

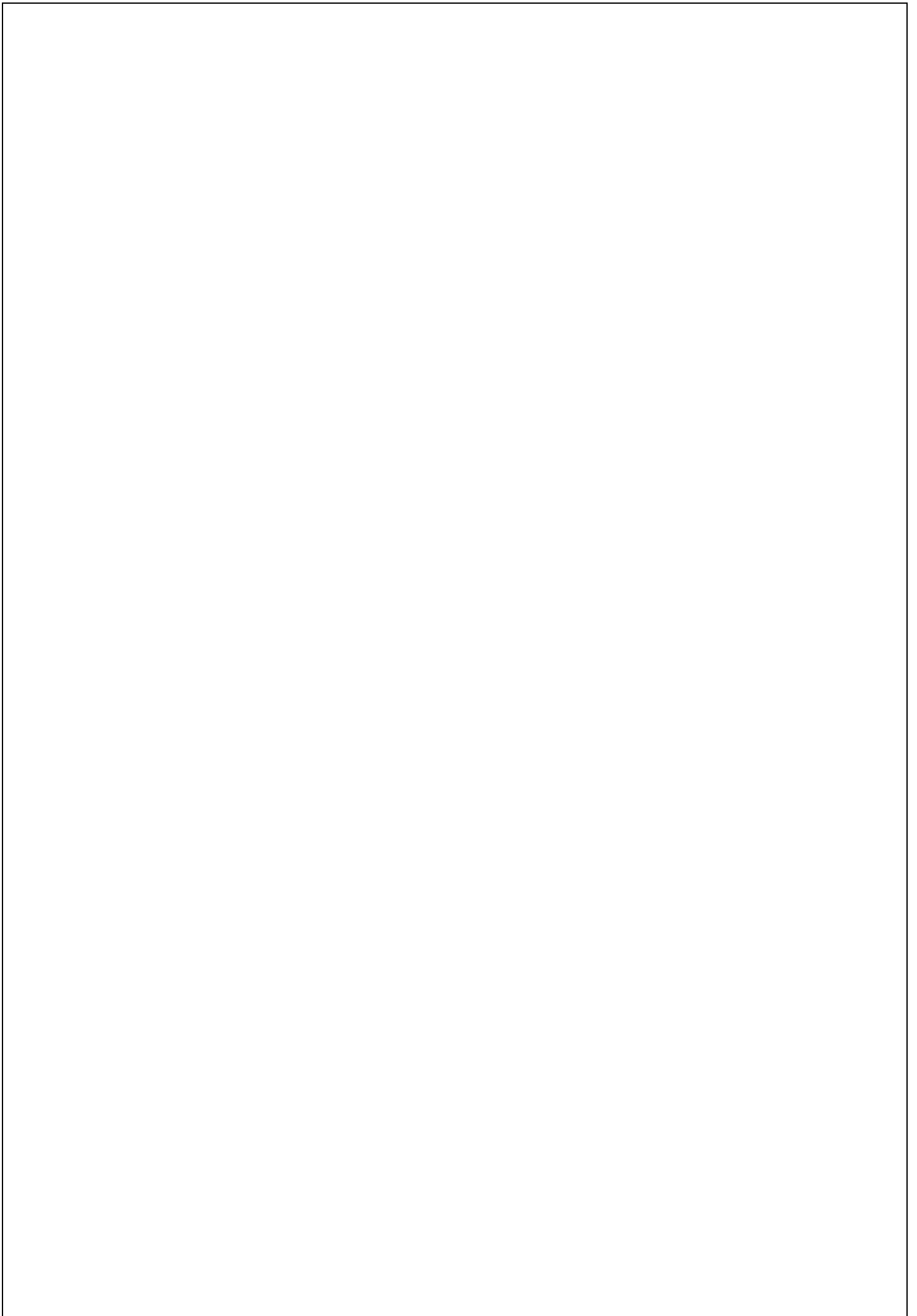


**SECURITIES & INVESTMENT INSTITUTE
MASTERS PROGRAMME
IN WEALTH MANAGEMENT**

**UNIT 2
PORTFOLIO CONSTRUCTION THEORY**

Effective for examination June 2009

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UNIT SUMMARY

The objective of the examination is to enable candidates to think critically and communicate clearly in the context of:

- the theory of investment as applied to the management of funds for private clients;
- the structuring of a portfolio of financial assets to suit the needs of a private client;
- the tax planning measures to be considered when structuring a portfolio of financial assets to suit the needs of a private client.

