

## **Advanced Portfolio Management Exam Spring 2013**

### **Important Exam Information:**

Exam Date and Time	A read-through time will be given prior to the start of the exam—15 minutes in the morning session and 15 minutes in the afternoon session.
<a href="#">Exam Registration</a>	Candidates may register online or with an application.
Order Study Notes	Study notes are part of the required syllabus and are not available electronically but may be purchased through the online store.
<a href="#">Introductory Study Note</a>	The Introductory Study Note has a complete listing of all study notes as well as errata and other important information.
<a href="#">Case Study</a>	A copy of the case study will be provided with the examinations. Candidates will not be allowed to bring their copy of the case study into the examination room.
<a href="#">Table</a>	A cumulative normal distribution table will be provided with the exam.
<a href="#">Formula Package</a>	A Formula Package will be provided with the exam. Please see the Introductory Study Note for more information.
<a href="#">Past Exams</a>	Past Exams from 2000-present are available on SOA web site
<a href="#">Updates</a>	Candidates should be sure to check the Updates page on the exam home page periodically for additional corrections or notices.

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**1. Learning Objective: Candidate will understand and be able to follow the investment management process for insurance companies, pension funds and other financial intermediaries**

**Learning Outcomes: The candidate will be able to:**

- a. Explain how an investment policy and an investment strategy can help manage risk and create value.
- b. Identify the obligations of a fiduciary in managing investment portfolios and explain how they apply in a given situation.
- c. Determine how a client's objectives, needs and constraints affect the selection of an investment strategy or the construction of a portfolio. Considerations include:
  - Funding objective
  - Risk-return trade-off
  - Regulatory and rating agency requirements
  - Risk appetite
  - Liquidity constraints
  - Capital, tax, and accounting considerations
- d. Identify and describe the impact on investment policy of financial and non-financial risks including but not limited to: Currency risk, credit risk, spread risk, liquidity risk, interest rate risk, equity risk, product risk, operational risk, legal risk and political risk.

**Syllabus Resources:**

Maginn & Tuttle, *Managing Investment Portfolios*, 3<sup>rd</sup> Ed., 2007

- Ch. 1, The Portfolio Management Process and the Investment Policy Statement, by Maginn, Tuttle, McLeavey, & Pinto
- Ch. 3, Managing Institutional Investor Portfolios, by Tschampion, Siegel, Takahashi, & Maginn.

V-C126-07: Derivatives: Practices and Principles , Section II

V-C136-10: Fiduciary Liability Issues for Selection of Investments

V-C138-09: Managing your Advisor: A Guide to Getting the Most Out of the Portfolio Management Process

V-C140-09: SOA Specialty Guide to Economic Capital (exclude appendices 2 and 3)

V-C194-12: Revisiting The Role of Insurance Company ALM within a Risk Management Framework

V-C207-13: Liability Relative Investing I, M. Barton Waring, Journal of Portfolio Management

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2. **Learning Objective: The candidate will understand the variety of financial instruments available to managed portfolios.**

**Learning Outcome: The candidate will be able to:**

- a. Compare and select specialized financial instruments that can be used in the construction of an asset portfolio supporting financial institutions and pension plan liabilities.

**Syllabus Resources**

Fabozzi, *Handbook of Fixed Income Securities*, 8<sup>th</sup> Edition, 2012

- Ch. 1, Overview of the Types and Features of Fixed Income Securities (background only)
- Ch. 2, Risks Associated with Investing in Fixed Income Securities (background only)
- Ch. 9, U.S. Treasury Securities
- Ch. 10, Agency Debt Securities
- Ch. 11, Municipal Bonds
- Ch. 12, Corporate Bonds
- Ch. 16, Private Money Market Instruments
- Ch. 18, Inflation-Linked Bonds
- Ch. 17, Floating-Rate Securities
- Ch. 21, Fixed Income Exchange Traded Funds
- Ch. 24, An Overview of Mortgages and the Mortgage Market
- Ch. 25, Agency Mortgage-Backed Securities
- Ch. 26, Agency Collateralized Mortgage Obligations

V-C143-09: Hedge Funds: Past, Present, and Future, R. Stulz, *Journal of Economic Perspectives*, Spring 2007

V-C144-09: Hedge Funds: Risk and Return, by B. Malkiel and A. Saha, *Financial Analysts Journal*, November 2005.

