

Notation and terminology used for Exam FM

The following notation and terminology will apply to the examination questions.

Unless otherwise stated in the examination question, rates are expressed as annual rates. For example, the rate of interest, the rate of discount, the force of interest, the yield rate, and the coupon rate.

The effective rate of interest is denoted by i . The nominal rate of interest payable m times per period is denoted by $i^{(m)}$.

When more than one interest rate is referenced in a question, additional letters such as j may be used to denote the additional interest rates.

The effective rate of discount is denoted by d and is equal to $\frac{i}{1+i}$. The nominal rate of discount payable m times per period is denoted by $d^{(m)}$.

The discount factor is denoted by v and is equal to $\frac{1}{1+i}$.

Force of interest:

A constant force of interest is denoted by δ

A force of interest varying by time is denoted by δ_t

Current Value: The current value, as of a given date, of a set of cash flows is equal to the accumulated value of the cash flows occurring prior to the given date plus the discounted value of the cash flows occurring on or after the given date. The term “present value” is used when all cash flows are discounted and the term “future value” is used when all cash flows are accumulated.

An annuity-immediate is an annuity where the payments are made at the end of each period.

The present value of an annuity-immediate with n payments of 1, at interest rate i , is denoted by

$$a_{\overline{n}|} \text{ or } a_{\overline{n}|}i$$

The accumulated value of an annuity-immediate with n payments of 1, at interest rate i , is denoted by

$$s_{\overline{n}|} \text{ or } s_{\overline{n}|}i$$

An annuity-due is an annuity where the payments are made at the beginning of each period.

The present value of an annuity-due with n payments of 1, at interest rate i , is denoted by

$$\ddot{a}_{\overline{n}|} \text{ or } \ddot{a}_{\overline{n}|}i$$

The accumulated value of an annuity-due with n payments of 1, at interest rate i , is denoted by

$$\ddot{s}_{\overline{n}|} \text{ or } \ddot{s}_{\overline{n}|}i$$

“Dollar-weighted rate of return” means the simple interest approximation to the yield rate.

Unless otherwise stated in the examination question, the redemption value of a bond is equal to the face amount (par value) of the bond.

Unless otherwise stated in the examination question, “duration” means Macaulay duration and “convexity” means modified convexity.

$$\text{Modified duration} = -\frac{P'(i)}{P(i)} \text{ and}$$

$$\text{Modified convexity} = \frac{P''(i)}{P(i)} \text{ where } P(i) = \sum_{t=1}^N (R_t(1+i)^{-t}) \text{ and } R_t \text{ is the cash flow at time } t.$$

$$\text{Macaulay duration} = \frac{\sum_{t=1}^N t(R_t e^{-\delta t})}{\sum_{t=1}^N (R_t e^{-\delta t})} \text{ where } \delta \text{ is the continuously compounded rate of}$$

interest or the force of interest.

$$\text{Macaulay convexity} = \frac{\sum_{t=1}^N t^2 (R_t e^{-\delta t})}{\sum_{t=1}^N (R_t e^{-\delta t})} .$$

Forward rate: An m -year spot rate that comes into effect t years in the future will be referred to as the “ m -year forward rate, deferred t years” or as the “ m -year forward rate, starting in t years”.

Margin Call: In a futures contract, a margin call requires that the investor either restores the margin account to the level of the initial margin amount or exits the contract. A margin call may have other meanings in contracts not covered for this exam.