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## THE-MACRO-INSTITUTE

# M2SD

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## Question: 1

After an 18-month bear market, equities rebound sharply from their lows as policy turns supportive. A standard 12-1 month momentum strategy is long recent winners, mainly defensive low-beta stocks, and short recent losers, mainly beaten-down high-beta cyclicals. What is the most likely outcome for the momentum factor during this turning point?

**A.** Steady gains as recent winners keep leading after the market bottom
**B.** Sharp losses as beaten-down high-beta losers rebound in a market recovery
**C.** Little effect since momentum is uncorrelated with market turning points
**D.** Gains from the short leg as distressed stocks keep falling

**Answer:** B

Explanation: Momentum crashes typically happen at market turning points, especially sharp rebounds after prolonged declines, such as in 2009 and in late 2020 after vaccine news. After a bear market, the momentum portfolio is short high-beta, distressed losers and long defensive winners, so it carries a large negative market beta. When the market recovers, the most beaten-down stocks rally hardest, and the strategy suffers large losses in a short period. Practitioners manage this with volatility scaling or by neutralizing the factor's beta and sector exposures around cycle turns.

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## Question: 2

A portfolio is tilted toward the minimum volatility factor. Its sector exposures are concentrated in utilities, consumer staples and REITs. Which macro environment

poses the greatest relative risk to this factor tilt?

**A.** It tends to overweight high-beta semiconductors and autos
**B.** It tends to outperform most in sharp risk-on rallies
**C.** It tends to underperform when bond yields rise sharply
**D.** It tends to be immune to interest rate changes

**Answer:** C

Explanation: Low-volatility strategies choose stocks with low historical volatility and beta. That usually concentrates them in stable dividend payers such as utilities, staples and REITs, which behave like bond proxies with long equity durations. The factor therefore has meaningful interest rate exposure. When bond yields rise sharply, these sectors are repriced lower and low volatility tends to lag the market, as in 2022. It also usually lags in strong risk-on rallies led by high-beta stocks. Its main strength is protecting capital in slowdowns and falling markets.

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## Question: 3

Brent crude rises 40% in two months because of a supply shock. A macro portfolio manager wants a currency pair that expresses the resulting terms-of-trade shift between oil exporters and oil importers. Which position best captures it?

**A.** Long JPY and short NOK, as importers benefit from higher energy bills
**B.** Long the EUR and short the NOK, as Europe's energy balance improves
**C.** Long NOK and short JPY, as terms of trade shift toward oil exporters
**D.** Long INR and short CAD, as oil importers gain on rising crude

**Answer:** C

Explanation: The terms of trade are the ratio of export prices to import prices. An oil price spike improves them for net exporters such as Norway, raising export revenue, current account balances and often central bank hawkishness, all of which support the krone. It worsens them for big net importers such as Japan and India, whose import bills rise and current account balances weaken, which weighs on the yen and rupee. A long NOK, short JPY position isolates that divergence. Pairs that are long importers against exporters bet the wrong way.

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## Question: 4

After the Bank of Japan ended yield curve control and raised its policy rate, 10-year JGB yields climbed to around 3%, the highest since the 1990s. Japanese pension funds and insurers are among the world's largest holders of foreign bonds. What is the most likely global spillover of sustained higher JGB yields?

**A.** Global term premia face upward pressure as Japanese capital is repatriated
**B.** Japanese yields rise while the yen weakens because carry trades expand
**C.** Japanese yields rise with no effect on foreign bond markets or the yen
**D.** Global term premia fall as Japanese buyers add unhedged foreign bonds

**Answer:** A

Explanation: For years, yield curve control held Japanese yields near zero and pushed domestic institutions into foreign bonds, especially Treasuries and European sovereigns, which suppressed term premia abroad. With JGBs now offering competitive yields, and hedged foreign yields often lower because of the US–Japan short-rate gap, Japanese investors have less reason to hold foreign bonds and more reason to bring money home. Reduced demand for foreign duration puts upward pressure on global long-end yields and term premia. Repatriation and narrowing rate

gaps also tend to strengthen the yen. Higher Japanese yields also make yen-funded carry trades less attractive.

