

CHARTERED ALTERNATIVE INVESTMENT ANALYST (CAIA) LEVEL I PRACTICE TEST (SAMPLE)

STUDY GUIDE



SAMPLE STUDY GUIDE WITH LIMITED QUESTIONS

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Table of Contents

Copyright	1
Table of Contents	2
Introduction	3
How to Use This Guide	4
Questions	5
Answers	8
Explanations	10
Next Steps	16

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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 is the primary focus of Standard VI: Conflicts of Interest?**
 - A. Investment returns for the member
 - B. Managing conflicts that could impair independence and objectivity
 - C. Minimizing client interactions
 - D. Maximizing personal investments
- 2. What aspect does the structural review of due diligence examine?**
 - A. Fund's investment strategies
 - B. Operational issues affecting the manager
 - C. Fund organization and manager's operations
 - D. Investment objectives and benchmarks
- 3. What is one of the primary advantages of Real Estate Investment Trusts (REITs) regarding taxation?**
 - A. They are subject to corporate taxation
 - B. They avoid double taxation by passing income to shareholders
 - C. They pay less in taxes than regular companies
 - D. They are fully exempt from taxes
- 4. What is the first step in hypothesis testing?**
 - A. Design the test
 - B. State the null and alternative hypotheses
 - C. Take a sample
 - D. Calculate the test statistic
- 5. Which performance characteristic is associated with the returns of the Strategic FoF?**
 - A. High mean returns and high volatility
 - B. Modest mean returns with moderate downside risk
 - C. Negative correlation with US HY bonds
 - D. Little diversification benefits during market crises

- 6. What is required of Members and Candidates regarding diligence in investment analysis?**
- A. To analyze investments with minimal effort
 - B. To rely on intuition without thorough research
 - C. To exercise diligence, independence, and thoroughness
 - D. To prioritize speed over accuracy in investing
- 7. What does Value at Risk (VaR) measure?**
- A. The upper limit of portfolio returns
 - B. The probability of earning a specific return
 - C. The potential loss under normal conditions
 - D. The fixed cost of risk management
- 8. What does the Information Ratio measure?**
- A. Management fees of a portfolio versus its worth.
 - B. Expected outperformance of an investment versus its benchmark divided by tracking error.
 - C. Overall profit margins of an investment.
 - D. Net income generated against total investment risk.
- 9. What is correlation risk primarily associated with?**
- A. Inability to refinance a singular loan
 - B. Potential of multiple bank loan defaults occurring simultaneously
 - C. High interest rates on loans
 - D. Increased liquidity in financial markets
- 10. What is the role of investors in unfunded CDOs?**
- A. Investors purchase CDO securities at a price
 - B. Investors act as the credit protection seller
 - C. Investors assume all credit risks without benefits
 - D. Investors hold the underlying assets until maturity

Answers

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

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Explanations

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1. What is the primary focus of Standard VI: Conflicts of Interest?

- A. Investment returns for the member
- B. Managing conflicts that could impair independence and objectivity**
- C. Minimizing client interactions
- D. Maximizing personal investments

The primary focus of Standard VI: Conflicts of Interest is centered around managing conflicts that could impair a member's independence and objectivity. This standard emphasizes the importance of maintaining integrity in investment decision-making and ensuring that personal interests do not influence professional judgments. Members are required to be transparent about any potential conflicts and take appropriate measures to mitigate them. This reinforces the trust that clients place in investment professionals, ensuring that their recommendations and actions are aligned with clients' best interests rather than being influenced by personal gains. In this context, the other options do not align with the core principles set out in the standard. While investment returns are important, they cannot come at the cost of compromising the professional's independence. Minimizing client interactions is counterproductive to fostering a strong and transparent relationship. Maximizing personal investments is directly opposed to the ethical obligations outlined in this standard, as it could lead to conflicts that impair objectivity. Hence, the focus on managing conflicts is crucial for upholding ethical standards in the investment profession.

