

Question #1 of 51

Question ID: 1722755

A private equity fund initially launches in Year 1 with a solicitation for capital calls. After receiving \$20 million in committed capital, the fund deploys the first \$10 million in Year 2 and the full amount by the middle of Year 3. The vintage year for the fund is:

A) Year 2.



B) Year 1.



C) Year 3.



Explanation

The vintage year is the year where capital is first deployed. So, though only the first \$10 million is deployed in Year 2 and the remainder is not deployed until Year 3, that is still considered the vintage year.

(Module M1.3, LOS M1.c)

Based on the data in Exhibit 1, which of the following statements regarding the performance of the Dundoon Buyout Opportunities Fund VIII is *inaccurate*?

- A) The PME terminal value for the fund is USD 473 million. 
- B) The IRR of the fund is greater than the compound annual return of a full investment in the public index in Year 0. 
- C) The PME IRR of the fund is higher than the IRR of the fund. 

Explanation

The IRR of the fund cash flows is calculated using a financial calculator as follows:

- CF0 –100
- C01: –200
- C02: –300
- C03: 10
- C04: 300
- C05: 600
- IRR CPT: 13.3%

The compound return of a full investment in the public index at Year 0 is calculated as $(3,650 / 3,000)^{(1/5)} - 1 = 4.0\%$. Therefore, Statement 1 is correct.

To calculate the PME IRR, we must calculate the value of the portfolio each year that the fund cash flows had been invested in the public index as follows:

The 100 invested in Year 0 would be worth $100 \times (2,809 / 3,000) = 93.63$ in Year 1. Adding the contribution of 200 in Year 1 gives a total value of $93.63 + 200 = 293.63$.

This 293.63 would be worth $293.63 \times (2,515 / 2,809) = 262.90$ in Year 2. Adding the contribution of 300 in Year 2 gives a total value of $262.90 + 300 = 562.90$.

This 562.90 would be worth $562.90 \times (3,142 / 2,515) = 703.23$ in Year 3. Subtracting the distribution of 10 in Year 3 gives a total value of $703.23 - 10 = 693.23$.

This 693.23 would be worth $693.23 \times (3,295 / 3,142) = 726.99$ in Year 4. Subtracting the distribution of 300 in Year 4 gives a total value of $726.99 - 300 = 426.99$.

This 426.99 would be worth $426.99 \times (3,650 / 3,295) = 472.99$ in Year 5.

We then perform a PME IRR using the same cash flows as listed previously, but with a terminal value of 472.99, giving a PME IRR of 8.5%.

From the numbers listed, we can see that it is inaccurate that the PME IRR of the fund is higher than the IRR of the fund.

(Module M1.3, LOS M1.c)

Which of the following scenarios is *most likely* to lead to improved performance of a private equity fund versus its PME IRR benchmark, all else equal?

- A) Lower public index levels occurring at the same time that significant distributions are made. 
- B) Higher public index levels occurring at the same time that significant distributions are made. 
- C) Lower public index levels occurring at the same time that significant contributions are made. 

Explanation

If public index levels are lower when significant distributions are made from the fund, then a larger proportion of the fund would theoretically have to be liquidated to fund the distribution. This would lower the performance of the PME benchmark and improve the IRR of the private equity fund versus the PME IRR. Higher public index levels occurring at the same time that significant distributions are made is the opposite of this scenario, so this answer option must be false.

Higher contributions at lower public index levels would boost the PME IRR and lower the relative performance of the private fund versus the PME IRR.

(Module M1.3, LOS M1.c)

Question #4 - 5 of 51

Question ID: 1782243

The NAV of the Dundoon Private Credit Opportunities Fund at the end of Year 4 is *closest* to:

A) 9,400.



B) 7,000.



C) 8,000.



Explanation

The total capital invested in the fund at Year 4 is the sum of the contributions into the fund:

Total capital invested = 2,000 + 2,500 + 3,000 + 500 = 8,000.

Total distributions from the fund as per Year 4 is equal to the distribution of 1,000 made in Year 4.

Total value to paid-in capital (TVPI) is calculated as follows: (distributions + NAV) / paid-in capital. This is stated as 1.3, so we can solve for NAV as follows:

$$1.3 = (1,000 + \text{NAV}) / 8,000.$$

Multiplying through by 8,000 gives $10,400 = 1,000 + \text{NAV}$, so NAV = 9,400.