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## Question: 5

A company reports net income of 120 million USD but operating cash flow of only 40 million USD. Its average total assets are 1,000 million USD. Using the balance sheet–free accrual ratio, $\frac{\text{Net Income} - \text{CFO}}{\text{Average Total Assets}}$, how should an analyst read the result?

**A.** Accruals of 16% of assets, a sign of strong cash conversion
**B.** Accruals of 8% of assets, a sign of conservative accounting
**C.** Accruals of negative 8% of assets, a sign of strong cash conversion
**D.** Accruals of 8% of assets, a red flag for weaker future earnings

**Answer:** D

Explanation: The accrual ratio here is $\frac{120-40}{1{,}000} = 8\%$ of assets, meaning a large share of reported earnings has not turned into cash. Richard Sloan's research showed that firms with high accruals tend to have lower future earnings and stock returns, because accrual-heavy earnings are less persistent and more exposed to aggressive estimates, such as optimistic revenue recognition, inventory buildup or reduced reserves. Persistently high or rising accruals are a classic earnings quality warning sign and should lead to a closer look at receivables, inventory and reserves.

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## Question: 6

A commodities strategist tracks China's credit impulse, defined as the change in the

new credit flow as a share of GDP. Last year, new total social financing equaled 27% of GDP. This year it equals 31% of GDP. How should the credit impulse be described, and what does it usually signal for global industrial commodities?

**A.** A positive impulse of 31 points equal to the full new credit flow
**B.** A negative impulse of 4 points that signals weaker metals demand ahead
**C.** A positive impulse of 4 points that signals immediate consumer deflation
**D.** A positive impulse of 4 points that signals firmer metals demand ahead

**Answer:** D

Explanation: The credit impulse measures the change in new credit relative to GDP, not the level of credit, because growth responds to the acceleration or deceleration of lending. Here the impulse is $31\% - 27\% = +4$ percentage points of GDP, a meaningful positive swing. Because Chinese credit funds infrastructure, property and manufacturing investment, positive impulses have historically led China's import demand, base metal prices such as copper and iron ore, and commodity-exporting economies by roughly six to twelve months. Strategists watch it to anticipate turns in global industrial and materials-linked markets.

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## Question: 7

An industrial firm's revenue grew 10% last year, while operating income (EBIT) rose 25%. Assuming its cost structure is unchanged, what is its degree of operating leverage, and what does it imply if sales fall 8% next year?

**A.** DOL of 0.4, implying EBIT falls about 3% if sales drop 8%
**B.** DOL of 2.5, implying EBIT falls about 20% if sales drop 8%
**C.** DOL of 15.0, implying EBIT falls about 120% if sales drop 8%
**D.** DOL of 2.5, implying EBIT falls about 8% if sales drop 8%

**Answer:** B

Explanation: Degree of operating leverage is $DOL = \frac{\%\Delta \text{EBIT}}{\%\Delta \text{Sales}} = \frac{25\%}{10\%} = 2.5$. With an unchanged cost structure, an 8% fall in sales implies an EBIT fall of about $2.5 \times 8\% = 20\%$. High operating leverage comes from a large share of fixed costs, which magnify profits in expansions and losses in contractions. That is why cyclical sectors such as industrials see big earnings swings at cycle turns, while firms with flexible, variable cost bases score better on operating efficiency.

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## Question: 8

A software company starts capitalizing a large share of its recurring customer-support and development salaries as intangible assets instead of expensing them as incurred, which boosts reported margins. Ignoring tax effects, how does this accounting choice affect the cash flow statement and EBITDA?

**A.** CFO and EBITDA rise, while the cash outflow moves to investing activities
**B.** Free cash flow rises, because capitalized costs never leave the company
**C.** Net income falls at once, because capitalized costs are expensed upfront
**D.** CFO falls and EBITDA rises, because capital spending is an operating cost

**Answer:** A

Explanation: When operating costs are capitalized, they leave the income statement now and return later as amortization, which sits below EBITD**A.** EBITDA and near-term operating profit therefore rise. On the cash flow statement, the spending moves from operating activities to investing activities, so cash flow from operations looks stronger even though the same cash has been spent. Free cash flow measured as

CFO minus capital spending is unchanged, but headline CFO and EBITDA flatter the business. Aggressive capitalization is a well-known earnings quality red flag, and analysts often reverse it to compare companies fairly.

