

Chartered Alternative Investment Analyst Association (CAIA) Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- Practice answering questions under realistic conditions,
- Improve accuracy and speed,
- Review explanations to strengthen weak areas, and
- Approach the exam with greater confidence.

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here's how to get the most out of your Examzify study guide:

1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Your goal is to identify knowledge gaps early.

2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 - 45 minutes). Review a handful of questions, reflect on the explanations.

3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

6. Repeat and Review

Don't just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning. Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There's no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly, adapt the tips above to fit your pace and learning style. You've got this!

Questions

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- 1. What factor primarily determines whether a commodity futures market is in contango or backwardation?**
 - A. Seasonal demand fluctuations**
 - B. The Slope of the term structure based on carrying costs**
 - C. Regulatory changes affecting commodity trading**
 - D. The number of participants in the futures market**
- 2. What is a common limitation of traditional valuation methods in private equity?**
 - A. They are quick and require minimal data**
 - B. They can overlook market anomalies**
 - C. They often overestimate company performance**
 - D. They simplify complex financial situations**
- 3. What is the primary purpose of an investment policy statement (IPS)?**
 - A. To outline the goals, investment strategies, and guidelines for an investment portfolio**
 - B. To track the performance of a fund**
 - C. To provide tax implications for investment gains**
 - D. To ensure compliance with legal regulations**
- 4. What does the capital gains tax specifically target?**
 - A. Fixed assets depreciation**
 - B. The total revenue generated from investments**
 - C. The profits from the sale of non-inventory assets**
 - D. Passive income from dividends**
- 5. How is "due diligence" most critical in private equity?**
 - A. To ensure that investments align with strategic goals and assess risks**
 - B. To speed up the investment process**
 - C. To increase tax efficiency of the investments**
 - D. To maximize public relations efforts**

6. What is meant by the term investment horizon?

- A. The duration an investor holds an investment before cashing out**
- B. The time frame for maximizing returns on investments**
- C. The period for which an investment is expected to perform**
- D. The total time from investment to exit strategy**

7. Which is NOT a major advantage of REIT ownership?

- A. Tax exemption at corporate level**
- B. Management services for property selection and operation**
- C. Access to high-risk investments**
- D. Liquid access to illiquid assets**

8. How is a Timberland Investment Management Organization (TIMO) typically financed?

- A. Through public funding sources**
- B. With personal investments from the management team**
- C. By institutional investors like pension plans and foundations**
- D. Through government grants**

9. Which of the following is NOT considered a major type of alternative investment?

- A. Real Assets**
- B. Hedge Funds**
- C. Structured Products**
- D. Mutual Funds**

10. An investment advisor accepts additional compensation from a client. Which measure should be prioritized according to CFA standards?

- A. Client satisfaction should be maximized at all times.**
- B. Disclosure of the compensation arrangement to all relevant parties.**
- C. Consistent performance over a long-term should be maintained.**
- D. Advisors should seek written consent from all clients.**

Answers

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

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Explanations

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1. What factor primarily determines whether a commodity futures market is in contango or backwardation?

- A. Seasonal demand fluctuations
- B. The Slope of the term structure based on carrying costs**
- C. Regulatory changes affecting commodity trading
- D. The number of participants in the futures market

The primary determinant of whether a commodity futures market is in contango or backwardation is the slope of the term structure based on carrying costs. This concept arises from the economics of storage, transportation, and interest associated with holding physical commodities. In contango, futures prices are higher than the spot price, reflecting the carrying costs of holding the commodity until the contract expiry. These costs include storage fees, insurance, and the opportunity cost of capital. As these costs increase or are anticipated to increase, the term structure slopes upward, indicating that future prices incorporate these expenses. Conversely, in backwardation, the futures prices are lower than the spot price. This often occurs when there is a high demand for the commodity in the short term or when there are anticipated shortages. The market reflects an immediate scarcity or increased urgency for the commodity, leading to futures prices that don't adequately cover the carrying costs. Whereas seasonal demand fluctuations might impact prices and can influence market behavior, they do not fundamentally govern the structure of contango and backwardation. Similarly, regulatory changes and the number of market participants can affect liquidity and speculative pressures but are secondary to the fundamental economic factors regarding carrying costs in determining the slope of the term structure.

