

2027 CFA® Exam Prep

IFT Mock Exams

Level III

Mock Exam 1: Session 2

PRIVATE WEALTH PATHWAY

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Exam 1 Session 2

Question Set	Topic	Minutes
1	Private Wealth	12
2	Portfolio Construction	12
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5	Private Wealth	12
6	Portfolio Construction	12
7	Private Wealth	12
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9	Derivatives	12
10	Performance Measurement	12
11	Performance Measurement	12
	Total	132

Start time: 2:00 PM

End time: 4:12 PM

QUESTION 1**TOPIC: PRIVATE WEALTH****THE TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS**

Manny Ramirez is 50 years old and runs his own real estate rental and leasing business. His wife, Aryana, 51, is a schoolteacher. Together, they earn USD 200,000. Manny and Aryana have two children: Maria, who has graduated from college and now works at an accounting firm, and Tomas, a high school senior who will graduate next year and begin his four-year college education. Maria helps keep books for Manny's business, Ramirez Rentals. Six months ago, Aryana inherited her mother's commercial real estate worth USD 2,500,000 after all estate and inheritance taxes were paid.

Excluding the real estate inheritance, Manny and Aryana have savings of USD 200,000. The Ramirezs live in their own house and have two cars. They own no stocks but have a portfolio of government and corporate bonds valued at USD 2,500,000. Ramirez has 50% ownership interests in his business. They each anticipate receiving a pension. Manny invests in a 401(k) plan; depending on the company's earnings, he contributes between 12% and 15% of his pay. Aryana will receive 80% of her salary as a pension benefit from the Teachers' Pension Scheme upon retirement. The couple currently has expenses of USD 150,000.

Ken Broady is a private wealth advisor who meets with the Ramirezes to discuss their financial goals and their priorities. The Ramirezs' main concern is maintaining their lifestyle in retirement, which will begin in 15 years and is estimated to last for 15 years. Broady sets the Ramirezs' financial targets for retirement as the following goals, as shown in Exhibit 1.

Exhibit 1

Non-discretionary needs:	USD 120,000 per year, growing at 2% annually to compensate for inflation, with their pensions making up any shortfall.
Discretionary goals:	USD 30,000
Aspirational goals:	USD 15,000

Broady estimates the couple's retirement spending. He assumes the amounts for each of the three financial goals will increase by 2% in nominal terms starting in year 15 and lasting for the retirement term. Broady uses a discount rate of 1.5% for non-discretionary retirement income, 7.0% for discretionary retirement income, and 10.0% for aspirational retirement income.

Given the tolerance for each goal, the Ramirezs' objectives for retirement spending are shown in Exhibit 2.

Exhibit 2

Retirement	Spending	Annual increase	Tolerance of not meeting the objective
Non-discretionary	USD 120,000	2%	Low (95%)
Discretionary	USD 30,000	2%	Medium (85%)
Aspirational	USD 15,000	2%	High (70%)

Broady plans to allocate the Ramirezs' funds across the most appropriate portfolios based on their risk tolerance and a 30-year time horizon. He ignores the effects of taxes for simplicity and uses a model that factored in estimated returns, volatility, and the couple's comfort with not meeting specific goals. Broady projects long-term returns and the initial investment needed for each goal, covering both saving and spending phases. Below is a table listing advisor-offered portfolios with current returns and volatility.

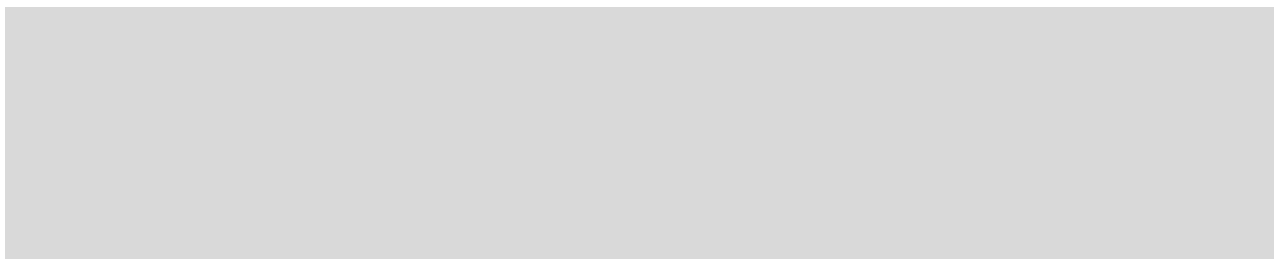
Exhibit 3

Investments	Portfolio A	Portfolio B	Portfolio C	Portfolio D	Portfolio E
Cash	30%	10%	5%	5%	5%
Government Bonds	60%	65%	45%	30%	30%
High Yield Bonds	10%	25%	10%	5%	5%
Domestic Large Cap stocks	0%	0%	20%	30%	25%
Domestic Small Cap stocks	0%	0%	20%	20%	15%
Emerging Market Equity	0%	0%	0%	10%	15%
Alternatives	0%	0%	0%	0%	5%

1.1 Discuss two advantages of the behavioral portfolio approach in managing the Ramirezs' discretionary and non-discretionary financial goals.

