is a disadvantage of Fee-Based Accounts?

A. Limited number of trades

B. Lower costs for clients

C. Greater transparency

D. No potential for neglect

A disadvantage of fee-based accounts is that they may have a limited number of trades. In fee-based structures, clients generally pay a flat fee or a percentage of assets under management, which can lead to advisors being less incentivized to execute frequent trades. This can create a perception of limited flexibility in managing investments compared to commission-based accounts, where traders are often rewarded for the volume of trades they execute. Therefore, the structure of fee-based accounts can sometimes result in less active trading strategies, which may not align with a client's desire for frequent trading opportunities. In contrast, the other options highlight attributes that are typically seen as advantages rather than disadvantages. Lower costs for clients and greater transparency are generally perceived as benefits of fee-based accounts, as they provide clarity around fees and often result in a more straightforward cost structure. Furthermore, "no potential for neglect" implies a relationship between the advisor and the client that is more engaged and attentive, which is advantageous rather than a disadvantage.

10. What characterizes small to mid-cap equity funds in terms of their volatility, dividend issuance, and market ranking?

A. High risk, high dividends, top 100 companies

B. Low risk, high dividends, smaller companies

C. High risk, no dividends, top 100 companies

D. High risk, no dividends, smaller companies

Small to mid-cap equity funds are known for being higher risk investments compared to large-cap funds due to the smaller size and potentially less established nature of the companies they invest in. They typically do not issue dividends as frequently as larger, more established companies, as these smaller companies may prefer to reinvest any profits back into the business for growth rather than paying out dividends to shareholders. Additionally, these funds focus on investing in smaller companies outside the top 100, making option D the correct choice. Options A, B, and C can be ruled out as they do not accurately characterize small to mid-cap equity funds in terms of their volatility, dividend issuance, and market ranking.