2. What aspect does the structural review of due diligence examine?

- A. Fund's investment strategies
- B. Operational issues affecting the manager
- C. Fund organization and manager's operations**
- D. Investment objectives and benchmarks

The structural review of due diligence primarily focuses on the fund organization and the manager's operations. This aspect is crucial because it assesses how well the fund is set up to achieve its investment objectives and how effectively the manager can operate within that structure. A thorough understanding of the organizational framework allows investors to evaluate the alignment of interests between the fund's management and its investors, as well as the institutional robustness of the fund. Evaluating the fund organization involves looking at the governance structure, policies, and procedures that guide the fund's operations. This includes examining who makes key decisions and how those decisions are made, which is vital for ensuring sound risk management and operational efficiency. Additionally, understanding the manager's operations—such as trade execution, compliance, and reporting systems—ensures that the fund is not only operationally capable but also adheres to regulatory and ethical standards. Thus, a comprehensive review in these areas helps investors mitigate risks and feel more confident in their investment decisions. Other aspects like the fund's investment strategies, operational issues affecting the manager, and investment objectives and benchmarks are essential as well, but they do not provide the same deep insight into the structural integrity of the fund and its management that the organization and operations review does.

3. What is one of the primary advantages of Real Estate Investment Trusts (REITs) regarding taxation?

- A. They are subject to corporate taxation
- B. They avoid double taxation by passing income to shareholders**
- C. They pay less in taxes than regular companies
- D. They are fully exempt from taxes

One of the primary advantages of Real Estate Investment Trusts (REITs) regarding taxation is that they avoid double taxation by passing income to shareholders. This mechanism allows REITs to distribute at least 90% of their taxable income to shareholders in the form of dividends. As a result, the REIT itself does not pay federal income tax on the income that is passed through to its investors. This structure is significant because it ensures that the income generated from real estate investments is only taxed at the shareholder level, preventing the same income from being taxed both at the corporate level and again when dividends are distributed to shareholders. This tax efficiency is one of the key attractions for investors looking for income-generating investments in real estate while maintaining favorable tax treatment. Other options like corporate taxation or being fully exempt from taxes do not accurately reflect the taxation framework for REITs, helping to clarify why the correct answer focuses on the avoidance of double taxation.

4. What is the first step in hypothesis testing?

- A. Design the test
- B. State the null and alternative hypotheses**
- C. Take a sample
- D. Calculate the test statistic

The initial step in hypothesis testing is to clearly state the null and alternative hypotheses. This fundamental process sets the framework for the entire testing procedure. The null hypothesis typically represents a statement of no effect or no difference, which researchers attempt to test against the alternative hypothesis, suggesting that there is a statistically significant effect or difference. By defining these hypotheses before any data collection or analysis occurs, researchers create a clear objective for what they are seeking to demonstrate or refute. This step is crucial because it guides the methodology of the experiment, including how data will be collected and analyzed, and establishes the criteria under which the hypotheses will be tested. The subsequent steps, such as designing the test, taking a sample, and calculating the test statistic, depend on the hypotheses that have been previously established. Thus, stating the null and alternative hypotheses is the foundational action in the hypothesis testing process.

5. Which performance characteristic is associated with the returns of the Strategic FoF?

- A. High mean returns and high volatility
- B. Modest mean returns with moderate downside risk**
- C. Negative correlation with US HY bonds
- D. Little diversification benefits during market crises

The choice of modest mean returns with moderate downside risk accurately reflects the typical performance characteristics of Strategic Funds of Funds (FoFs). These types of funds are designed with a strategic approach to allocate capital across various hedge funds and alternative investments, aiming to generate stable returns while managing volatility. Strategic FoFs often prioritize risk-adjusted performance and diversification over high absolute returns, which makes them more suited for investors seeking stability rather than aggressive growth. The focus on moderate downside risk indicates that these funds manage their exposure to volatile assets, thereby providing a cushion against adverse market movements. This characteristic aligns with their goal of achieving steady, reliable performance over time rather than chasing peak returns accompanied by high fluctuations. In contrast, the other options imply higher levels of volatility or risk, which are not the primary aim of Strategic FoFs, as they strategically mitigate risks to safeguard investors' capital.

6. What is required of Members and Candidates regarding diligence in investment analysis?

- A. To analyze investments with minimal effort
- B. To rely on intuition without thorough research
- C. To exercise diligence, independence, and thoroughness**
- D. To prioritize speed over accuracy in investing

Members and Candidates are expected to exercise diligence, independence, and thoroughness when conducting investment analysis. This standard emphasizes the importance of a rigorous and disciplined approach to analyzing investment opportunities. Diligence in this context refers to the responsibility of investment professionals to conduct comprehensive and meticulous research to ensure informed decision-making. Independence implies that members should strive to avoid biases or conflicts of interest that could skew their analysis, which is crucial for maintaining objectivity. Thoroughness highlights the necessity of covering all relevant aspects of an investment, including quantitative data, qualitative factors, and market conditions, ensuring a well-rounded evaluation. By adhering to this standard, investment professionals uphold the ethical and practical integrity required in the alternative investment space, allowing for sound investment judgments that benefit both their clients and the broader market. This diligent approach is integral in helping to mitigate risks and enhance the potential for achieving positive investment outcomes.