1.2 Based on Exhibit 1 and Broady's assumptions, **calculate** the present value of the Ramirez's non-discretionary and discretionary retirement spending.

1.3 Based on Exhibit 2 and Exhibit 3, ignoring taxes, **recommend** the most appropriate portfolios for non-discretionary and discretionary retirement spending of the Ramirez. **Justify** each response.



QUESTION 2**TOPIC: PORTFOLIO CONSTRUCTION****THE TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS**

Theo Radcliff works as an investment adviser for institutional investors at JD Warren, an investment management company. He meets with Karen Santiago, the CFO of Network Solutions (NS), to discuss the company's DB pension plan investments. NS is solely responsible for funding its Defined Benefit (DB) plan by making annual contributions. Santiago asks Radcliff to compare NS's DB plan with its two main competitors, Tyler Technologies (TT) and Munis Support (MS). Radcliff collects the following financial data and pension plan characteristics for the three companies.

	NS	TT	MS
Sales	21,000,000	38,000,000	29,500,000
Profit margin	29%	35%	35%
Projected benefit obligations	23,500,000	34,000,000	27,600,000
Long term debt-to-capital ratio	47%	43%	53%
Provision allowing lump-sum distribution	YES	YES	NO
Provision allowing early retirement	NO	YES	NO
Proportion of active lives as a percent of total participants	43%	28%	64%
Plan funded status	Deficit	Surplus	Surplus

Radcliff also has an endowment among his clientele associated with the University of Brussels (UB).

- The endowment currently has a planned time horizon until 2037.
- The endowment's investment returns are tax-exempt.
- UB currently receives enough funds from the endowment to meet its spending needs, and in recent years, it has had a budget surplus.
- UB's board is confident that it could raise funds through donor contributions, if necessary.

JD Warren manages a large fund for Hassler Insurance Corp (HIC), a non-life insurance company.

- The timing and amount of claims are uncertain, but HIC has a policy of settling all its liabilities within 3 years.
- The return requirement for HIC is calculated every year based on its forecast for expected claims, capital market expectations, and the market value of its portfolios.

David Ernst, president of JD Warren, asks Radcliff to review the IPSs of both the endowment and HIC.

Radcliff is approached by Safeway International (SI), a US-based company that operates a DB pension plan for its employees. SI is profitable, with a sound balance sheet and lower debt ratios than its peers. Its DB pension plan is in surplus. The company's percentage ratio of active employees to retired employees is 75%/25%. The average age of its employees is 39 years, and the workforce is stable. SI's management aims to maintain the plan's funded status (pension surplus) relative to plan liabilities and intends to cease making contributions to the plan in the next two years. However, after 2 years, it will make the necessary contributions if needed.

The plan maintains an asset allocation of 30% in US equities, 10% in emerging market equities, and 60% in US fixed income. The fixed-income allocations consist of 40% in US Treasury bonds and 20% in cash and short-term Treasury bills. However, the expected returns of both equities and fixed income are below long-term averages. As a result, SI's management is considering investing in alternatives. After reviewing the expected returns of various asset classes, Radcliff recommends the following asset allocation to SI.

Exhibit 1

Asset Class	Recommended Asset Allocation	Expected Long-Term (10-Year) Annual Return
Cash and US T-bills	5%	0.5%
US equities	20%	5.0%
Emerging market equities	5%	6.0%
US Treasury Bonds	30%	3.0%
Private Debt	20%	7.0%
Hedge Funds	20%	9.0%

2.1 Determine which company's pension plan has the highest risk tolerance based on:

- i. Financial status/profitability.
- ii. Plan features.

Justify each response with one reason.

2.2 Compare each of the following components of HIC's IPS and UB Endowment's IPS:

- i. Risk tolerance.
- ii. Liquidity requirement.

Justify each response with two reasons.

2.3 Determine the investment horizon (short-term or long-term)/risk tolerance and the liquidity needs (high, low) of the DB plan. **Justify** each response.

- Investment horizon– short term, long term
- Risk Tolerance – higher, lower
- Liquidity needs – high, low

2.4 Determine the *most likely* effect (increase, decrease, no change) on the SI DB pension plan's funded status because of the recommended asset allocation. **Justify** your response with two reasons.

- Increase
- Decrease
- No change