ASSESSMENT STRUCTURE

This is a 3-hour examination of 100 marks comprising five sections:

SECTION A worth 40 marks

- candidates answer **ALL** parts of the case-study question in this section.

SECTION B worth 20 marks

- candidates answer **ALL** parts of the question in this section.

SECTION C worth 10 marks

- candidates answer **TWO** questions from **THREE**, worth **5 marks** each.

SECTION D worth 20 marks

- candidates answer **ALL** parts of the question in this section.

SECTION E worth 10 marks

- candidates answer **TWO** questions from **THREE**, worth **5 marks** each.

SYLLABUS STRUCTURE

The syllabus is divided into **learning objectives**. These are broken down into a series of **assessment criteria**.

CANDIDATE UPDATE

Candidates are reminded to check the 'Candidate Update' area of the Institute's website (www.sii.org.uk) on a regular basis for updates that could affect their examination as a result of industry change.

PORTFOLIO CONSTRUCTION THEORY SYLLABUS

LEARNING OUTCOME 01 - Be able to explain the fundamentals of investment theory

1.1 Explain the fundamentals of investment theory:

- conceptualisations of risk within an investment context
- investment return
- risk free rate of return and the risk premium
- diversification
- pound cost averaging

1.2 Apply the concept of risk diversification to:

- assessment of a client's financial circumstances: age, wealth, stage of life, cycle, time horizon, need for liquidity, tax position and ethical preferences
- assessment of a client's risk profile
- evaluation of the client's appetite for risk in
- construction of a suitable client portfolio

LEARNING OUTCOME 02 - Be able to compare and contrast the properties and performance of the principal asset classes held directly by clients and via intermediated investments

2.1 Evaluate cash as a component of a portfolio:

- definition and key properties of cash
- risk, price, liquidity and return
- historic performance of cash

2.2 Evaluate bonds as a component of a portfolio:

- definition and key properties of bonds
- risk, price, value, liquidity and return
- sovereign bonds (gilts)
- corporate bonds
- historic performance of bonds

2.3 Evaluate equities as a component of a portfolio:

- definition and the key properties of equities
- risk, price, value, liquidity and return
- historic performance of equities

2.4 Evaluate property as a component of a portfolio:

- definition and the key properties of real estate
- risk, price, value, liquidity and return
- historic performance of real estate

LEARNING OUTCOME 03 - Be able to compare and contrast the properties and performance of alternative asset classes

3.1 Evaluate private equity as an asset class:

- definition and the key properties of private equity
- problems due to information asymmetry
- risk, liquidity and return
- performance of private equity

3.2 Evaluate commodities as an asset class:

- definition and key properties of commodities
- problems associated with particular types of commodity investment
- distinguish between direct and indirect investments in commodities
- performance of commodities

- 3.3 Evaluate infrastructure funds as an asset class:
- definition and key properties of infrastructure funds
 - problems due to lumpiness and indivisibility
 - risk, liquidity and return
 - performance of infrastructure funds

- 3.4 Evaluate hedge funds as an asset class:
- definition and key properties of hedge funds
 - unique features of hedge funds
 - performance of hedge funds
 - charges of hedge funds
 - benefits of fund of funds

LEARNING OUTCOME 04 - Be able to evaluate Modern Portfolio Theory and the Capital Asset Pricing Model

- 4.1 Evaluate the uses of Modern Portfolio Theory:
- the principle of diversification
 - the numeric application of portfolio theory
 - the impact of correlation upon portfolio risk
 - the interaction of indifference curves, the efficient frontier, and the capital market line via graphic illustration / narrative illustration
 - the market portfolio

- 4.2 Evaluate the Capital Asset Pricing Model:
- using numeric illustration and narrative illustration
 - the use and application of betas via numeric illustration, graphic illustration and narrative illustration
 - assessment of the degree of diversification through R² via numeric and narrative illustration
 - the limitations of CAPM and the efficient frontier

