CHAPTER 48

PORTFOLIO MANAGEMENT AN OVERVIEW

1. (B) **Choosing a target asset allocation.**

Explanation

The three major steps in the portfolio management process are (1) planning, (2) execution, and (3) feedback. The planning step includes evaluating the investor's needs and preparing an investment policy statement. The execution step includes choosing a target asset allocation, evaluating potential investments based on top-down or bottom-up analysis, and constructing the portfolio. The feedback step includes measuring and reporting performance and monitoring and rebalancing the portfolio.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

2. (C) **money market fund.**

Explanation

Money market funds invest primarily in short-term debt securities and are managed to maintain a constant net asset value, typically one unit of currency per share. A bond mutual fund typically invests in longer-maturity securities than a money market fund. A balanced fund invests in both debt and equity securities.

(Study Session 17, Module 48.2, LOS 48.f)

Related Material

SchweserNotes - Book 5

3. (C) **planning step.**

Explanation

Identification of the client's benchmark would be established in the planning step, to allow assessment of performance in the feedback step.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

4. (A) **Venture capital fund.**

Explanation

Hedge funds and buyout firms typically employ high leverage to acquire assets. Venture capital typically involves an equity interest.

(Study Session 17, Module 48.2, LOS 48.f)

Related Material

Schweser Notes - Book 5

5. (C) **defined benefit pension plan.**

Explanation

A defined benefit pension plan typically has a long investment time horizon, low liquidity needs, and high risk tolerance. Insurance companies and banks typically have low risk tolerance and high liquidity needs. Banks and property and casualty insurers typically have short investment horizons.

(Study Session 17, Module 48.1, LOS 48.c)

Related Material

SchweserNotes - Book 5

6. (B) **The execution step.**

Explanation

Top-down analysis would be used to select securities in the execution step.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

7. (C) **a defined benefit plan only.**

Explanation

In a defined benefit plan the promised payments to beneficiaries are a responsibility of the firm sponsoring the plan. In a defined contribution plan no fixed payments are promised to beneficiaries.

(Study Session 17, Module 48.1, LOS 48.d)

Related Material

SchweserNotes - Book 5

8. (A) **an industry's prospects within the global business environment are a major determinant of how well individual firms in the industry perform.**

Explanation

In general, an industry's prospects within the global business environment determine how well or poorly individual firms in the industry do. Thus, industry analysis should precede company analysis. The goal is to find the best companies in the most promising industries; even the best company in a weak industry is not likely to perform well.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

9. (A) effect on portfolio risk and return.

Explanation

Modern portfolio theory concludes that an investor should evaluate potential investments from a portfolio perspective and consider how the investment will affect the risk and return characteristics of an investor's portfolio as a whole.

(Study Session 17, Module 48.1, LOS 48.a)

Related Material

SchweserNotes - Book 5

10. (A) employee.

Explanation

In a defined contribution plan, the employee makes the investment decisions and assumes the investment risk.

(Study Session 17, Module 48.1, LOS 48.d)

Related Material

SchweserNotes - Book 5

11. (A) asset allocation and security analysis.

Explanation

The three major steps in the portfolio management process are planning, execution, and feedback. Asset allocation and security analysis are components of the execution step, as is portfolio construction. Preparation of an investment policy statement is a component of the planning step. Portfolio monitoring and rebalancing, as well as performance measurement and reporting, are part of the feedback step.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

12. (C) contribution to the investor's overall risk and return.

Explanation

The portfolio approach to investing refers to evaluating individual investments based on their contribution to the overall risk and return of the investor's portfolio. Evaluating potential investments on a standalone basis, such as by analyzing their fundamentals or their potential to generate excess return, does not describe the portfolio approach to investing.

(Study Session 17, Module 48.1, LOS 48.a)

Related Material

SchweserNotes - Book 5

13. (B) **open-end funds stand ready to redeem their shares, while closed-end funds do not.**

Explanation

Open-end funds redeem existing shares or issue new shares in accordance with investor demand. Closed-end fund shares are fixed in number and trade on exchanges as though they were common stock.

For Further Reference:

(Study Session 17, Module 48.2, LOS 48.0

CFA® Program Curriculum, Volume 5, page 425

Related Material

SchweserNotes - Book 5

14. (A) **Fiscal policy.**

Explanation

In the top-down valuation approach, the investor should analyze macroeconomic influences first, then industry influences, and then company influences. Fiscal policy, as part of the macroeconomic landscape, should be analyzed first.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

15. (A) **closed-end fund.**

Explanation

Closed-end funds' share prices can differ significantly from their NAVs. Open-end fund shares can be purchased and redeemed at their NAVs. Market forces keep exchange-traded fund share prices close to their NAVs because arbitrageurs can profit by trading when there are differences.