2. What is a common limitation of traditional valuation methods in private equity?

- A. They are quick and require minimal data
- B. They can overlook market anomalies**
- C. They often overestimate company performance
- D. They simplify complex financial situations

The correct answer highlights a significant limitation of traditional valuation methods in private equity, which is that they can overlook market anomalies. Traditional valuation techniques, such as discounted cash flow (DCF) analysis or comparable company analysis, often rely on historical data and assumptions about the future performance of companies. These methods may not effectively capture the unique characteristics and fluctuations present in private markets, where data can be less transparent and where market conditions can change rapidly due to various external factors, creating anomalies. For instance, traditional methods generally assume a level of market efficiency that may not hold true in private equity, where less frequent trading and limited information can lead to discrepancies between actual market conditions and the valuations produced by standard models. This limitation means that investors relying exclusively on traditional valuation metrics might misprice investments or fail to adjust for unexpected changes in the market environment. In contrast, while the other choices touch upon aspects of valuation methods, they do not capture the core limitation as effectively. The speed and simplicity of traditional methods (the first and fourth options) may present practical advantages but can also lead to oversights in complex financial situations. The belief that these methods often overestimate company performance (the third option) is also not a universally applicable limitation, as estimation bias can just as easily go

3. What is the primary purpose of an investment policy statement (IPS)?

- A. To outline the goals, investment strategies, and guidelines for an investment portfolio**
- B. To track the performance of a fund**
- C. To provide tax implications for investment gains**
- D. To ensure compliance with legal regulations**

The primary purpose of an investment policy statement (IPS) is to outline the goals, investment strategies, and guidelines for an investment portfolio. An IPS serves as a foundational document that provides clarity and structure to the investment process. It establishes the investor's objectives, risk tolerance, and investment preferences, creating a framework within which the investment manager can operate. This comprehensive approach ensures that all investment decisions align with the specified goals and constraints, facilitating better communication between the investor and the investment manager. Additionally, the IPS often addresses the time horizon for investments, asset allocation strategies, and specific investment vehicles that are considered acceptable. By having this clear set of guidelines, both the investor and the investment manager can work towards achieving the desired financial outcomes while adhering to the agreed-upon strategies. Considering the other choices, tracking the performance of a fund focuses on evaluating results rather than setting foundational guidelines, while providing tax implications deals with a specific aspect of investment outcomes rather than investment strategy. Ensuring compliance with legal regulations is important, but it is generally a requirement that falls under broader operational policies rather than the primary objective of the IPS itself.

4. What does the capital gains tax specifically target?

- A. Fixed assets depreciation**
- B. The total revenue generated from investments**
- C. The profits from the sale of non-inventory assets**
- D. Passive income from dividends**

The capital gains tax specifically targets the profits made from the sale of non-inventory assets. This tax is imposed on the appreciation in value of investments or properties when they are sold for more than their purchase price. Essentially, it applies to the gain realized on investments such as stocks, real estate, or other capital assets that are not held as inventory in a business. The inherent premise of a capital gains tax is that any profit made from these transactions reflects an increase in wealth, which the government captures via taxation upon realization of that gain through the sale. This taxation structure encourages investors to think strategically about the timing of their asset sales and the potential tax implications of realizing gains. In contrast, depreciation targets the decline in value of fixed assets, total revenue encompasses a broader spectrum of income, and passive income from dividends constitutes a different category of investment income not measured by capital gains taxation.

5. How is "due diligence" most critical in private equity?

- A. To ensure that investments align with strategic goals and assess risks**
- B. To speed up the investment process**
- C. To increase tax efficiency of the investments**
- D. To maximize public relations efforts**

Due diligence is most critical in private equity as it involves a comprehensive appraisal of a potential investment to ensure that it aligns with the fund's strategic objectives while thoroughly assessing associated risks. This process helps investors understand the business's financial health, market position, potential for growth, management capability, and any potential liabilities. By meticulously analyzing these factors, private equity firms can make informed decisions that mitigate risks and enhance the likelihood of successful investments. Through diligent investigation, firms can identify potential red flags and determine whether the investment aligns with their risk tolerance and investment strategy. This thorough approach is crucial given the long-term nature of private equity investments, as poor investment decisions can lead to significant financial losses and missed opportunities. Other options, while they may hold some relevance in different contexts, do not encapsulate the core purpose of due diligence in private equity as effectively as the selected answer does. Speeding up the investment process, increasing tax efficiency, or maximizing public relations efforts may be beneficial in certain scenarios, but they do not address the fundamental goal of understanding and managing risks associated with an investment.

6. What is meant by the term investment horizon?

- A. The duration an investor holds an investment before cashing out**
- B. The time frame for maximizing returns on investments**
- C. The period for which an investment is expected to perform**
- D. The total time from investment to exit strategy**

The investment horizon refers to the duration an investor holds an investment before cashing out. This concept is crucial for investors as it influences their investment strategy, asset allocation, and risk tolerance. Different investments may be better suited for varying horizons; for example, stocks might be more appropriate for a long-term horizon due to their potential for growth and volatility, while fixed-income securities might be used for shorter horizons as they typically provide stability and predictable returns. Understanding the investment horizon aids in making informed decisions about when to enter and exit an investment, ensuring that it aligns with the investor's financial goals and liquidity needs. It is an essential aspect of investment planning and portfolio management. The other options, while related to investment timelines, do not capture the essence of the investment horizon as directly. The second option talks about maximizing returns, which is related but broader and not solely tied to the holding period. The third option discusses expected performance, which can vary independently of the holding duration. The fourth option mentions the total time from investment to exit strategy, which again encompasses more than just the holding duration, potentially including planning and execution phases.

