Investment portfolio management

Objective: To develop in the candidate the ability to:

- describe investment markets and the main types of financial investments;
- explain how investment markets are affected by economic, technological and political conditions;
- explain the theory and practical implications of investment risk and portfolio theory;
- evaluate the success of investment strategies and asset allocation models;
- describe the regulatory requirements for investment portfolio management;
- apply knowledge and skills to practical situations;
- synthesise different aspects of the syllabus and apply them to given scenarios.

Assumed knowledge and application skills: Assumed knowledge may not appear in detail within the learning outcomes but forms part of the syllabus and thus may be examined. It is assumed that the candidate already has the knowledge and application skills gained from a study of the relevant elements of the Certificate in Financial Planning or equivalent qualification. The candidate is also assumed to have a basic knowledge of statistical methods and financial mathematics and is advised to have studied for APFC unit, G20 Personal investment planning before attempting this unit, since it builds on the knowledge gained from G20.


Notes:
- The syllabus is examined on the basis of the legislative position in England three months prior to the examination date.
- Where law and practice in Scotland differs, this will be explained in the primary text.

1. The economic environment

1.1 The key political and social factors which affect investment markets

Candidates should be able to
- describe in outline the main political and social factors which affect investment values and returns.

1.2 Economic and financial factors which affect financial markets

Candidates should be able to
- describe the main economic and financial factors which affect investment values and returns, including:
  - economic growth trends;
  - the effects of inflation and deflation;
  - productivity of labour and capital;
  - technological change;
  - sectional, regional, national and world business cycles;
  - international trade;
  - capital movements;
  - exchange rates;
  - money supply;
  - interest rates;
  - inflation;
  - demographic changes;
  - types of unemployment;
  - monopolies and perfect competition;
  - demand and supply curve;
  - Phillips curve.

1.3 How political, social, economic and financial factors affect investment markets

Candidates should be able to
- describe how these factors can affect the development and behaviour of financial institutions and markets;
- explain these issues in relation to the UK and make comparisons with other markets (USA, Japan, Europe) and also emerging markets.

1.4 The role of governments in investment markets

Candidates should be able to
- outline the role of governments in determining monetary and fiscal policy, interest rates, public sector finance, government borrowing, regulation of financial markets and other businesses.

1.5 Central banks and the banking system

Candidates should be able to
- outline the functions of central banks and the banking system and their relationship to bond markets.

2. Direct financial investments

2.1 Cash investments

Candidates should be able to
- describe the main classes of cash investments including deposits, certificates of deposit, Treasury bills;
- distinguish between the main types of cash investment and be able to contrast cash investments with other main categories of investments, such as fixed interest securities and equities;
- describe the risks and returns of cash investments;
- describe methods of analysing cash investments;
- explain the main issues with respect to investment in different currencies.

### 2.2 Fixed interest investments
Candidates should be able to
- explain and distinguish between:
  - the main types of fixed interest investment including gilts, both fixed interest and index-linked (including the basic function of strips and repo markets);
  - debentures and loan stock;
  - convertibles and preference shares;
  - foreign government bonds;
  - local authority bonds;
  - UK and overseas corporate bonds;
  - Eurobonds;
- explain their uses and applications;
- describe fixed interest markets and how fixed interest securities are issued and redeemed;
- describe the structure and use of the yield curve;
- interpret yield curves;
- evaluate how economic, political and other developments may affect fixed interest investments;
- explain how yields are calculated;
- describe the risks and returns of fixed interest investments;
- distinguish between financial risks and credit risks;
- explain the relevance of credit rating;
- explain duration and modified duration.

### 2.3 Equity investments
Candidates should be able to
- describe the characteristics of different equity investments including:
  - market ratings;
  - size;
  - sector classifications;
  - financial strength;
  - extent of cyclical influences;
- demonstrate how shares are valued including:
  - Gordon’s growth model;
  - dividend yield;
  - price earnings ratio;
  - net asset value;
  - borrowing;
  - liquidity;
  - cash flow;
- explain the basic mechanics of mergers and takeovers, privatisations, demutualisations and management buy-outs and how mergers and acquisitions are financed and analysed;
- describe the main features of venture capital markets;
- explain the operation of the new issues market, scrip issues, rights issues, splits and how these affect investors and investment decisions;
- describe the risks and returns of equity investments.

### 2.4 Derivatives
Candidates should be able to
- describe the main kinds of derivatives: futures, options (including warrants), hedge funds and their main investment characteristics, how they are traded and their use in investment management including the role of warrants in the issue of new investment trusts;
- explain the risk involved including counterparty risk;
- assess the potential risks and rewards of derivatives;
- demonstrate how investment managers can use derivatives to stimulate markets and to increase or reduce risk in portfolios.