LEARNING OUTCOME 05 - Be able to examine the concepts of behavioural finance and how it is used in the industry

- 5.1 Define and evaluate the concepts of behavioural finance:
- key properties
 - heuristics that help investment decisions
 - prospect theory
 - cognitive illustrations
 - types of trader in the market: information traders, noise traders

LEARNING OUTCOME 06 - Be able to implement long term and tactical asset allocation strategies

- 6.1 Assess and select long term asset allocation strategies:
- definition and key properties
 - implications of risk appetite
 - liquidity, time horizon, liabilities and religious and ethical preferences as constraints upon potential asset allocation
 - portfolio optimisation via numeric illustration and narrative illustration

- 6.2 Assess and select tactical asset allocation strategies:
- definition and key properties
 - portfolio insurance via narrative illustration
 - spread measures used in tactical asset allocation via narrative illustration

LEARNING OUTCOME 07 - Be able to appraise different views of market efficiency and their impact on investment style

7.1 Explain market efficiency:

- definition and key features
- random walk
- informational efficiency
- theory and evidence on the three classic forms of market efficiency

7.2 Determine a strategy of active equity selection:

- investment styles: value, growth and growth at a reasonable rate
- investment philosophy: fundamental analysis, technical analysis and quantitative analysis

7.3 Determine a strategy of passive equity selection:

- indexation
- duplication
- stratified sampling
- factor matching
- co-mingling
- tracking error
- subjectivity with indexation

7.4 Apply a strategy of active bond selection:

- duration switching
- riding the yield curve
- bond switching

7.5 Apply a strategy of passive bond selection:

- duration matching (immunisation)
- cash flow matching
- horizon matching (combination)

LEARNING OUTCOME 08 - Explain the role and responsibilities of fund managers

8.1 Explain the key properties of the fund manager's role:

- investment considerations
- types of client and differences in their time horizon, risk and liquidity
- factors considered by sponsors when selecting a fund manager

8.2 Evaluate the different approaches to fund management:

- investment strategy and style: active / passive and top down / bottom up
- global and specialised fund management expertise
- quantitative and qualitative based
- investment research and investment decisions
- responsible investment

8.3 Explain the regulatory framework influencing a fund manager's decisions:

- responsibilities of Institutional Shareholders with Combined Code on Corporate Governance
- Higgs Report on reporting of interaction between institutional shareholders and non-executive directors
- Myners' Principles
- ISC Principles

LEARNING OUTCOME 09 - Be able to apply a range of techniques to measure portfolio performance

9.1 Apply benchmarking techniques:

- peer group benchmark
- customised benchmark
- benchmark index

- 9.2 Calculate total, absolute and relative returns and include:
- raw investment returns: holding period return
 - annualising returns of less than one year and more than one year
 - relative investment returns
- 9.3 Calculate time-weighted and money-weighted returns
- via numeric illustration and narrative illustration
 - explain why time weighted returns are considered superior
- 9.4 Evaluate performance attribution:
- asset allocation
 - stock selection
 - currency
- 9.5 Evaluate investment performance using Risk and Return:
- total risk
 - Jensen measure
 - relative duration (bonds)
 - Sharpe ratio
 - M2 Measure
 - Treynor measure
 - Appraisal ratio
 - Information ratio

LEARNING OUTCOME 10 - Be able to assess the impact of personal taxation on the investment decision-making process

- 10.1 Determine the impact of income tax on individuals:
- its scope
 - liability
 - sources of income
 - reliefs
 - allowances
 - planning
 - calculation
- 10.2 Identify and explain the nature of special reliefs available to individuals:
- ISAs
 - Enterprise Investment Scheme (EIS)
 - Venture Capital Trusts (VCTs)
 - Share option schemes
- 10.3 Explain the nature of overseas income:
- UK paying agents
 - types of income
 - withholding taxes
 - double taxation agreements
 - basic calculations
- 10.4 Establish the scope of family tax planning:
- allowances
 - reliefs
 - planning
- 10.5 Establish the scope of inheritance tax:
- its calculation
 - exemptions and reliefs
 - allowances
 - administration of estates
 - planning

LEARNING OUTCOME 11 - Be able to assess the impact of SDLT / SDRT on the investment decision-making process