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## Question: 9

Over six months, the Federal Reserve cuts rates by 75 basis points while the European Central Bank keeps its rates unchanged. The US–German 2-year yield spread narrows from 200 bp to 125 bp, and growth expectations in both regions are steady. Based on interest-rate differential models of exchange rates, what is the most likely direction for EUR/USD?

**A.** EUR/USD tends to rise because narrowing spreads reduce the US carry advantage
**B.** EUR/USD is unaffected because only 10-year spreads drive the exchange rate
**C.** EUR/USD moves only with equity flows, so rate spreads carry no information
**D.** EUR/USD tends to fall because narrower spreads raise US carry appeal

**Answer:** A

Explanation: Short-dated yield spreads, especially at the 2-year point, which best captures expected policy paths, are among the most reliable fundamental drivers of major currency pairs. When the Fed eases and the ECB holds, the dollar's yield premium shrinks. Holding dollar assets earns less carry relative to euro assets, and money tends to move toward the euro, so EUR/USD tends to rise. This is the classic effect of monetary policy divergence on exchange rates. In practice, risk sentiment and growth surprises can temporarily override the relationship, but the narrowing spread itself favors euro strength.

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## Question: 10

Over three months, the copper-to-gold price ratio rises about 15% as industrial metals rally and gold is flat. The US 10-year Treasury yield, which historically moves closely with this ratio, stays unchanged. How should a macro analyst read this divergence?

**A.** Growth expectations are falling because industrial metal demand is weak
**B.** The ratio carries no macro information because both are commodities
**C.** Bond yields may be too low relative to the growth signal from metals
**D.** Bond yields may be too high because gold is outperforming copper

**Answer:** C

Explanation: Copper depends on industrial activity and construction, which earned it the nickname Dr. Copper, while gold is a defensive store of value. Their ratio is therefore a market-based gauge of growth expectations and has historically tracked long-term government bond yields. When it rises sharply, markets are pricing stronger global growth or reflation. If the 10-year yield does not follow, analysts often see the bond market as lagging, with yields too low for the growth signal and room to move higher. Supply shocks or China-specific demand can distort the ratio, so it is best confirmed with other indicators.

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## Question: 11

An investor has been funding long positions in Mexican peso and Brazilian real assets by borrowing in Japanese yen. The trade earns 6% annual carry against 12% annualized FX volatility. The Bank of Japan then signals an unexpected run of rate

hikes, and JGB yields jump. Which market pattern is most consistent with a yen-funded carry trade unwinding?

**A.** Funding currency rallies, high-yielders sell off, and implied FX volatility rises
**B.** Funding currency weakens, high-yielders rally, and implied FX volatility falls
**C.** Implied volatility collapses as carry trades are added to exploit wider spreads
**D.** High-yield currencies hold steady while the funding currency trades flat

**Answer:** A

Explanation: Carry trades borrow in low-yielding funding currencies and invest in high-yielding ones, earning the rate gap as long as exchange rates stay calm. Here the carry-to-risk ratio is $\frac{6\%}{12\%} = 0.5$, a modest buffer. When the funding currency's central bank turns hawkish, the rate gap narrows and positions are closed together. Investors buy back yen to repay their loans, so the yen strengthens, and they sell the high-yield currencies and assets. The rush to cut leverage raises realized and implied FX volatility, which lowers carry-to-risk ratios further and forces more closures. That feedback is why carry unwinds tend to be sudden and correlated across many high-yield currencies.

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## Question: 12

A packaged food company buys wheat, edible oils and packaging, and raises its own prices with a lag of about two quarters because of contracts and retailer negotiations. Input commodity costs suddenly rise 20%. What is the most likely near-term effect on its reported margins?

**A.** Gross margins expand at once because pricing power is instantaneous
**B.** Gross margins compress first because price increases lag input costs
**C.** Gross margins hold steady because input costs are fully hedged by law

**D.** Gross margins rise because volumes jump when prices increase

**Answer:** B

Explanation: Consumer staples companies usually pass cost inflation through over time, but not immediately. Retailer negotiations, promotional calendars and contracts delay price increases, while commodity and packaging costs reach the cost of goods sold quickly, often within a quarter or two, depending on hedges and inventory accounting. The typical pattern is gross margin compression first, followed by recovery as price increases take effect, possibly with some volume loss. Investors watch this lag closely, which is why defensive staples can still disappoint during the early stages of a commodity cost surge.

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## Question: 13

A strategist expects a hawkish Federal Reserve surprise that pushes up US real yields and the dollar. Which emerging-market sovereign profile is most vulnerable to wider spreads and currency stress?

**A.** Country with mostly local-currency public debt, a surplus, and a floating exchange rate
**B.** Country with a current account deficit of 5% of GDP and reserves below short-term external debt
**C.** Country with net creditor status, low inflation, and a credible inflation-targeting central bank
**D.** Country with a current account surplus of 3% of GDP and reserves at 3x short-term external debt

**Answer:** B

Explanation: When US real yields rise and the dollar strengthens, global capital becomes scarcer and more expensive. The most exposed emerging markets are those that depend on foreign funding. A large current account deficit means the country must attract capital every year to pay its bills. Reserves below short-term external debt (failing the Greenspan-Guidotti rule) mean it cannot cover maturing obligations if foreign lenders pull back. This was the pattern of the 2013 taper tantrum, when the so-called Fragile Five sold off hardest. Surpluses, ample reserves, local-currency debt and credible central banks all reduce reliance on foreign funding.

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## Question: 14

A commodity index fund holds long Brent futures and rolls them monthly. The front-month contract trades at 82 USD per barrel and the next-month contract at 80 USD. If the curve shape stays the same, what is the curve structure, and approximately what roll yield does a long investor earn per roll?

**A.** Contango with a positive roll yield of about 2.4% per roll
**B.** Backwardation with a positive roll yield of about 2.5% per roll
**C.** Contango with a negative roll yield of about 2.4% per roll
**D.** Backwardation with a negative roll yield of about 2.5% per roll

**Answer:** B

Explanation: When nearby futures trade above deferred contracts, the curve is in backwardation, which usually reflects tight current supply and a premium for immediate delivery. A long investor rolling the position sells the expiring contract at the higher price and buys the next one cheaper, earning roll yield of about $\frac{82-80}{80} = 2.5\%$ per roll if the curve shape is unchanged. Backwardation therefore adds to returns from commodity exposure, which helps explain why energy-linked

holdings often hedge well in supply-driven inflation. In contango the reverse happens, and rolling erodes returns.

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## Question: 15

An analyst wants a timely macro indicator to anticipate turning points in the industrials sector's aggregate earnings growth. Which indicator has historically led industrial earnings most usefully?

**A.** Wage growth, which moves inversely to industrial order intake
**B.** Unemployment rate, which leads industrial earnings by about two years
**C.** Manufacturing PMI, which tends to lead industrial earnings by several months
**D.** Retail sales volumes, which track industrial order books with no lag

**Answer:** C

Explanation: Industrials have high operating leverage and depend on the capital spending and manufacturing cycle. Purchasing managers' indexes, especially the ISM manufacturing index and its new orders component, survey companies about orders, production and supplier deliveries in real time. They tend to turn several months before reported earnings, which reflect activity only after orders are delivered and invoiced. A sustained move in the PMI above or below 50 has historically signaled turns in industrial revenue and earnings growth. The unemployment rate lags the cycle and is a poor leading signal.

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## Question: 16

A quality-factor screen uses gross profitability, defined as revenue minus cost of goods sold divided by total assets. Company A has revenue of 1,000, COGS of 600 and total assets of 800. Company B has revenue of 2,000, COGS of 1,700 and total assets of 1,000. Which company has higher gross profitability, and what are the two values?