7. What does Value at Risk (VaR) measure?

- A. The upper limit of portfolio returns
- B. The probability of earning a specific return
- C. The potential loss under normal conditions**
- D. The fixed cost of risk management

Value at Risk (VaR) is a widely used risk management tool that quantifies the potential loss in value of a portfolio over a defined period for a given confidence interval. It estimates the maximum expected loss that could occur under normal market conditions, thereby providing a clear measure of risk. By establishing a threshold for loss, VaR allows investors and risk managers to understand the worst-case scenario they might face, based on historical data and statistical methods. For example, if a portfolio has a 1-day VaR of \$1 million at a 95% confidence level, this means there is only a 5% chance that the portfolio will lose more than \$1 million in a single day. This measure helps in making informed decisions about risk tolerance and capital allocation. The other options do not accurately reflect what VaR represents. It does not measure upper limits or probabilities of earning specific returns, nor does it quantify fixed costs of risk management. Instead, it specifically focuses on potential losses, thereby providing critical insight into the risk exposure of a portfolio.

8. What does the Information Ratio measure?

- A. Management fees of a portfolio versus its worth.
- B. Expected outperformance of an investment versus its benchmark divided by tracking error.**
- C. Overall profit margins of an investment.
- D. Net income generated against total investment risk.

The Information Ratio is a key performance measure used to evaluate the consistency of an investment manager's outperformance relative to a benchmark, adjusted for the risk taken. It specifically calculates the expected excess return (or outperformance) of an investment over its benchmark and divides this amount by the tracking error, which is the standard deviation of the excess returns. By focusing on the ratio of the excess return to the tracking error, the Information Ratio provides insight into how effectively a portfolio manager is generating returns relative to the risk of deviating from the benchmark. A higher Information Ratio indicates that the manager is achieving greater outperformance for each unit of risk assumed. This makes it a valuable tool for investors who want to compare the skill of different managers or strategies while accounting for the risk they're taking. Other options mentioned do not accurately describe what the Information Ratio measures. For instance, management fees, overall profit margins, and net income against total investment risk focus on different aspects of investment evaluation rather than the relationship between excess returns and risk relative to benchmarks, which is central to understanding the Information Ratio.

9. What is correlation risk primarily associated with?

- A. Inability to refinance a singular loan
- B. Potential of multiple bank loan defaults occurring simultaneously**
- C. High interest rates on loans
- D. Increased liquidity in financial markets

Correlation risk is primarily associated with the potential of multiple bank loan defaults occurring simultaneously. This concept refers to the risk that the performance of various assets, such as loans or investments, may become more tightly linked during periods of market stress or financial crisis. When multiple borrowers are affected by similar conditions—like economic downturns or industry-specific challenges—the likelihood of defaults increases simultaneously, leading to significant losses for financial institutions and investors. This risk becomes crucial to understand, especially in the context of portfolios containing different loans or securities, as it highlights the interconnectedness of risks and the cascading effects that can occur when correlations increase. Understanding correlation risk is essential for managing credit risk in portfolios and attempting to mitigate potential collective defaults, which can amplify losses beyond what might be expected from individual loan performance alone.

10. What is the role of investors in unfunded CDOs?

- A. Investors purchase CDO securities at a price
- B. Investors act as the credit protection seller**
- C. Investors assume all credit risks without benefits
- D. Investors hold the underlying assets until maturity

In the context of unfunded collateralized debt obligations (CDOs), investors primarily engage in acting as credit protection sellers. Unfunded CDOs do not involve a pool of assets purchased upfront; instead, they are structured to provide credit risk transfer, where investors take on the credit risk of a specified portfolio without directly holding the underlying assets. When investors act as credit protection sellers, they essentially provide protection to other parties (such as the issuer or the protection buyers) against potential defaults in the pool of referenced assets. In this arrangement, the credit protection sellers receive periodic premium payments in exchange for taking on the risk associated with the potential default of the underlying assets over the life of the transaction. This role is crucial in the functioning of unfunded CDOs as it allows the market to efficiently manage and distribute credit risks, enabling parties to hedge their exposures effectively. The dynamics of unfunded CDOs hinge on this transfer of risk, where investors' involvement is pivotal in maintaining the stability and liquidity within the broader credit markets.

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://caialevel1.examzify.com>

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

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