

Investment principles, markets and environment

At the end of this unit, candidates should be able to demonstrate an understanding of:

- The main principles governing how to construct an investment portfolio;
- How portfolio risk and return are measured and managed;
- The range of investment management services and how their performance is evaluated;
- The risks, returns and uses of different asset classes;
- How the economic environment affects investment performance.

Summary of learning outcomes

1. Understand fundamental economic issues relevant to investment portfolios;
2. Understand the main principles of portfolio risks and returns;
3. Understand how to establish client objectives and constraints;
4. Understand the risks and returns of cash, debt investments, equities and property;
5. Understand the risks and returns from alternative investments and derivatives;
6. Understand the portfolio construction process and asset allocation;
7. Understand how to assess investment portfolio performance and investment management services.

Important notes

- This syllabus will be examined in the October 2009, April 2010 and July 2010 sessions. Candidates will be examined on the basis of English Law and practice in the year 2009/2010 unless otherwise stated.
- The general rule is that exams are based on the English legislative position three months before the date of the exams.
- Candidates should refer to the CII update website www.cii.co.uk/updates for the latest information on changes to law and practice and when they will be examined.
- This syllabus gives greater emphasis to asset classes and portfolio management than the 2007/2008 syllabus, and gives less emphasis to collective investments. Candidates are therefore encouraged to ensure they have up to date study material for the current examination.

1. Understand fundamental economic issues relevant to investment portfolios

- 1.1 The main phases of the economic and financial cycle;
- 1.2 Inflation and interest rate drivers – money supply, expectations, interest rates, exchange rates, business cycle;
- 1.3 Basic concepts of supply and demand in relation to financial investments and markets – the market process, application of concepts;
- 1.4 The roles of governments, central banks and financial regulators in investment markets – fiscal policy and public finances, monetary policies and interest rates;
- 1.5 Trends in the financial markets since 1985 and their impact on investment performance and markets;
- 1.6 Systemic/non-systemic risk.

2. Understand the main principles of portfolio risks and returns

- 2.1 Measuring investment returns;
- 2.2 The principles of investment risk – volatility of returns;
- 2.3 Covariance and correlation – positive correlation, negative correlation and no correlation, risk reduction through investment diversification;
- 2.4 Modern Portfolio Theory, the efficient frontier and constructing optimal portfolios;
- 2.5 Systematic and unsystematic risk – role of beta;
- 2.6 Capital Asset Pricing Model (CAPM) – the concept, the limitations of CAPM, application of CAPM, alternative models, e.g. the Arbitrage Pricing Model.

3. Understand how to establish client objectives and constraints

- 3.1 Risk and return objectives;
- 3.2 The importance of timescale – investment, timescales and risk, the time value of money;
- 3.3 Inflation and deflation – the potential impact on investment values;
- 3.4 Tax – the impact on long term investment performance;
- 3.5 Gearing – effect on increasing investment returns and risk;
- 3.6 Types of risk – currency risk, event risk;
- 3.7 Socially responsible investment – variations.

4. Understand the risks and returns of cash, debt investments, equities and property

- 4.1 Cash – typical returns, main risks;
- 4.2 Debt investments – methods of measuring performance, risk factors, yield curves, uses of bonds;
- 4.3 Equities – shareholders' rights, measures of value, different categories of shares, risks and returns from equity investments, the role of collectives;
- 4.4 Analysing companies – using financial ratios to assess credit risk, profitability and liquidity;
- 4.5 Property – characteristics as an asset class, risks and returns, valuation and liquidity issues, investment features of property holding vehicles.

5. Understand the risks and returns from alternative investments and derivatives

- 5.1 Private equity – suitability, venture capital, AIM and other ways to invest, tax relief, Enterprise Investment Schemes;
- 5.2 Commodities – characteristics, drivers of performance, ways to invest;
- 5.3 Hedge Funds – characteristics, strategies, advantages and disadvantages of investment, funds of funds;
- 5.4 Art and antiques;
- 5.5 Structured products – the main types of retail products and how to appraise the risks and returns;
- 5.6 Derivatives – characteristics of futures, forwards, options, and swaps. Use of contracts for difference and spread betting;
- 5.7 Uses of derivatives in portfolios, hedging, income generation.

6. Understand the portfolio construction process and asset allocation

- 6.1 Asset allocation models – meeting different portfolio objectives, working within different constraints, setting benchmarks;
- 6.2 The relative importance of asset allocation in portfolio performance;
- 6.3 How property is used in the construction of an investment portfolio;
- 6.4 Passive investment funds – comparison with active investment, rationale and efficient market hypothesis, the main criteria in passive funds selection, ETFs;
- 6.5 Active investment management styles – top down, bottom up, value, growth and income investment styles;
- 6.6 Switching and churning – reasons, tax issues.

