

Question 1 of 100

In addition to fees paid to the private equity funds in a private equity fund of funds, an investor in the fund of funds can expect to pay which of the following fees to the fund of funds manager?

- A. 0.5%-1% management fee and 5%-10% carried interest
- B. 0.5%-1% management fee and 15%-20% carried interest
- C. 1%-2% management fee and 15%-20% carried interest
- D. 1%-2% management fee and 5%-10% carried interest

EXPLANATION • Learning Objective 8.1.2

ID: L1-8.1.2-009

For FoFs, the management fee and carried interest are typically lower than those of the underlying PE funds (eg, 2% and 20%). For FoFs, the management fee is typically of 0.5%-1% of committed capital and carried interest is 5%-10% of realized gains.

Question 2 of 100

Tatiana Petrov is a seasoned hedge fund manager who wants to tap into the large U.S. retail market. As a result, she launches a diversified liquid alternative fund that complies with all relevant U.S. regulatory requirements. Which of the following most likely applies to Petrov's liquid alternative fund?

- A. It applies a fixed-income arbitrage strategy.
- B. 14.7% of the fund is invested in distressed securities.
- C. 26.4% of the fund is invested in Amazon stock.

EXPLANATION • Learning Objective 8.1.9

ID: L1-8.1.9-010

For '40 Act funds, at most 15% of AUM can be invested in illiquid securities, so 14.7% in distressed securities is acceptable.

Other responses -

- At most 25% can be invested in a single security, so 26.4% in Amazon is too high.
- AUM have limits on their leverage use (33% of the fund's assets), so the fund would not implement a fixed-income arbitrage strategy that uses considerable leverage.

Question 3 of 100

Which of the following best describes a disadvantage of investing in funds of hedge funds (FoFs) as opposed to investing in other hedge fund strategies?

- A. FoFs are subject to significant survivorship bias.
- B. FoFs are subject to two layers of fees.
- C. FoFs charge exceptionally high management fees.
- D. FoFs are exposed to market risk.

EXPLANATION • Learning Objective 8.1.7

ID: L1-8.1.7-007

FoF investors pay management and performance-based fees to the FoF manager and to the managers of the hedge funds that comprise the FoF. This double layer of fees represents a drawback to FoF investing.

Other response: FoFs have less (if any) survivorship bias than individual hedge funds since FoFs retain the returns of liquidated funds in their performance history.

Question 4 of 100

A portfolio has equal holdings in 20 hedge funds that have uncorrelated returns, equal return volatilities, and no systematic risk. If each hedge fund has a 3% monthly return volatility, which of the following comes closest to the ANNUAL volatility of the portfolio?

- A. 0.671%
- B. 2.324%
- C. 5.59%
- D. 8.05%

EXPLANATION • Learning Objective 8.1.6

ID: L1-8.1.6-003

$$\text{Annual volatility}_{\text{port}} = \text{Monthly volatility}_{\text{port}} \times \sqrt{12}$$

Find Monthly volatility_{port} (given zero correlation, equal asset vol., and no systematic risk).

$$\text{Monthly vol.}_{\text{port}} (\sigma_{\text{port}}) = \frac{\sigma}{\sqrt{n}} = \frac{0.03}{\sqrt{20}} = 0.00671$$

$$\Rightarrow \text{Annual vol.}_{\text{port}} = 0.00671 \times \sqrt{12} = 0.02324 = 2.324 \%$$

Question 5 of 100

Which of the following are considered areas in which fund of funds do NOT have an advantage over funds for investors?

- A. education
- B. transparency
- C. leverage
- D. professional management

EXPLANATION • Learning Objective 8.1.1

ID: L1-8.1.1-007

Transparency is a disadvantage of FoFs, since some FoF managers are not willing to disclose their capital allocation in individual funds.

Other responses –

- Leverage – some FoF provide leverage to investors.
- Educational role – FoFs provide a good way for investors to first get involved in the industry.
- Professional management – this service is provided by FoF managers and can be expensive at the individual investor level.

Question 6 of 100

Which of the following is a likely reason for a private equity investor to prefer a fund-of-funds allocation over individual fund allocations?

- A. industry focus
- B. single layer of fees
- C. better diversification
- D. increased need for oversight

EXPLANATION • Learning Objective 8.1.2

ID: L1-8.1.2-008

Fund of funds may be a better option for some private equity investors due to -

1. Diversification - larger pools of capital allow for better diversification across funds, vintage years, etc.
2. Cost - potentially lower fees negotiated with PE funds may more than offset the FoF's fees.
3. Selection and monitoring skills - FoF's provide expertise in allocating to and monitoring PE funds.
4. Access - potentially better access to quality PE funds due to past relationships and scale.