### 3. Collective investments

#### 3.1 Unit trusts and open ended investment companies (OEICs) and investment companies with variable capital (ICVCS)
Candidates should be able to
- describe the structure, pricing, roles of key participants such as trustees, mechanics of buying, selling and pricing of unit trusts, OEICs and ICVCS;
- compare the structure, investment objectives and tax treatment of different types of unit trusts, OEICs and ICVCS, both in the UK and offshore;
- compare OEICs, unit trusts and ICVCS, with particular reference to pricing, purchase and sale of investments and the impact of charges.

#### 3.2 Investment trusts (ITs)
Candidates should be able to
- describe the structure and management of ITs and their role within investment portfolios;
- distinguish between the main types of ITs including those with split capital structure and how they are analysed and evaluated;
- explain the concepts of net asset value (including diluted and undiluted net asset value), premium and discount;
- describe the impact of charges;
- explain the roles of warrants, C shares, S shares and packaged units;
- explain and evaluate the different investment objectives of investment trusts;
- explain the investment powers of the directors and the role of gearing in investment trust management;
- describe pricing, the roles of participants and the mechanics of buying and selling.

#### 3.3 Life assurance based investments
Candidates should be able to
- evaluate investment objectives of unit-linked fund managers;
- distinguish between different types of with-profits policies and explain the criteria used in choosing between different with profits providers;
- describe and evaluate onshore and offshore product structures and the concept of linked funds, unit pricing, charges and the tax position of the life office and how it can impact on unit-linked funds;
- describe the structure and use of derivative based life contracts; evaluate the advantages and limitations of broker funds.
3.4 Index tracker funds
Candidates should be able to
– describe the advantages and limitations in using index tracker funds;
– describe the different ways of constructing index tracker funds and evaluate and explain their role in portfolio planning;
– describe the criteria to be used in selecting index tracker funds.

4. Other investments

4.1 Unlisted securities
Candidates should be able to
– describe and evaluate the risks involved in investment in unlisted securities.

4.2 Venture capital trusts, enterprise investment schemes, enterprise zone buildings
Candidates should be able to
– describe the main tax features, principal rules and risks involved in venture capital trusts, enterprise investment schemes and enterprise zone buildings.

4.3 Physical assets and commodities
Candidates should be able to
– describe and evaluate the main risks and costs of buying and selling physical assets (including works of art and commodities) as well as investing in commodity futures and options;
– compare the risks and returns of investing in these assets in relation to equity investments.

4.4 Property
Candidates should be able to
– describe the basic issues surrounding both commercial and residential property investment and property markets, including the main participants (institutions, tenants, developers, planners, investors), direct and indirect holdings, valuations, investment characteristics;
– compare the risks and returns of property investment in relation to equity and fixed interest investment.

5. Interpretation of financial data

5.1 Accounts and accounting principles
Candidates should be able to
– interpret company accounts in the investment context;
– explain the requirements for company accounts.

5.2 How financial data underpin investment decisions
Candidates should be able to
– explain how accounts and annual reports are relevant to investment decisions and the limitations of such information;
– compare different company profiles;
– describe the use of accounting ratios which will be helpful in making investment decisions;
– describe research methodology and different types of information sources.

6. Dealing in investment markets

6.1 The UK equity and fixed interest markets
Candidates should be able to
– describe the mechanics of dealing in UK equity and fixed interest investments, including the roles of market makers and agency brokers, commission structures and other dealing costs, registration and settlement procedures (including CREST).

6.2 Comparison of UK and other international markets
Candidates should be able to
– compare in outline the different nature of dealing in UK markets, including the Alternative Investment Market, with that of dealing in other international markets.

7. Portfolio design

7.1 Managing investment risk
Candidates should be able to
– describe in a qualitative way the concepts contained in modern portfolio theory including the efficient frontier, covariances and correlation between asset types;
– describe how risk can be managed and how diversification can reduce certain elements of investment risk;
– distinguish between systematic risk and non systematic risk;
– describe the principles behind the capital asset pricing model (CAPM);
– evaluate portfolio risk using this model;
– identify limitations in CAPM;
– explain alternative models such as Arbitrage Pricing Model;
– explain the principles of investment risk.

7.2 Asset allocation and the role of the investment manager and adviser
Candidates should be able to
– describe different approaches to the management of portfolios including portfolio optimisation, correlation matrices;
– evaluate asset classes and collective investments such as unit trusts, OEICs and investment trusts within portfolios;
– construct and justify different asset allocation models to achieve different portfolio objectives under specified constraints for income needs, risk tolerance, timescale, tax position.