7. Understand how to assess investment portfolio performance and investment management services

- 7.1 Financial calculations – time value of money, compound interest, present value;
- 7.2 Risk measures, risk adjusted returns, alpha, beta, Sharpe, information ratio;
- 7.3 Indices – UK, overseas, limitations;
- 7.4 Understanding and using statistical data – performance measurement, evaluation, peer comparisons;
- 7.5 Investment criteria – investment process, experience, performance, structure and style of management, size and resources, staff, administration, costs;
- 7.6 Past performance – investment classes, fund managers, whether a guide to future performance;
- 7.7 The main features of investment management services;
- 7.8 The investor policy statement;
- 7.9 Portfolio managers – roles, responsibilities, discretionary services, advisory services, requirements for regular reporting to clients;
- 7.10 Charging structures – direct investment stock broking, investment funds, discretionary management, ISAs/PEPs, the VAT position on fees and commissions.

Reading list

The following list provides details of various publications which may assist with your studies. Periodicals and publications will be of value in ensuring candidates keep up to date with developments and in providing a wider coverage of syllabus topics. Any reference materials cited are authoritative, detailed works which should be used selectively as and when required.

Note: The examination will test the syllabus alone.

The reading list is provided for guidance only and is not in itself the subject of the examination.

CII/PFS members can borrow most of the study materials from CII Knowledge Services and may be able to purchase some at a special discount. For further information on lending and discounts go to www.cii.co.uk/knowledge.

Investment principles, markets and environment. London: CII. Coursebook J06.

Investment and risk. London: CII. Coursebook CF2.

Understanding commercial property investment : a guide for financial advisers. 2007 ed. Available online at www.ipf.org.uk.

Financial calculations. Sarah Dingley-Brown. Bristol: SDB Training, 2008.

Financial market analysis. David Blake. 2nd ed. Chichester, West Sussex: John Wiley, 2000.

Investment appraisal and financial decisions. Steve Lumby, Chris Jones. 6th ed. London: Thomson Learning, 1999.

Modern portfolio theory and investment analysis. 6th ed. New York: John Wiley, 2002.

The complete guide to investing in property. Liz Hodgkinson. 3rd ed. London: Kogan Page, 2008.

Reference materials

The Financial Times guide to investing: the definitive companion to investment and the financial markets. Glen Arnold. Harlow [England]: Pearson Education, 2004.

Lamont's glossary: the definitive plain English money and investment dictionary for the finance professional and money-minded consumer. Barclay W Lamont. 9th ed. Surbiton, Surrey: Lamonts Glossary Ltd, 2004. Also available online at www.cii.co.uk/knowledge/dictionaries (CII/PFS members only).

PFS focus. London: CII Knowledge Services. Comprehensive archive of PFS publications, including technical and regulatory bulletins and technical tips. Available online at www.cii.co.uk/knowledge/pfs (CII/PFS members only).

Periodicals

Financial Adviser. London: FT Business. Weekly. Also available online at www.ftadviser.com.

Financial Solutions. London: Personal Finance Society. Six issues a year. Also available online at www.cii.co.uk/knowledge/financialsolutions (CII/PFS members only).

Financial Times. London: Financial Times. Daily. Also available online at www.ft.com.

Investment Adviser. London: FT Business. Weekly. Also available online at www.ftadviser.com.

Investors Chronicle. London: FT Business. Weekly.

Investment Week. London: Incisive Media. Weekly. Also available at www.investmentweek.co.uk.

Money Management. London: FT Business. Monthly.

Money Marketing. London: Centaur Communications. Weekly. Also available online at www.moneymarketing.co.uk.

Examination guides

Guides are produced for each sitting of written answer examinations. These include the exam questions, examiners' comments on candidates' performance and key points for inclusion in answers. You are strongly advised to study guides for the last two sittings. Please visit www.cii.co.uk to buy online or contact CII Customer Service for further information on +44 (0)20 8989 8464. Older examination guides are available (for members only) at www.cii.co.uk/knowledge/examguides.

Exam technique/study skills

There are many modestly priced guides to study skills and exam techniques in bookshops. You will also find advice at www.cii.co.uk/careersupport (CII/PFS members only).

For a more interactive approach, you should consider: Winning the brain game. London: CII, 2006. CD-Rom.