**A.** Company A at 0.40 versus 0.15 for Company B
**B.** Company B at 0.30 versus 0.50 for Company A
**C.** Company A at 0.50 versus 0.30 for Company B
**D.** Company B at 2.00 versus 1.25 for Company A

**Answer:** C

Explanation: Gross profitability, popularized by Robert Novy-Marx, is $\frac{\text{Revenue} - \text{COGS}}{\text{Total Assets}}$. Company A gives $\frac{1{,}000-600}{800} = 0.50$ and Company B gives $\frac{2{,}000-1{,}700}{1{,}000} = 0.30$. Company A has higher profitability despite being smaller. Gross profit sits high in the income statement, so it is less affected by accounting choices than net income, and research shows it predicts future returns about as well as traditional value measures. That is why it is a core profitability signal in many quality factor definitions.

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## Question: 17

Benchmark European natural gas prices (TTF) triple over a quarter because of a supply disruption, while global oil prices rise only modestly. Eurozone producers cannot easily pass higher energy costs on to customers in competitive export markets. Which Eurozone equity segment is most likely to suffer the sharpest margin damage?

**A.** Energy-intensive chemicals with gas feedstock and export price competition
**B.** Pharmaceutical firms with patent-protected pricing and low energy costs

**C.** Global energy producers selling at international benchmark prices
**D.** Domestic utilities with regulated returns and full cost pass-through

**Answer:** A

Explanation: Natural gas is both a fuel and a feedstock for European chemical producers, used for ammonia, fertilizers and basic chemicals. When regional gas prices spike far above those paid by US or Middle Eastern rivals, European producers' costs rise sharply. Because they sell into global markets priced by cheaper competitors, they cannot raise prices enough, so margins collapse and output may be cut. This happened during the 2022 European energy crisis. The shock also worsens the Eurozone's terms of trade, because it is a net energy importer, which weighs on the euro and on wider industrial activity.

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## Question: 18

A forensic analyst calculates the Beneish Days' Sales in Receivables Index (DSRI). Last year, receivables were 100 and revenue 1,000. This year, receivables are 180 and revenue 1,200. What is the DSRI, and how should it be read?

**A.** DSRI of 0.67, suggesting tighter credit and lower manipulation risk
**B.** DSRI of 1.80, equal to receivables growth and a neutral reading
**C.** DSRI of 1.50, suggesting possible revenue inflation or channel stuffing
**D.** DSRI of 1.20, matching revenue growth and showing no anomaly

**Answer:** C

Explanation: DSRI compares receivables relative to sales across two years:

$DSRI = \frac{AR_t/Sales_t}{AR_{t-1}/Sales_{t-1}} = \frac{180/1{,}200}{100/1{,}000} = \frac{0.15}{0.10} = 1.50$. Receivables are growing much faster than revenue. That can mean customers are paying more slowly, but in the Beneish M-score framework a high DSRI is a key sign of possible earnings manipulation, such as booking sales before delivery or pushing goods onto distributors. Analysts follow up by checking days sales outstanding, revenue recognition policies and any changes in credit terms.

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## Question: 19

A US-based fund buys a one-year Brazilian local-currency government bond yielding 13.00% and holds it to maturity. Over the year, the Brazilian real depreciates 8% against the US dollar, while the bond pays its full local return. Approximately what is the fund's total return in US dollars?

**A.** About 13.00%, since currency moves do not affect a held-to-maturity return
**B.** About 21.00%, since currency weakness raises the bond's local price
**C.** About 3.96%, since local return and currency loss compound multiplicatively
**D.** About 5.00%, since the currency loss is simply subtracted from the yield

**Answer:** C

Explanation: An unhedged foreign bond's return in the investor's currency combines the local return with the currency change multiplicatively: $(1 + R_{local})(1 + R_{FX}) - 1 = (1.13)(0.92) - 1 \approx 0.0396$, or about 3.96%. Simply subtracting the depreciation (13% minus 8% = 5%) ignores the cross term, because the currency loss also applies to the interest earned. This is why high nominal yields in emerging markets do not guarantee high dollar returns. Uncovered interest parity suggests that high-yield currencies will on average depreciate, and when they depreciate faster than the yield advantage, the carry is wiped out.

## Question: 20

A strategist sees three signals: the ISM manufacturing new orders minus inventories spread has turned negative, the Conference Board Leading Economic Index has fallen for six straight months, and the Fed's tightening cycle began about 12 months ago. Consistent with a leading-indicator approach to sector rotation, which tilt is most appropriate for the next 6–12 months?