V-C146-09: Greer, R., The Role of Commodities in Investment Portfolios, CFA Conference proceedings Quarterly December 2007, Vol 24 #4

V-C154-09: Bertram, R., "Balancing the Opportunities in Real Return Investments," *CFA Institute Conference Proceedings Quarterly*, September 2007

V-C165-09: IMF, Global Financial Stability Report, April 2008, Chapter 2, pp.54-84.

V-C174-09: Anson, *The Handbook of Alternative Assets*, Second Edition, 2006, Chapter 20

V-C179-10: The Economics of Structured Finance, *Journal of Economic Perspective*, Winter 2009

V-C186-11: When Safe Proves Risky: Commercial Paper during the Financial Crisis of 2007-2009, *Journal of Economic Perspectives*, Winter 2010

V-C208-13: Anson, *The Handbook of Alternative Assets*, Second Edition, 2006, Chapter 22

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**3. Asset Allocation**

**Learning Objective:**

**The candidate will understand the importance of the techniques and theory behind portfolio asset allocation**

**Learning Outcomes: The Candidate will be able to:**

- a. Explain the importance of asset allocation, relative to a particular situation
- b. Critique and propose asset allocation strategies that can be used to construct an asset portfolio.
- c. Evaluate the significance of liabilities in the determination of the asset allocation
- d. Demonstrate how to include risk management principles in the establishment of investment policy and strategy including asset allocation.

**Syllabus Resources:**

Maginn & Tuttle, *Managing Investment Portfolios*, 3<sup>rd</sup> Ed.

- Ch. 5, Asset Allocation, by Sharpe, Chen, Pinto, & McLeavey
- Ch. 7, Equity Portfolio Management, by Gastineau, Olman, & Zielinski

Litterman, *Modern Investment Management: An Equilibrium Approach*, 2003

- Ch. 10, Strategic Asset Allocation in the Presence of Uncertain Liabilities
- Ch. 26, Strategic Asset Allocation and Hedge Funds

V-C111-07: Creating Value in Pension Plans (Or, Gentlemen Prefer Bonds)

V-C127-09: Liability-Relative Strategic Asset Allocation Policies

V-C148-09: Perspectives on the Equity Risk Premium, by J. Siegel, *Financial Analysts Journal*, November/December 2005.

V-C150-09: Stocks, Bonds, the Sharpe Ratio, and the Investment Horizon,” by C. Hodges, W. Taylor, & J. Yoder, *Financial Analysts Journal*, November/December 1997

V-C164-09: Dynkin, L., J. Hyman, & W. Wu, Value of Security Selection versus Asset Allocation in Credit Markets: Part II – An Imperfect Foresight Study, Lehman Bros., June 2000

V-C184-11: Deciphering the Liquidity and Credit Crunch 2007-2008 , *Journal of Economic Perspectives* Volume 23 #1, Winter 2009

V-C187-11: The U.S. Equity Return Premium: Past, Present, Future, *Journal of Economic Perspectives*, Vol. 23, Winter 2009

V-C194-12: Revisiting The Role of Insurance Company ALM within a Risk Management Framework

V-C195-12: Impact of Skewness and Fat Tails on the Asset Allocation Decision, *Financial Analysts Journal*, Volume 67, number 2, 2011

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**4. Learning Objective:**

**The candidate will understand and apply quantitative techniques for portfolio management.**

**Learning Outcomes: The candidate will be able to:**

- a. Describe, contrast and assess techniques to measure credit risk, including spread risk.
- b. Describe, contrast and assess techniques to measure equity risk.
- c. Describe, contrast and assess techniques to measure interest rate risk.
- d. Describe, contrast and assess techniques to measure foreign exchange risk.
- e. Describe, contrast and assess techniques to measure liquidity risk.
- f. Describe, contrast and assess techniques for risk aggregation and diversification.

**Syllabus Resources:**

Bohn and Stein, *Active Credit Portfolio Management in Practice*, 2009

- Chapter 3- Structural Models,
- Chapter 4 – Econometric Models
- Chapter 5 – Loss Given Default
- Chapter 6 -Reduced Form Models

V-C182-10: “*Modeling of Mortgage Defaults*”, January 22, 2008, pp 5 – 38 excluding pp13-25(background only)

V-C183-10: “Bond-CDS Basis Handbook”, February 2009, pp. pp, 3- 48

V-C188-11: Babbel, Merrill and Panning, *Default Risk and the Effective Duration of Bonds* Financial Analysts Journal January 1997.

