

FREE SERIES 26 PRACTICE EXAM

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1. Under the investment company concept of "mutuality" of ownership, shareholders can:
 - A. Participate with management in the day-to-day selection of investments for the fund
 - B. Share proportionately in the fund's income, losses and profits
 - C. Restrict the investor's respective investments to specific securities in the fund's portfolio
 - D. All of the above

2. An initial issue of shares of an open-end management investment company may be offered to the general public at what price:
 - A. The price described in the current prospectus only
 - B. At or below the public offering price as described in the current prospectus only
 - C. At or above the public offering price as described in the current prospectus only
 - D. At any price negotiated between the buyer and the broker/dealer

3. An open-end investment company is distinguished from a closed-end investment company by the primary characteristic of:
 - A. The open-end company has a fixed number of shares outstanding
 - B. The open-end company shares are traded on an exchange
 - C. The fund makes a continuous public offering of shares
 - D. The open-end company does not redeem its shares

4. Concerning open-end investment companies, all of the following are true, EXCEPT:
 - A. Investors may purchase shares directly from the issuing company, underwriter and/or broker/dealer
 - B. The number of outstanding shares is fixed at all times
 - C. The public offering of shares is continuous in nature
 - D. The shares are redeemed by the issuing fund

5. Normally, the mutual fund management fee is:
 - A. Included as part of the sales charge for the fund shares
 - B. Not more than 8.5% of the average current annual net asset value
 - C. $\frac{1}{2}$ of 1% of the average annual net assets computed daily
 - D. Not more than 5% of the total assets being managed by the firm

6. An investment company's list of securities held by the fund is known as its:
- A. Net assets
 - B. Capitalization
 - C. Portfolio
 - D. Capital structure
7. Some open-end investment companies grant investors an "exchange privilege." This most nearly means that investors are permitted to:
- A. Replace fund shares with securities that are currently listed on a national auction exchange
 - B. Have capital gains distributions and earned dividends converted into additional fund shares
 - C. Switch investments among investment companies with different investment objectives and realize a deferment of taxation on any realized appreciation until such time as the account is liquidated
 - D. Exchange shares of one open-end investment company for another within the family of funds at the respective current net asset value on a dollar-for-dollar basis
8. An investor's earned dividends that are reinvested in the fund:
- A. Assures preservation of the original invested principal
 - B. Results in a compounding of shares effect
 - C. Allows the investor to defer all federal income taxes until the plan is liquidated
 - D. Makes it possible for the investor to purchase additional shares at a price substantially below the current net asset value
9. The purchase of open-end investment company shares provides advantages to small investors including all of the following, EXCEPT:
- A. Daily control over the investment portfolio
 - B. Systematic and regular investment of small amounts
 - C. Diversification of investments
 - D. Professional management of the investments
10. Open-end investment company "net investment income" represents:
- A. Net income from dividends and interest paid on securities in the fund portfolio
 - B. Proceeds gained from the sale of mutual fund shares to the general public
 - C. Net capital gains on sales of portfolio securities held by the fund for longer than one year
 - D. An accumulation of dividends plus interest plus net long-term capital gains realized from the sale of securities

11. The management fee paid by an investment company is part of the:
- A. Underwriter's concession
 - B. Operating expenses of the fund
 - C. Initial sales load
 - D. Fund's improvements
12. During economic periods when stock prices are declining and interest rates are remaining relatively stable, would a growth fund or a balanced fund provide the investor with the best protection against loss of principal:
- A. The balanced fund would afford better downside protection because the fund's holding consists primarily of preferred stock and high-quality debt issues
 - B. The balanced fund, because they are convertible and would therefore permit a high appreciation of the securities
 - C. The growth fund, because the portfolio will consist primarily of common stock thereby providing greater diversification
 - D. The growth fund, because of the greater potential for appreciation of the securities in the portfolio
13. An investor would expect there to be the greatest appreciation of which of the following during periods when general stock market prices are increasing:
- A. A bond fund portfolio
 - B. An income fund portfolio
 - C. A balanced fund portfolio
 - D. A common stock fund portfolio
14. A registered representative should inform an investor that short-term trading in mutual fund shares involving a sales load is not advisable due to:
- A. The limited marketability of such funds
 - B. The consequences of the IRS "wash sale" rules
 - C. The ability to obtain credit on such transactions under Regulation T
 - D. The impact of reoccurring sales charges that could drastically reduce the investor's potential for profit
15. Fund share prices of a common stock fund generally fluctuate:
- A. In exact ratio with the general market
 - B. With the changing values of the underlying portfolio
 - C. In direct relation to interest rate movements
 - D. In the same manner as closed-end company shares