(Module M1.3, LOS M1.c)

Question #5 - 5 of 51

Question ID: 1782244

Which of the following statements regarding paid-in capital-based measures made in communications with clients are correct?

A) Statement 1 only.



B) Statement 2 only.



C) Both of the statements are correct.



Explanation

Statement 1 is correct—the paid-in capital-based ratios do not reflect the time value of money in that there is no reflection of the time that has passed in generating the ratio.

Statement 2 is incorrect—the TVPI, not the DPI, ratio is also known as the "multiple of money."

(Module M1.3, LOS M1.c)

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Question ID: 1722776

In evaluating the drivers of periodic return for a private market investment, which of the following statements is most accurate?

- A)** The internal rate of return (IRR) is positive when returns equal capital contributed. 
- B)** Investors will generate relatively high returns on their committed capital. 
- C)** Fees and negative returns are common during the phase where capital is initially deployed. 

Explanation

During the phase where capital is deployed, returns are often negative due to the lack of realized positive returns (which hopefully happens later on) and the assessment of fees. Investors generate relatively low returns on committed capital because those funds need to be held in safe, liquid public investments. The internal rate of return is zero when returns equal capital contributed.

(Module M1.4, LOS M1.d)

Question #7 of 51

Question ID: 1868354

To assess the return on a private investment, a common metric is to look at the cash flow in relation to the investment that was made. Other metrics will look at the estimated value of the investment in relation to the total investment. Which of the following returns measures is an unrealized return?

- A)** RVPI. 
- B)** TVPI. 
- C)** DPI. 

Explanation

RVPI (residual value to paid-in) is NAV/paid in. The NAV is an estimate of the current value of the future cash flows of the investment, not a realized return. DPI (cumulative distributions to paid in) is a measure of realized cash-on-cash return. TVPI (total value to paid in) includes both realized and unrealized components, as it is the sum of DPI and RVPI.

(Module M1.3, LOS M1.c)

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Question ID: 1868341

Junior investment advisor Logan Martin is discussing investment ideas with senior advisor, Kevin Platt. Martin is confused in regards to how to classify alternative investments. Platt informs him that alternative investments typically:

- A) are used interchangeably with private investments. 
- B) include some public investment securities. 
- C) include some, but not most, investments in private securities. 

Explanation

The term alternative investments typically refers to investments other than those in cash or publicly traded debt and equity securities. It is broader than private investments in that some real estate, commodity, and infrastructure investments that are publicly traded are considered alternative investments. Most private investments are included in what are referred to as alternative investments.

(Module M1.1, LOS M1.a)

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Question ID: 1868351

Investor Miles Graham is making his first investment in private debt. In reviewing the documentation for his investment, Graham notices descriptions of senior secured, prepayable with restrictive debt covenants and a variable rate coupon. Graham is *most likely* investing in a

- A) nonsubordinated loan. 
- B) mezzanine loan. 
- C) leveraged loan. 

Explanation

A leveraged loan is a floating-rate coupon loan that is prepayable and senior secured. It also tends to have restrictive debt covenants. A mezzanine loan is subordinated debt that ranks below senior debt. The term nonsubordinated may be used to describe a loan, but it is not a comprehensive title for the type of loan described in this question.

(Module M1.2, LOS M1.b)

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Question ID: 1722728

Kim Carter, CFA, is a private wealth manager meeting with a prospective client. The client has \$3 million in investable cash, but most of his investments are in publicly traded equities and fixed-income instruments. In helping the client to understand how private investments may differ from public, Carter will most likely explain that private investments:

- A)** have asset prices that are often based on estimates.
- B)** are generally liquid and relatively easy to trade.
- C)** have an open-ended investment process.



Explanation

Compared to public investments, private investments have asset prices that are often based on estimates (as opposed to public investments, which have observable asset prices due to regular trading). Private investments also have a closed-end investment process and are generally illiquid.

(Module M1.1, LOS M1.a)

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Question ID: 1722756

An investment has a net present value (NPV) of \$150,000 on an initial investment of \$150,000. If the discount rate used to determine the NPV is equal to 7.25%, the internal rate of return (IRR) must be:

- A)** less than 7.25%.
- B)** equal to 7.25%.
- C)** greater than 7.25%.