V-C189-11: Salomon Smith Barney, Mortgage Duration and Price Moves, March 6, 2001-

V-C190-11: Bluhm, Overbeck and Wagner, *Introduction to Credit Risk Modeling*, Chapter 1

V-C191-11: B. Tuckman, *Fixed Income Securities* – chapters 5 -7

V-C196-12: Quantitative Financial Economics by K. Cuthbertson and D. Nitzsche Ch 7 Performance Measure, CAPM and APT

V-C202-12: Babbel, D. and Fabozzi, F.J., *Investment Management for Insurers*, 1999Ch. 17, Effective and Ineffective Duration Measures for Life Insurers

V-C 204-12 “Foreign Exchange Rate Risk: Institutional Issues and Stochastic Modeling” by R. Gorvett

V-C205-12: “Developments in Modelling Risk Aggregation” – Basel, October 2010

V-C206-12: Liquidity Risk, Measurement and Management: A practitioner’s guide to global best practices, Chapter 2 (Liquidity Risk Measurement) and Chapter 3 (Scenario Analysis and Stress Testing) Matz and Neu, Wiley Finance 2007

Report of the Life Liquidity Work Group of the AAA to the Life Liquidity Risk Working group of the NAIC, September, 2000

[http://actuary.org/pdf/naic/lifeliqu\\_0900.pdf](http://actuary.org/pdf/naic/lifeliqu_0900.pdf)

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**5. Learning Objective:**

**The candidate will understand the specific considerations relative to managing an equity and /or alternative asset portfolio within an asset allocation framework**

**Learning Outcomes: The candidate will be able to:**

- a. Explain how an investment policy affects the selection of an investment strategy or the selection of an optimal portfolio.
- b. Assess a portfolio position against portfolio management objectives using qualitative and quantitative techniques
- c. Evaluate situations associated with the presence of embedded options and hedging strategies.
- d. Recommend an investment strategy for a given situation
  - Portfolio policy and objectives
  - Asset selection criteria
  - Capital market expectations
  - Risk management strategy
  - Portfolio rebalancing strategy

**Syllabus Resources:**

Maginn & Tuttle, *Managing Investment Portfolios*, 3<sup>rd</sup> Ed. 2007,

- Ch. 7, “Equity Portfolio Management,” by Gastineau, Olman, & Zielinski
- Ch. 8, “Alternative Investments Portfolio Management,” by Yau, Schneeweis, Robinson, & Weiss
- Ch. 11, “Monitoring & Rebalancing,” by Arnott, Burns, Plaxco, & Moore

Litterman, *Modern Investment Management: An Equilibrium Approach*, 2003

- Ch. 26, Strategic Asset Allocation and Hedge Funds
- Ch. 27, Managing a Portfolio of Hedge Funds

V-C135-08: Living with Mortality: Longevity Bonds and Other Mortality-Linked Securities, by Blake, Cairns and Dowd, Institute of Actuaries, 2006 (Sections 3-5)

V-C192-11: *Commercial Real Estate Analysis & Investments* by Geltner, Miller, Clayton and Eichholtz, Chapter 12, Market Value and Investment Value

V-C197-12: Secular and Cyclic Determinants of Capitalization Rates: the role of Property Fundamentals, Macroeconomic Factors and “structural changes”. *Journal of Portfolio Management* 2009

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**6. Learning Objective:**

**The candidate will understand the specific considerations relative to managing a fixed income portfolio within an asset allocation framework**

**Learning Outcomes: The Candidate will be able to:**

- a. Explain how an investment policy affects the selection of an investment strategy or the selection of an optimal portfolio.
- b. Assess a portfolio position against portfolio management objectives using qualitative and quantitative techniques
- c. Evaluate situations associated with the presence of embedded options and hedging strategies.
- d. Recommend an investment strategy for a given situation
  - Portfolio policy and objectives
  - Asset selection criteria
  - Capital market expectations
  - Risk management strategy
  - Portfolio rebalancing strategy
- e. Show the impact of risk analysis, including interest rate and equity risk, on portfolio construction.
- f. Demonstrate how to apply funding and portfolio management strategies to control interest rate and credit risk, including key rate risks.
- g. Explain how derivatives, synthetic securities, and financial contracting may be used to manage risk and recommend appropriate ones for a given situation.
- h. Describe and critique the role of rating agencies in evaluating credit risk.
- i. Explain and recommend best practices in credit risk management, including:
  - credit and underwriting policies
  - comprehensive due diligence
  - diversification requirements and aggregate counter-party exposure limits
  - use of credit derivatives and credit support agreements
- j. Recommend a credit risk management strategy for a given situation