16. A fund's net asset value would be decreased by:
- A. Appreciation of the fund's securities in the investment portfolio
 - B. Purchase payments to the fund received from investors
 - C. Dividends distributed to fund shareholders
 - D. Dividends and interest received by the fund from the securities held in the portfolio
17. A fund's net asset value per share would be increased by:
- A. Appreciation of the securities in the fund's portfolio
 - B. Purchase payments received by the fund from investors
 - C. Capital gains and dividends distributed to shareholders
 - D. Investors reinvesting capital gains and/or dividend distributions
18. Sales charges on purchases made under a letter of intent are usually deducted:
- A. In their entirety at the end of the investment period as stipulated in the letter of intent
 - B. In their entirety on the front end of the first payment for the program
 - C. From each payment at the rate stipulated in the letter of intent
 - D. None of the above - the investor is assessed applicable sales charges at the end of the investment period
19. Shares of an open-end investment company would increase in value due to the increasing:
- A. Cost of living
 - B. Market value of portfolio securities
 - C. Relative demand for fund shares
 - D. Volume of trading of the securities
20. An open-end investment company shares are quoted as \$14.17 - \$15.32. To determine the sales charge as a percentage of the amount invested, the procedure would be to:
- A. Divide \$15.32 by \$14.17
 - B. Divide \$1.15 by \$15.32
 - C. Divide \$14.17 by \$15.32
 - D. Divide \$1.15 by \$14.17
21. Quantity purchases of investment company shares by the general public would entitle investors to discounts from the principal underwriter of the fund by each of the following except:
- A. A custodian purchasing under the uniform gifts to minors act for the minor
 - B. A husband and wife purchasing for their joint account and for each separate account of their three minor children
 - C. A 40-year-old daughter and her parent purchasing for their individual accounts
 - D. A husband and wife purchasing for their joint account

22. Individuals are permitted to combine purchases of open-end investment company shares under the Investment Company Act of 1940 and would qualify for reduced sales charges provided the securities are being purchased by:
- A. A single fiduciary account, such as a qualified employee profit sharing plan
 - B. The duly designated agent for a group of individuals joining together for a common purpose
 - C. Individuals joining together to form an investment club
 - D. None of the above
23. The fundamental investment policies of an open-end investment company may be changed only with the approval of the:
- A. Management company
 - B. Securities and Exchange Commission
 - C. Investment advisors
 - D. Fund directors and majority vote of the shares
24. In order to make a public offering of its shares and to become registered, the investment company must have a minimum net worth of:
- A. \$500,000
 - B. \$300,000
 - C. \$200,000
 - D. \$100,000
25. The management company fee received from a mutual fund is usually based on:
- A. The kind of securities in the portfolio
 - B. Net asset value of the fund
 - C. Amount of capital stock in the fund
 - D. Volume of new shares issued by the fund

ANSWERS & RATIONALES

1. **B** The investment company concept of "mutuality" of ownership allows shareholders to share proportionately in the fund's income, losses and profits.
2. **A** An initial issue of shares of an open-end management investment company may be offered to the public only at the price described in the current prospectus. The purchase of additional shares will always be at the current NAV next computed after receipt of the order.
3. **C** An open-end investment company is distinguished from a closed-end investment company in that the closed-end investment company has a fixed number of shares; whereas, an open-end investment company makes continuous offerings of shares.
4. **B** A closed-end company has a fixed number of shares; whereas, an open-end company has continuous offerings of shares.
5. **C** The mutual fund management fee is normally $\frac{1}{2}$ of 1% of the average annual net assets computed daily.
6. **C** The list of securities held by an investment company is known as its portfolio.
7. **D** The "exchange privilege" allows investors to exchange shares of one open-end investment company for those of another within the family of funds at the current net asset value respectively on a dollar-for-dollar basis. It is important to note that doing so would, in all likelihood, create a taxable event for the investor even if the investor did not receive any money.
8. **B** When an investor reinvests earned dividends and/or capital gains distributions, the net result is a compounding of shares effect. Potentially, this provides the investor with additional shares that, in turn, would earn additional dividends and capital gains, etc.
9. **A** In an open-end investment company, the advantages to the investor are professional management, diversification and regular, systematic investments of small amounts. The investor does not have control over the daily management of the fund portfolio.
10. **A** An open-end investment company's "net investment income" represents only income from dividends and interest earned from the fund's portfolio of securities. It does not include net long-term capital gains.
11. **B** The management fee paid by an investment company is part of the fund's operating expenses.
12. **A** During periods of declining stock prices and stable interest rates, a balanced fund would provide better downside protection and, therefore, have a greater potential of preserving

the invested capital. The interest earnings from the debt issues of the balanced portfolio would offset the dividend losses of the stock issues.

13. **D** When general stock market prices are increasing appreciably, a common stock fund would have the greatest potential for increase in value.
14. **D** A potential investor should be advised by the registered representative that short-term trading in mutual funds which involve a sales load are inadvisable because the investor will be incurring sales charges which drastically reduce the potential for profit.
15. **B** Any fund is only as strong as the securities in the underlying portfolio. Therefore, common stock fund share prices will fluctuate with the changing values of the fund's underlying portfolio securities.
16. **C** A fund's net asset value per share would be decreased by the fund distributing dividends to the shareholders.
17. **A** A fund's net asset value per share would be increased by appreciation of the fund's securities in the underlying portfolio.
18. **C** Sales charges on purchases of funds made pursuant to a letter of intent are usually deducted from each investment payment at the rate stipulated in the letter of intent.
19. **B** Shares of an open-end investment company would increase in value as a result of an increase in the market value of the fund's underlying portfolio.
20. **B** To determine the sales charge as a percentage of the amount invested, the procedure is to determine the sales load and divide that amount by the ask price.
21. **C** Sales load quantity discounts are only available for individuals purchasing for their individual account, which could include a husband and wife purchasing for their joint account. Discounts are not permitted for individuals banding together, such as a 40-year old daughter and her parent.
22. **A** Sales charge discounts are permitted for a single fiduciary account, such as an employee profit sharing plan or pension plan.
23. **D** The fundamental investment policies of an open-end investment company may be changed only with the approval of the board of directors and majority vote of the shares.
24. **D** In order to make a public offering of its shares and to become registered, an investment company must have a minimum net worth of \$100,000.
25. **B** The management company fee paid by the mutual fund company is based on the annual net asset value of the fund shares computed daily at the close of the NYSE.