**A.** Overweight industrials and consumer discretionary versus utilities
**B.** Overweight small-cap cyclicals versus large-cap defensive sectors
**C.** Overweight semiconductors and autos versus staples and health care
**D.** Overweight consumer staples and health care versus industrials and tech

**Answer:** D

Explanation: Macro-driven sector rotation relies on the fact that monetary tightening affects the economy with long lags, often 12 to 18 months, and that leading indicators turn before earnings do. A negative ISM new orders minus inventories spread means demand is falling faster than stock is being worked down, which signals weaker production ahead. A persistently falling leading index confirms a slowdown. In that phase, defensive sectors with steady earnings, such as consumer staples and health care, usually outperform cyclicals such as industrials, technology, autos and small caps, whose earnings are more sensitive to the economic cycle.

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## Question: 21

A REIT index trades at an implied capitalization rate of 5.50% while the 10-year

Treasury yields 4.50%. Over the past twenty years, the spread between REIT implied cap rates and the 10-year yield has averaged about 250 bp. How should an analyst read the current relative valuation of REITs?

**A.** Spread of 100 bp, well above its norm, so REITs look cheap versus bonds
**B.** Spread of 100 bp, well below its norm, so REITs look expensive versus bonds
**C.** Spread of 1,000 bp, because cap rates and yields are multiplied
**D.** Spread of 250 bp, at its norm, so REIT valuations look fairly priced

**Answer:** B

Explanation: The implied cap rate is the unlevered income yield that the REIT market prices into its property holdings. Comparing it with the risk-free yield gives a risk premium for property: $5.50\% - 4.50\% = 1.00\%$, or 100 bp. That is far below the 250 bp average, so investors are accepting little extra return for property risk compared with Treasuries. REITs therefore look expensive relative to bonds. If yields stay high, cap rates may need to rise, which lowers property values and REIT prices, unless income growth closes the gap. This is why REITs are highly sensitive to interest rates.

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## Question: 22

A leveraged company has EBITDA of 500 million USD and net debt of 2,500 million USD at a 5% average interest rate. Its debt matures next year and must be refinanced at 8% because credit spreads and base rates have risen. EBITDA and debt are unchanged. How does the EBITDA-to-interest coverage ratio change?

**A.** Coverage stays near 5.0x because net debt to EBITDA is unchanged
**B.** Coverage falls from about 5.0x to about 3.1x on the higher rate
**C.** Coverage rises from about 2.5x to about 4.0x on the higher rate

**D.** Coverage falls from about 4.0x to about 2.5x on the higher rate

**Answer:** D

Explanation: Current interest expense is $2{,}500 \times 5\% = 125$, so coverage is $\frac{500}{125} = 4.0\times$. After refinancing at 8%, interest rises to $2{,}500 \times 8\% = 200$ and coverage falls to $\frac{500}{200} = 2.5\times$. Leverage measured by net debt to EBITDA stays at 5.0x, but the ability to service the debt weakens sharply. This shows why rising rates hurt highly leveraged companies through refinancing risk, and why credit and quality analysis should look at maturity schedules and coverage, not only leverage multiples.

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## Question: 23

A Japanese life insurer is choosing between a 10-year JGB yielding 3.00% and a 10-year US Treasury yielding 4.30%. It would hedge the dollar exposure back to yen with rolling 3-month FX forwards. Three-month USD rates are 3.75% and 3-month JPY rates are 0.90%. Ignore the cross-currency basis and assume covered interest parity holds. What is the approximate FX-hedged yield on the Treasury for the yen-based investor, and what does it imply for cross-border flows?