- 11.1 Determine the nature of chargeable securities:
- their scope
 - liability
 - rates
 - relief and exemptions
 - accountable persons
 - planning
- 11.2 Assess the application of stamp duty on unit trusts

LEARNING OUTCOME 12 - Be able to determine the tax treatment of On-Shore and Offshore funds

- 12.1 Explain the taxation of unit trusts and unauthorised unit trusts:
- ISAs
 - Qualified Investor Schemes (QIS)
- 12.2 Explain the taxation of OEICS and Investment Companies with Variable Capital (ICVCs)
- 12.3 Explain the taxation of offshore funds:
- distributor and non-distributor status
 - uses of offshore funds
 - planning

LEARNING OUTCOME 13 - Be able to determine the scope of international taxation and tax planning strategies

- 13.1 Explain concepts of residence, ordinary residence and domicile:
- remittance basis of taxation
 - planning
 - basic calculations
- 13.2 Explain overseas aspects of income tax, capital gains tax and inheritance tax: allowances and reliefs (basic calculations)

LEARNING OUTCOME 14 - Be able to identify and explain the uses of trusts and the rights of beneficiaries

- 14.1 Explain the characteristics of trusts:
- concepts of settlor, beneficiary and trustee
 - express, resulting and constructive trusts
 - investment powers of trustees
 - Trustee Act 2000
- 14.2 Identify and explain the uses of trusts including:
- tax and estate planning
- 15 Be able to compare the different types of trusts
- 15.1 Distinguish between the following types of trust:
- Bare Trusts
 - Interest-in-possession trusts (Life Interest and Revisionary Interest)
 - Non-interest-in-possession trust (accumulation and maintenance trusts / discretionary trusts)
 - charitable trusts

LEARNING OUTCOME 16 - Be able to examine the taxation of trusts

16.1 Specify the income tax implications of trusts:

- interest in possession trusts
- non-interest in possession trusts
- bare trusts
- tax rates
- exemptions and reliefs

16.2 Specify the capital gains tax implications of trusts:

- the liability of the settlor and trustees
- the tax rates
- the exemptions and reliefs

16.3 Specify the inheritance tax implications of trusts:

- chargeable lifetime transfers
- periodic charges
- exit charges
- tax rates
- exemptions and reliefs

READING LIST

Periodicals and Newspapers

1. Financial Times
2. FT Weekend
3. Risk Magazine
4. Journal of Derivatives
5. Journal of the Futures Market
6. Investors' Chronicle
7. Securities & Investment Review
8. Investment Week
9. Professional Investor (the quarterly journal of the CFA)
10. Money Management
11. What Investment?
12. Investment Adviser
13. Professional Adviser
14. Money Observer
15. Bloomberg Money

Books

1. Mastering Credit Derivatives; Andrew Kasapi; FT/Prentice Hall
2. Options, Futures and other Derivatives; John C. Hull; Prentice Hall
3. Investments: AND S&P; Bodie Z, Kane A, Marcus AJ; McGraw Hill Higher Education; 7th edn 2007
4. An Investor's Guide to Analysing Companies and Valuing Shares; Cahill M; FT Prentice Hall
5. The Intelligent Guide to Stockmarket Investment; Keasey, K; Hudson, R; Little, K; Wiley 1998
6. Investment Management; Lofthouse S; J Wiley 2001
7. An Introduction to Stock Exchange Investment; Rutterford, J; Davison M; 3rd Edn; 2007
8. A Guide to Stockpicking; O'Connor G; Random House 1996
9. Tolley's Tax Guide; Homer A & Burrows, R; Butterworths Law;
10. Allied Dunbar Expatriate Tax Investment Handbook; Well A (ed); Eastway, N; Gamtlett P; FT Prentice Hall; 7th Edn 2000
11. Financial Times Guide to Personal Tax; FT Prentice Hall
12. Zurich Tax Handbook; Foreman, A & Mowles, G; Allied Dunbar

Websites:

1. www.bankofengland.co.uk
2. www.dmo.gov.uk
3. www.euronext.com
4. www.fsa.gov.uk
5. www.ft.com
6. www.ftse.com
7. www.londonstockexchange.com
8. www.nationalsavings.co.uk
9. www.trustnet.com
10. www.hm-treasury.gov.uk