(Study Session 17, Module 48.2, LOS 48.f)

Related Material

SchweserNotes - Book 5

16. (C) **Property and casualty insurance company.**

Explanation

Foundations and life insurance companies typically have long investment horizons. Property and casualty insurance companies typically have shorter investment horizons than life insurance companies because claims against their policies occur sooner on average.

(Study Session 17, Module 48.1, LOS 48.c)

Related Material

SchweserNotes - Book 5

17. (A) **Passive management's share of industry revenues is smaller than its share of assets under management.**

Explanation

Because fees for passive management are lower than fees for active management, passive management represents a smaller share of industry revenues than assets under management. Passive management has been gaining market share over time versus active management. Smart beta is a passive management strategy that focuses on a specific market risk factor.

(Study Session 17, Module 48.2, LOS 48.e)

Related Material

SchweserNotes - Book 5

18. (A) **employee.**

Explanation

Defined contribution pension plans require the plan sponsor (the employer) to make payments to the employees' retirement accounts throughout the duration of their employment. Once payments are made by the sponsor, the sponsor's obligation is fulfilled and the investment risk is borne by the employees.

For Further Reference:

(Study Session 17, Module 48.1, LOS 48.d)

CFA® Program Curriculum, Volume 5, page 419

Related Material

SchweserNotes - Book 5

19. (B) **Write a policy statement.**

Explanation

The policy statement is the foundation of the entire portfolio management process. Here, both risk and return are integrated to determine the investor's goals and constraints.

(Study Session 17, Module 48.1, LOS 48.b)

Related Material

SchweserNotes - Book 5

20. (C) **Defined benefit pension plan.**

Explanation

A defined benefit pension plan has less need for liquidity than a bank or a property and casualty insurance company. Banks have high liquidity needs because assets may have to be sold quickly if depositors withdraw their funds. Property and casualty insurance companies need to keep liquid assets to meet claims as they arise.

(Study Session 17, Module 48.1, LOS 48.c)

Related Material

SchweserNotes - Book 5

21. (A) **diversification ratio.**

Explanation

The diversification ratio is calculated by dividing a portfolio's standard deviation of returns by the average standard deviation of returns of the individual securities in the portfolio (sometimes calculated as the average annualized standard deviation of portfolio securities selected at random over the historical measurement period).

(Study Session 17, Module 48.1, LOS 48.a)

Related Material

SchweserNotes - Book 5

22. (A) **the employee is promised a periodic payment upon retirement.**

Explanation

In a defined benefit pension plan, a periodic payment, typically based on the employee's salary, is promised to the employee upon retirement and the employer contributes to an investment trust that generates the principal growth and income to meet the pension obligation. The employees do not direct the investments in their accounts as they do in a defined contribution plan. Pension expense for a defined benefit plan has several components, including service cost, prior service cost, and interest cost, and depends on actuarial assumptions and the expected rate of return on plan assets.

(Study Session 17, Module 48.1, LOS 48.d)

Related Material

SchweserNotes - Book 5

23. (C) **Open-end mutual fund shares.**

Explanation

Shares of open-end mutual funds trade at NAV. The others may deviate from NAV.

For Further Reference:

(Study Session 17, Module 48.2, LOS 48.f)

CFA® Program Curriculum, Volume 5, page 425

Related Material

SchweserNotes - Book 5

24. (B) **private equity fund.**

Explanation

A private equity fund or buyout fund is one that acquires entire public companies, takes them private, and reorganizes the companies to increase their value. An event-driven fund is a hedge fund that invests in response to corporate events such as mergers or acquisitions. Venture capital funds invest in start-up companies.

(Study Session 17, Module 48.2, LOS 48.f)

Related Material

SchweserNotes - Book 5

25. (B) **multi-boutique firm.**

Explanation

A multi-boutique firm is a holding company that includes a number of different specialist asset managers.

Related Material

SchweserNotes - Book 5

26. (A) **long time horizon, high risk tolerance, and low liquidity needs.**

Explanation

Endowments and foundations invest for the long term to provide ongoing funding for a specific purpose or charitable cause. They typically have relatively low cash payout rates as a percentage of total assets. Their investment needs are best characterized as long time horizons, low liquidity needs, and high risk tolerance.

(Study Session 17, Module 48.1, LOS 48.c)

Related Material

SchweserNotes - Book 5