Explanation

The IRR is the discount rate that produces an NPV of zero for a series of cash flows over n periods. When the NPV is positive (which it is here), that implies that the IRR must be greater than the discount rate (7.25%) used to determine the NPV. If it were a case that the NPV was zero (which happens when the present value of cash outflows equals the present value of cash inflows), the IRR would be exactly 7.25%.

(Module M1.3, LOS M1.c)

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Question ID: 1868344

Investment Advisor Darren McKenna is discussing private investment structures with his client, Anna Wong. Wong wants to ensure that her investments are well diversified and McKenna is explaining how private investments can be focused on various stages of a company's life cycle. In comparison, public market investments are most likely to be concentrated in the company life cycle stage of:

A) decline.



B) growth.



C) mature.



Explanation

While private investments span the entire company life cycle (start-up, growth, mature, and decline), public markets investments are concentrated among mature companies.

(Module M1.1, LOS M1.a)

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Question ID: 1722745

A pattern of initial negative returns followed over time by positive investment returns is most likely exhibited by:

A) private equity investments, but not private debt investments.



B) private equity investments and public equity investments.



C) private equity investments and private debt investments.



Explanation

With both private equity investments and private debt investments, management fees are charged on committed capital before actual investment in portfolio equity or debt, resulting in returns that are initially negative. This is not the case with investment in public equity or public debt securities.

(Module M1.3, LOS M1.c)

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Question ID: 1722772

What type of investment strategy is most likely to focus on event-driven or distressed assets?

- A) Momentum. 
- B) Value investing. 
- C) Special situations. 

Explanation

Special situation investments focus on companies or assets undergoing significant events like mergers, bankruptcies, or restructurings. Special situations offer potentially high returns, but they require specialized knowledge and carry significant risk. Value investing, by contrast, seeks out undervalued companies (that are not necessarily distressed) with strong fundamentals. Momentum investing focuses on stocks exhibiting recent upward trends—not distressed companies with uncertain recovery.

(Module M1.4, LOS M1.d)

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Question ID: 1732948

The investment method that is *least likely* to be used for a public market investment is:

- A) co-investment. 
- B) fund investment. 
- C) direct investment. 

Explanation

The co-investment method can refer to (1) investment in private equity or in private debt by direct investment with one or more partners, or (2) by indirect investment with a fund general partner managing the investment. Public market investments can be either direct investment in public equity or debt, or they can be investment in a *fund* of public equity or debt.

(Module M1.2, LOS M1.b)

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Question ID: 1868355

There are various metrics to assess the return to investors when making private investments, including TVPI, RVPI, and DPI. DPI is the ratio of:

- A) periodic fund distributions to periodic paid-in capital. 
- B) cumulative fund distributions to committed capital. 
- C) cumulative fund distributions to cumulative capital investments. 

Explanation

DPI is the ratio of cumulative fund distributions to cumulative capital investments at a point in time, not for discrete periods. Paid-in capital, rather than committed capital, is the relevant measure.

(Module M1.3, LOS M1.c)

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Question ID: 1868356

Which of the following statements regarding comparing the IRR of a private equity fund investment over its life to the compound annual returns of a benchmark index of public equities is incorrect?

- A) The IRR of the PME values of the private fund accounts for the timing of the fund cash flows in the context of public market index returns. 
- B) The comparison is appropriate, assuming that fund cash flows can be reinvested at the fund investment IRR. 
- C) The IRRs of individual fund venture capital investments require no adjustment for appropriate comparison to public index compound returns. 

Explanation

The public market return is computed as an annual return that ignores the uneven cash flow timing of the private equity fund, so comparison to the fund IRR is inappropriate. The PME (public market equivalent) methodology creates a public market investment index in which private fund cash outflows are hypothetically invested and from which cash inflows are sold. The fund investment's PME IRR is appropriate for comparison with the compound public index return. A venture capital investment most often involves an initial investment and a payoff multiple some periods in the future—so that irregular interim cash flows, as are typical with many private equity funds, are not an issue for returns comparisons.

(Module M1.3, LOS M1.c)