8. Fund management services

8.1 Portfolio investment management
Candidates should be able to
– explain the roles of investment managers and advisers for the main types of institutional and private clients in relation to different markets, investment objectives and legal constraints, different risk, profit, growth and income needs;
– describe the main features of portfolio investment management services;
distinguish between the roles and responsibilities of portfolio managers and compare discretionary and advisory services and requirements for reporting to clients on a regular basis;

- evaluate different charging structures and their impact on investment decisions.

8.2 Management of direct investments, unit trusts, offshore funds, fund of funds, pooled investments, OEICs, ICVCS, investment trusts and life assurance products

Candidates should be able to
- describe the features of management services as they apply to direct investments, unit trusts, offshore funds, fund of funds, pooled investments, OEICs, ICVCS, investment trusts, and life assurance products and multi managers;
- compare the relative merits of investing in these different structures and vehicles.

8.3 Pensions

Candidates should be able to
- describe the investment requirements of individual pension arrangements including Self Invested Personal Pension (SIPP), Small Self Administered Scheme (SSAS), Individual Pension Accounts (IPA) and unit-linked pensions generally;
- recommend appropriate strategies for pension funds where fund withdrawal facilities are used.

8.4 Personal Equity Plans (PEPs)/Individual Savings Accounts (ISAs)

Candidates should be able to
- evaluate how PEPs/ISAs fit into overall portfolio planning and determine when switches are appropriate.

8.5 Fund supermarkets and wrap accounts

Candidates should be able to
- describe and evaluate the features of fund supermarkets and wrap accounts.

8.6 Legislative requirements

Candidates should be able to
- outline the proposed changes to the legislative regimes for pensions and their potential impact on investment strategies.

8.7 Child trust funds

Candidates should be able to
- describe and evaluate the features of child trust funds.

9. Performance assessment and financial calculations

9.1 Time value of money

Candidates should be able to
- describe the principle of the time value of money;
- carry out simple compound interest and related calculations including effective rate of interest.

9.2 Benchmarks and indices

Candidates should be able to
- describe the broad principles of financial index construction, distinguishing between those indices used in the main investment markets both in the UK and overseas;
- demonstrate how financial indices are used in assessing portfolio performance.

9.3 Qualitative data and quantitative statistical data:
measurement of investment performance and returns of equity, fixed interest and other investment portfolios

Candidates should be able to
- use qualitative data and quantitative statistical data for the measurement of investment performance;
- calculate rates of return and distinguish between time-weighted and money-weighted returns;
- evaluate the uses and limitations of performance measurement;
- calculate Sharpe ratios.

9.4 Investment criteria, switching

Candidates should be able to
- establish and evaluate criteria for the selection of investment managers, pension funds, insurance funds, unit trusts and investment trusts;
- describe and justify criteria for making switching decisions between investments;
- define appropriate performance benchmarks.

9.5 Risk indicators

Candidates should be able to
- appraise critically statistical information about measures of volatility including Beta factors and other indicators of risk.

10. Regulatory environment

10.1 The conduct of investment business as it applies to investment managers and advisers

Candidates should be able to
- describe the main regulatory rules as they apply to investment management issues in relation to both discretionary and advisory management service, including broker funds;
- explain the regulatory provisions relating to money laundering and insider dealing;
- describe the regulatory provisions of the Financial Services Compensation Scheme and the Financial Ombudsman Service.

10.2 The responsibilities and expertise of investment managers and advisers

Candidates should be able to
- explain marketing, classification of clients, know your client, client agreements, conduct of business, best execution, execution only, record keeping, client money, information provision, complaints, safe custody, personal dealing and suitability of products.

10.3 Investment Services Directive

Candidates should be able to
- explain the provisions of the Investment Services Directive.
Reading list
The following list provides details of various publications which may assist with your studies. The primary text for this syllabus is shown in bold type. Periodicals and publications listed as additional reading 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/Personal Finance Society members can borrow most of these additional study materials from CII Information 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/is

Primary text
Investment portfolio management. London: The CII. Coursebook G70.

Additional reading
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: Lamont's Glossary Ltd, 2004. Also available online at www.cii.co.uk/is/dictionaries (CII/Personal Finance Society members only).

Periodicals
The Journal. London: The CII. Six issues a year. Also available online (CII/Personal Finance Society members only) at www.cii.co.uk/is.
Money Marketing. London: Centaur Communications. Weekly. Also available online at www.moneymarketing.co.uk

Examination guides
You are strongly advised to study these before the examination. Please visit www.cii.co.uk to buy online or contact CII Customer Service for further information on +44 (0)20 8989 8464.

Exam technique/study skills
There are many modestly priced guides available in bookshops. You should choose one which suits your requirements. An example is:
For a more interactive approach, you should consider: