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PRACTICE QUESTIONS

CFA Institute - CFA® Program

CFA3M

Level III CFA® - Private Markets

EDITION	QUESTIONS	ISSUED
Demo	9	September 3, 2026

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Before you begin

What this is

9 practice questions for CFA Institute - CFA® Program `CFA3M`, each with its answer key and an explanation. Answer a question before you read its key — the explanation is worth more once you have committed.

If something looks wrong

Send us three things and we will check it:

- the exam code, `CFA3M`
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QUESTION 1 SINGLE CHOICE

Which of the following characteristics most accurately describes private market investments relative to traditional public market investments?

A Higher liquidity and lower return potential compared to public markets

B Lower return potential but higher liquidity compared to public markets

C Longer investment horizons and limited liquidity compared to public markets

D Similar liquidity profiles but lower return potential compared to public markets

ANSWER **C**

WHY Private market investments are characterized by longer investment horizons (typically 5–10 years or more) and limited liquidity because interests in private funds are not readily tradable. They also generally offer the potential for higher risk-adjusted returns (illiquidity premium), not lower.

QUESTION 2 SINGLE CHOICE

In a typical private equity fund, which of the following terms best describes the 'carried interest'?

A The management fee paid to the general partner regardless of fund performance

B The general partner's share of fund profits, typically paid after a specified return threshold is met

C The limited partners' initial capital commitment to the fund

D The discount applied to the net asset value of fund holdings

ANSWER **B**

WHY Carried interest is the general partner's share of fund profits, traditionally around 20%, paid only after the fund has returned the limited partners' contributed capital plus a specified preferred return (hurdle rate). It is not the management fee, the capital commitment, or an NAV discount.

QUESTION 3 MULTIPLE CHOICE

Which of the following statements about the J-curve effect in private equity are correct? (Choose two.)

A It reflects the pattern of negative returns in early years followed by positive returns as portfolio companies mature

B It results from capital being called and invested before any significant distributions are realized

C It can be eliminated through proper fund manager selection

D It indicates that early-year returns should be viewed in isolation when evaluating manager performance

ANSWER **B · D**

WHY The J-curve reflects the typical pattern of negative IRRs in the early years of a fund's life as capital is called and invested before distributions occur, followed by improving returns as portfolio companies are exited. Early-year returns should NOT be viewed in isolation; they need to be evaluated alongside subsequent years. The J-curve is a structural feature of private equity and cannot be eliminated through manager selection.

QUESTION 4 SINGLE CHOICE

An advisor is conducting due diligence on a private equity fund. Which of the following factors is most important to evaluate when examining the general partner's track record?

A The total number of funds raised by the general partner in the past decade

B The risk-adjusted performance of prior funds, the consistency of returns across vintages, and how performance compares to appropriate benchmarks

C The geographic location of the general partner's headquarters

D The names of the limited partners in the general partner's prior funds

ANSWER **B**

WHY The GP's track record is best assessed through risk-adjusted performance, consistency across vintages, and benchmarking against relevant public market equivalents. Fund count, HQ location, and limited partner names are not meaningful indicators of investment skill.

QUESTION 5 SINGLE CHOICE

Which private equity strategy typically involves investing in mature companies using significant amounts of debt financing to fund the acquisition?

- A Venture capital
- B Growth equity
- C **Leveraged buyout**
- D Distressed investing

ANSWER C

WHY Leveraged buyouts (LBOs) involve acquiring mature, often established companies using significant debt financing, with the acquired company's assets and cash flows typically serving as collateral. Venture capital funds early-stage companies with little to no debt, growth equity invests in expanding companies with moderate leverage, and distressed investing targets companies in financial difficulty.

QUESTION 6 MULTIPLE CHOICE

Which of the following are common forms of private debt? (Choose two.)

- A **Direct lending**
- B **Mezzanine debt**
- C Treasury bills
- D Investment-grade corporate bonds traded on major exchanges

ANSWER A · B

WHY Direct lending and mezzanine debt are recognized categories of private debt. Treasury bills and exchange-traded investment-grade corporate bonds are public market instruments, not private debt.

QUESTION 7 SINGLE CHOICE

Which of the following statements best distinguishes private real estate funds from publicly traded REITs?

- A Private real estate funds offer daily liquidity while REITs do not
- B Private real estate funds typically offer higher liquidity than publicly traded REITs
- **C Private real estate funds generally have longer holding periods and lower liquidity than publicly traded REITs**
- D Private real estate funds and REITs have identical liquidity profiles but differ in tax treatment

ANSWER C

WHY Private real estate funds typically have multi-year holding periods with infrequent redemption opportunities, making them significantly less liquid than publicly traded REITs, which trade on exchanges daily. They generally offer higher return potential to compensate for this illiquidity.

QUESTION 8 SINGLE CHOICE

Which of the following is a defining characteristic of private infrastructure investments?

- A Short investment horizons with frequent mark-to-market valuations
- **B Exposure to long-lived physical assets that often generate stable, predictable cash flows**
- C Traded daily on major public exchanges
- D Low correlation with inflation expectations

ANSWER B

WHY Private infrastructure investments involve long-lived physical assets (such as toll roads, utilities, and pipelines) that typically produce stable, predictable cash flows and offer an inflation hedge through contractual inflation linkages. They have long investment horizons and are illiquid.

QUESTION 9 SINGLE CHOICE

Which valuation approach is most commonly used to value mature private companies in leveraged buyout transactions?

- A Probability-weighted expected return method
- **B Discounted cash flow based on detailed operating projections**
- C Comparables approach using trading multiples of similar public companies
- D Cost approach based on the replacement value of assets

ANSWER **B**

WHY Mature private companies in LBO transactions are most commonly valued using discounted cash flow analysis based on detailed operating projections, often cross-checked with comparable transaction multiples. Early-stage companies more often rely on comparables and probability-weighted scenarios.