7. Which is NOT a major advantage of REIT ownership?

- A. Tax exemption at corporate level**
- B. Management services for property selection and operation**
- C. Access to high-risk investments**
- D. Liquid access to illiquid assets**

The question seeks to identify which statement does not represent a major advantage of Real Estate Investment Trusts (REITs). The focus here is on understanding the characteristics of REITs and what typically defines their benefits to investors. REITs are designed to provide investors with a means of participating in real estate markets without directly owning property. One of the key advantages of REITs is the tax exemption they receive at the corporate level, provided they adhere to specific regulatory requirements. This allows them to avoid double taxation, which can enhance the returns distributed to shareholders. Another prominent advantage is that REITs offer professional management services that handle property selection and operation. This alleviates the burden on individual investors to manage their investments actively, making real estate ownership more accessible. REITs also provide liquid access to assets that are ordinarily illiquid, such as physical real estate properties. Investors can buy and sell shares of publicly-traded REITs on stock exchanges, enabling them to exit their positions more easily compared to traditional property investments. In contrast, access to high-risk investments is not a major advantage of REIT ownership. While some REITs may invest in riskier assets or markets, the general appeal of REITs lies in their ability to

8. How is a Timberland Investment Management Organization (TIMO) typically financed?

- A. Through public funding sources**
- B. With personal investments from the management team**
- C. By institutional investors like pension plans and foundations**
- D. Through government grants**

A Timberland Investment Management Organization (TIMO) is typically financed by institutional investors like pension plans and foundations. These entities are drawn to TIMOs due to the long-term, stable cash flows and diversification that timberland investments offer. Institutional investors often have substantial capital at their disposal and seek to allocate funds into alternative investments to enhance their portfolios, manage risk, and achieve return objectives. By attracting institutional capital, TIMOs are able to acquire and manage large tracts of timberland, implement sustainable forestry practices, and ultimately generate returns for their investors. This relationship is strategic, as it allows TIMOs to leverage the expertise of institutional investors while providing them with access to a specialized asset class that may not be readily available to individual investors. In contrast, financing through public funding sources, personal investments from management, or government grants is less common in the context of TIMOs, as these avenues do not align with the typical funding model that focuses on institutional investment strategies.

9. Which of the following is NOT considered a major type of alternative investment?

- A. Real Assets**
- B. Hedge Funds**
- C. Structured Products**
- D. Mutual Funds**

The correct answer is that mutual funds are not considered a major type of alternative investment. In the investment world, alternative investments typically refer to asset classes and strategies that fall outside of the traditional investments like stocks and bonds. Major types of alternative investments include real assets, such as real estate and commodities, hedge funds that employ various strategies for generating returns, and structured products, which are pre-packaged investments that derive their value from underlying assets. Mutual funds, on the other hand, primarily consist of investments in traditional securities—like stocks and bonds—pooled together from many investors. They are managed by professional portfolio managers and are designed to provide investors with a diversified exposure to the market. Therefore, while mutual funds are a popular investment vehicle, they do not fit within the category of alternative investments. This distinction helps investors understand the nature and characteristics of their portfolios, especially when considering risk and return profiles.

10. An investment advisor accepts additional compensation from a client. Which measure should be prioritized according to CFA standards?

- A. Client satisfaction should be maximized at all times.**
- B. Disclosure of the compensation arrangement to all relevant parties.**
- C. Consistent performance over a long-term should be maintained.**
- D. Advisors should seek written consent from all clients.**

The correct choice emphasizes the obligation of investment advisors to provide full and fair disclosure regarding any compensation arrangements. According to CFA standards, transparency is crucial in maintaining the integrity of the advisor-client relationship. By disclosing the additional compensation received, advisors help clients understand potential conflicts of interest that may arise from such arrangements. This transparency allows clients to make informed decisions based on a complete understanding of the advisor's incentives. Prioritizing disclosure aligns with the CFA's ethical guidelines, which stress the importance of honesty and transparency in all aspects of the advisory relationship. Failure to disclose could lead to a breach of trust and could mislead clients about the advisor's motivations, ultimately undermining the advisor's credibility and the effectiveness of the advisory relationship. While client satisfaction, consistent performance, and obtaining written consent are important aspects of investment advisory services, they do not take precedence over the need for robust disclosure. Ensuring that clients are aware of all compensation arrangements is essential to uphold ethical standards and maintain the quality of client relations.

Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

<https://caia.examzify.com>

We wish you the very best on your exam journey. You've got this!

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