**A.** Hedged UST yield of about 2.20%, close to the JGB yield, so flows are neutral
**B.** Hedged UST yield of about 1.45%, below the JGB yield, which favors repatriation
**C.** Hedged UST yield of about 7.15%, because the rate gap adds to the hedged return
**D.** Hedged UST yield of about 4.30%, because hedging costs cancel over the horizon

**Answer:** B

Explanation: Under covered interest parity, hedging a foreign-currency asset back to

the home currency costs roughly the short-term rate gap between the two currencies. A yen investor selling dollars forward gives up about $i_{USD} - i_{JPY} = 3.75\% - 0.90\% = 2.85\%$ a year. The hedged Treasury yield is therefore about $4.30\% - 2.85\% = 1.45\%$. That is well below the 3.00% now available on domestic JGBs. Once the Bank of Japan stopped capping long yields, domestic bonds became more attractive than hedged foreign bonds for Japanese institutions. That encourages them to bring money home, which can push up term premia in the markets they leave.

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## Question: 24

A dollar-denominated emerging-market sovereign bond with an effective duration of 6.0 yields 7.80%, which is 350 bp over the comparable US Treasury. In one month, the Treasury yield falls 50 bp while the sovereign's spread widens 100 bp. Ignoring convexity and carry, what is the approximate price change of the sovereign bond?

**A.** A price decline of about 9%, as the two moves add up to 150 bp
**B.** A price decline of about 6%, as only the 100 bp spread widening matters
**C.** A price gain of about 3%, as the Treasury rally outweighs the spread move
**D.** A price decline of about 3%, as the all-in yield rises by a net 50 bp

**Answer:** D

Explanation: A dollar sovereign bond's yield is the risk-free Treasury yield plus the credit spread, and its price responds to the change in the total yield. Here the total yield moves by $-50 \text{ bp} + 100 \text{ bp} = +50 \text{ bp}$. With duration of 6.0, the price change is about $-D \times \Delta y = -6.0 \times 0.0050 = -3.0\%$. This shows why falling US yields can partly offset widening emerging-market spreads, and why investors split sovereign returns into a Treasury part and a spread part. In risk-off episodes, spreads often widen by more than Treasuries rally, so total yields still rise.

## Question: 25

US gasoline prices jump 35% in a quarter, real average hourly earnings growth turns negative, and the personal saving rate is already near cyclical lows. Which relative sector performance is most likely over the following quarters?

**A.** Consumer discretionary underperforms staples as real incomes are squeezed
**B.** Consumer discretionary outperforms as nominal sales rise with prices
**C.** Consumer staples underperform as their sales are most cyclical
**D.** Consumer staples and discretionary move together in such periods

**Answer:** A

Explanation: Consumer discretionary spending, such as autos, travel, leisure and durable goods, depends heavily on real disposable income and confidence. When energy costs absorb a larger share of household budgets, real wages fall, and low saving rates leave little cushion, households cut optional purchases first. Consumer staples sell necessities with steadier demand and usually some pricing power, so their earnings hold up better. That relative strength makes discretionary versus staples a widely used gauge of consumer health and of the economic cycle.

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## Question: 26

Using the constant-growth framework, a stock's equity duration can be approximated as $D \approx \frac{1}{r-g}$. A growth stock and a value stock both have a required return of 9%. The growth stock's long-run growth rate is 6%, and the value stock's is 2%. What are the

approximate equity durations, and what do they imply when rates rise?

**A.** Growth duration about 15 years versus about 11 years for value
**B.** Growth duration about 14 years versus about 33 years for value
**C.** Growth duration about 33 years versus about 14 years for value
**D.** Growth duration about 67 years versus about 50 years for value

**Answer:** C

Explanation: Equity duration measures how sensitive a stock's value is to changes in the discount rate. For the growth stock, $D \approx \frac{1}{0.09-0.06} \approx 33.3$ years. For the value stock, $D \approx \frac{1}{0.09-0.02} \approx 14.3$ years. Growth stocks receive more of their value from distant cash flows, so they behave like long-dated bonds and fall more when real yields rise. This mechanism helps explain the style swings at cycle turns, for example value's sharp outperformance in 2022 as yields climbed, and growth's leadership when yields fall.

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## Question: 27

The Fed raises its policy rate by 200 bp within a year. Analysts note that Russell 2000 companies underperform the S&P 500 by more than earnings revisions alone would suggest. Which balance sheet feature best explains why small caps are more vulnerable to rate hikes?

