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8 Learning Outcomes, Summary Overview, and Problems

risk tolerance, he described it as "average." He was surprised when informed that U.S. small-cap portfolios have experienced extremely high volatility.

He does not expect to retire before age 70. His current income is more than sufficient to meet his expenses. Upon retirement, he plans to sell his surgical practice and use the proceeds to purchase an annuity to cover his postretirement cash flow needs.

Both his income and realized capital gains are taxed at a 30 percent rate. No pertinent legal or regulatory issues apply. He has no pension or retirement plan but does have sufficient health insurance for postretirement needs.

5. The comments about investment policy statements made by Stephenson's patients are *best* characterized as

	Hrdina	Gionta
A.	Correct	Correct
B.	Correct	Incorrect
C.	Incorrect	Correct
D.	Incorrect	Incorrect

6. In formulating the return objective for Stephenson's investment policy statement, the *most* appropriate determining factor for Coppa to focus on is

A. Return desires
B. Ability to take risk
C. Return requirement
D. Stephenson's returns over past five years

7. Stephenson's willingness and ability to accept risk can be *best* characterized as

	Willingness to Accept Risk	Ability to Accept Risk
A.	Below average	Below average
B.	Below average	Above average
C.	Above average	Below average
D.	Above average	Above average

8. Stephenson's tax and liquidity constraints can be *best* characterized as

	Tax Constraint	Liquidity Constraint
A.	Significant	Significant
B.	Significant	Insignificant
C.	Insignificant	Significant
D.	Insignificant	Insignificant

9. Stephenson's time horizon is best characterized as

A. Short-term and single-stage
B. Short-term and multistage

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Chapter 1 The Portfolio Management Process and the Investment Policy Statement

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C. Long-term and single-stage

D. Long-term and multistage

10. Stephenson's return objective and risk tolerance are most appropriately described as

	Return Objective	Risk Tolerance
A.	Below average	Below average
B.	Below average	Above average
C.	Above average	Below average
D.	Above average	Above average

11. James Stephenson Investment Profile

Case Facts

Type of investor	Individual; surgeon, 55 years of age, in good health
Asset base	\$2 million
Stated return desire or investment goal	10 percentage points above the average annual return on U.S. small-capitalization stocks
Annual spending needs	\$150,000
Annual income from nonportfolio sources (before tax)	\$350,000 from surgical practice
Other return factors	Inflation is 3%
Risk considerations	Owns large concentration in U.S. small-capitalization stocks
Specific liquidity requirements	\$70,000 charitable donation in 10 months
Time specifications	Retirement at age 70
Tax concerns	Income and capital gains taxed at 30 percent

Questions

1. Underline the word at right that best describes the client's:

A. <u>Willingness to accept risk</u>	Below average	Above average
B. <u>Ability to accept risk</u>	Below average	Above average
C. <u>Risk tolerance</u>	Below average	Above average
D. <u>Liquidity requirement</u>	Significant	Not significant
E. <u>Time horizon</u>	Single stage	Multistage
F. <u>Overall time horizon</u>	Short to intermediate term	Long term
G. <u>Tax concerns</u>	Significant	Not significant

2. Discuss appropriate client objectives:

A. Risk

B. Return

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12. Foothill College Endowment Fund

Case Facts

Type of investor	Institutional; endowment
Purpose	Provide annual scholarships currently totaling \$39.5 million
Asset base	\$1 billion
Stated return desire	6 percent, calculated as spending rate of 4 percent plus previously expected college tuition inflation of 2 percent
Other return factors	Revised expectation of college tuition inflation is 3 percent
Tax concerns	Tax exempt

Questions

1. Underline the word at right that best describes the client's:

A. <i>Risk tolerance</i>	Below average	Above average
B. <i>Liquidity requirement</i>	Significant	Not significant
C. <i>Time horizon</i>	Single stage	Multistage
D. <i>Overall time horizon</i>	Short to intermediate term	Long term
E. <i>Tax concerns</i>	Significant	Not significant

2. Discuss appropriate client objectives:

A. <i>Risk</i>
B. <i>Return</i>

13. Vincenzo Donadoni Investment Profile (adapted from 1998 CFA Level III exam)

Case Facts

Type of investor	Individual; 56 year old male in good health
Asset base	13.0 million Swiss francs (CHF)
Stated return desire <i>or</i> investment goal	Leave a trust fund of CHF 15.0 million for three children
Annual spending needs	CHF 250,000 rising with inflation
Annual income from other sources (after tax)	CHF 125,000 consulting income for next two years only
Ability to generate additional income	No
Willingness to accept risk	Impulsive, opinionated, successful with large bets as a businessman, believes success depends on taking initiative
Specific liquidity requirements	CHF 1.5 million immediately to renovate house CHF 2.0 million in taxes due in nine months
Time specifications	Long term except for liquidity concerns
Legal and regulatory factors	None
Unique circumstances	None

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