**Syllabus Resources:**

Fabozzi, *Handbook of Fixed Income Securities*, 8<sup>th</sup> Edition, 2012

- Ch. 48, Hedging Interest-Rate Risk with Term-Structure Factor Models
- Ch. 61, Controlling Interest-Rate Risk with Futures and Options

Maginn & Tuttle, *Managing Investment Portfolios*, 3<sup>rd</sup> Ed. 2007,

- Ch. 6, Fixed-Income Portfolio Management, by Fong & Guin

V-C164-09: Dynkin, L., J. Hyman, & W. Wu, "Value of Security Selection versus Asset Allocation in Credit Markets: Part II – An Imperfect Foresight Study, Lehman Bros., June, 2000.

V-C185-11: Mind the Gap: Using Derivative Overlays to Hedge Pension Duration, *Financial Analysis Journal*, Volume 65, #4, CFA Institute

V-C198-12: *Risk Management*, 2001, Ch. 7, Credit Rating Systems

V-C199-12: *Credit Derivatives* Saunders and Allen, Ch. 12

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**7. Learning Objective:**

**The candidate will understand the purposes and methods of portfolio performance measurement**

**Learning Outcomes: The candidate will be able to:**

- a. Describe and assess performance measurement methodologies for investment portfolios.
- b. Describe and assess techniques that can be used to select or build a benchmark for a given portfolio or portfolio management style.
- c. Recommend a benchmark for a given portfolio or portfolio management style.
- d. Recommend a performance measurement methodology.

**Syllabus Resources:**

Fabozzi, *Handbook of Fixed Income Securities*, 8<sup>th</sup> Edition, 2012

- Ch. 50, Quantitative Management of Benchmarked Portfolios, by F. Fabozzi

Maginn & Tuttle, *Managing Investment Portfolios: A Dynamic Process*, Third Edition

- Ch. 12, “Evaluating Portfolio Performance,” by Bailey, Richards, & Tierney

V-C168-09: *Journal of Performance Measurement* Fall 2006, Murira, B. and H. Sierra, Fixed Income Attribution: A Unified Framework – Part 1, pp. 23 – 35.

V-C169-09: *Journal of Performance Measurement* Winter 2006/2007, Murira, B. and H. Sierra, “Fixed Income Attribution: A Unified Framework – Part 2, pp. 8 – 21.

V-C200-12: *Quantitative Financial Economics*”, K. Cuthbertson and D. Nitzsche, Ch. 9

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**8. Learning Objective:**

**The candidate will understand the behavior characteristics of individual and firms, and be able to identify and apply concepts of behavioral finance**

**Learning Outcomes: The candidate will be able to:**

- a. Explain how behavioral characteristics of individuals or firms affect the investment or capital management process.
- b. Describe how behavioral finance explains the existence of some market anomalies.
- c. Identify and apply the concepts of behavioral finance with respect to individual investors, institutional investors, portfolio managers, fiduciaries and corporate managers.

**Syllabus Resources**

- V-C119-07: From Efficient Markets Theory to Behavioral Finance, by R. Shiller, *Journal of Economic Perspectives*, Winter 2003
- V-C120-07: The Efficient Market Hypothesis and Its Critics, B. Malkiel, *Journal of Economic Perspectives*, Winter 2003,
- V-C122-07: Anomalies: The Law of One Price in Financial Markets, Lamont & Thaler, *Journal of Economic Perspectives*, Fall 2003,
- V-C171-09: Behavioral Finance and Investment Committee Decision Making, by A. Wood, *CFA Institute Conference Proceedings*, December 2006.
- V-C172-09: Managing the Credit Cycle: A Behavioral Risk Interpretation, by J. Rizzi, *Commercial Lending Review*, January 2006
- V-C173-09: What Are Stock Investors' Actual Historical Returns? Evidence from Dollar-Weighted Returns, by I. Dichev, *American Economic Review*, 91(1):386-401, March 2007.
- V-C180-10: A. Lo, The Three P's of Total Risk Management, *Financial Analyst Journal*, January/February 1999
- V-C203-12: How Psychological Pitfalls Generated the Global Financial Crisis, Hersh Shefrin. CFA institute, 2009.

Byrne & Brooks, "Behavioral Finance: Theory and Evidence,"

<http://www.cfapubs.org/doi/pdf/10.2470/rflr.v3.n1.1?prevSearch=allfield%3A%28Behavioral+finance%5C%3A+Theories%29+and+%28allfield%3A%28Alistair%29%29>