**A.** Lower leverage makes small caps less sensitive to rising rates
**B.** Higher foreign revenue exposure shields them from rate increases
**C.** A higher share of floating-rate debt raises their interest costs faster
**D.** Long-dated fixed-rate debt delays their interest cost increases

**Answer:** C

Explanation: Large companies mostly finance themselves with long-dated, fixed-rate bonds, which lock in low coupons and delay the impact of higher rates. Smaller companies rely far more on bank loans, leveraged loans and other floating-rate borrowing, so a much larger share of their debt reprices as short-term rates rise. Interest expense climbs quickly, coverage ratios weaken and profitability falls, especially for the many unprofitable or highly leveraged members of small-cap indexes. That is why small caps tend to lag during tightening and do best early in a cycle, when rates are falling and credit conditions are easing.

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## Question: 28

A headline CPI report surprises sharply to the upside, driven mainly by energy prices, while core inflation is roughly in line. Historically, which equity sector has most consistently outperformed the broad market during periods of rising, commodity-driven inflation surprises?

**A.** Energy, as revenues reprice with the commodity inflation in the print
**B.** Technology, as long-duration earnings gain when yields climb
**C.** Utilities, as regulated tariffs reset instantly with headline CPI
**D.** Real estate, as rising discount rates lift property valuations

**Answer:** A

Explanation: When inflation surprises come from commodities, energy producers' revenues are directly tied to the prices pushing the index up, so earnings rise with inflation while most sectors face cost pressure. Energy, and often materials, have historically been the most reliable equity hedges in high and rising inflation, such as the 1970s and 2021–2022. Long-duration growth stocks and rate-sensitive sectors

tend to suffer as inflation lifts yields and discount rates. Regulated utilities usually reset tariffs with a lag, so their earnings do not keep pace in the short term.

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## Question: 29

A regional bank has 100 billion USD of earning assets, 40% of which reprice immediately with short-term rates. It has 80 billion USD of interest-bearing deposits, whose rates move with a deposit beta of 30%. The Fed raises short-term rates by 100 bp. Ignoring balance sheet changes and other liabilities, what is the approximate first-year impact on net interest income and net interest margin?

**A.** NII is unchanged because deposit costs fully offset asset yields
**B.** NII rises by about $400 million and NIM widens by about 40 bp
**C.** NII falls by about $240 million and NIM narrows by about 24 bp
**D.** NII rises by about $160 million and NIM widens by about 16 bp

**Answer:** D

Explanation: Interest income rises on the repricing assets: $40\text{ bn} \times 1.00\% = 400\text{ m}$. Deposit costs rise only by the deposit beta times the rate move: $80\text{ bn} \times 1.00\% \times 0.30 = 240\text{ m}$. Net interest income increases by about 160 million USD, and on 100 billion USD of earning assets that is about $\frac{160\text{ m}}{100\text{ bn}} = 16\text{ bp}$ of margin expansion. An asset-sensitive bank with low deposit betas benefits from rate hikes. Margins can later erode if deposit betas rise as customers move cash to higher-yielding alternatives, or if the yield curve inverts.

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## Question: 30

A regulated utility is valued with the constant-growth dividend discount model. Next year's dividend is 2.00 USD, the long-run dividend growth rate is 4%, and the market's required return is 8%. A jump in long-term bond yields raises the required return to 8.5%, with growth unchanged. What is the approximate change in the model value per share?

**A.** A fall of about 5%, from roughly $50.00 to $47.50 per share
**B.** A rise of about 11%, from roughly $50.00 to $55.56 per share
**C.** A fall of about 6%, from roughly $50.00 to $47.06 per share
**D.** A fall of about 11%, from roughly $50.00 to $44.44 per share

**Answer:** D

Explanation: The Gordon growth model values a stock as $P = \frac{D_1}{r-g}$. Before the shock, $P = \frac{2.00}{0.08-0.04} = 50.00$. After it, $P = \frac{2.00}{0.085-0.04} \approx 44.44$, a decline of about 11.1%. A rise of only 50 bp in the discount rate cuts value by more than 10% because the gap between required return and growth is small, which gives the stock a long effective duration. This is why utilities and other bond-proxy sectors are so rate-sensitive and tend to underperform when long-term yields rise sharply.

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