## NDEX

a priori probability 28 absolute advantage 83 accounting equation 18, 97-8, 99 accounting profit 58 accounting warning signs 152 accounts payable 119, 175 accounts receivable 119, 175 accruals 98, 108 activity ratio 122 ADR see American Depositary Receipts after-tax cash flow (ATCF) 291 aggregate demand and supply 54, 70-1, 72 aggregate output sample question/answer 72, 301 alternative hypothesis 41 alternative investments 287, 289 closely held companies 293, 294 equity investment 292 Exchange Traded Funds 292 fees 290 fund of funds investment 293 hedge funds 292, 293 net asset value of fund 290 open-end/closed-end fund difference 290 overview 288 real estate investment 293 real estate valuation 291-2 sample question/answer 294, 315 venture capital investment 292 American Depositary Receipts (ADR) 216 American options 277, 278-9 amortization 135 annual interest rate 15-16 annual pay bond 254 annual report 95 annuity 14, 16, 17 arbitrage 278-9 definition/role 266-7 profit 249-50 arbitrage-free value 226, 249-50 arithmetic mean 22 asset-backed security 237-8 asset-based valuation models 223 asset/s 96, 113 allocation 46, 197 classes 197 current/non-current 114 leasing/purchasing 145

prices 36

tangible/intangible 134, 135–6 values 135–6 ATCF *see* after-tax cash flow auctions 55 audits 95 average cost 59 average product 59 average revenue 59

backwardation 295 balance of payments (BOP) 85 balance sheet 94, 98, 178-9 assets 114 common-size 112-13 elements 113 formats 113-14 liabilities 114 limitations 113 liquidity/solvency ratios 113 sample question/answer 115 shareholder equity 114-15 balancing adjustment 98 bank discount yield 14 20 banker's acceptances 239 barter transactione 108 Bayes' formula 27-8 Bernoulli random variable 34, 36, 299 beta calculation 165, 193 bias 39 binomial random variable 34 binomial trees 34 bond equivalent yield 14, 20-1, 175, 254 bond sectors and instruments 236-9 asset-backed security 237-8 corporate debt 239 coupon/principal strips 236-7 government securities 238 mortgage-backed securities 237 primary/secondary markets 239 sample question/answer 240, 311 Bond-Yield plus Risk Premium method 165 bonds accrued interest, full price, clean price 229 affirmative/negative covenants 229 arbitrage-free value 226 call options 234 callable/prepayable security disadvantages 233

coupon rate 227, 231, 232 deferred coupon 228 duration/dollar duration 234, 258 embedded option 226, 228 exchange rate risk 235 expected cash flow estimation 250 indentures 229 inflation risk 235 institutional investors 229 interest rate risk 232-3 investment risk 226, 234 liquidity risk 234–5 margin buying/repurchase agreements 229 maturity 250 measurement of interest rate risk 257-61 non-amortizing 229 par value 227 price 227 price relative to par value 231, 232 redemption/retirement 229 reinvestment risk 233 risks 231-5 sample questions/answers 235, 240, 311 sovereign/event risk 235 spot/forward rates 226 step-up notes 228 taxable/tax-exempt 242 valuation 226, 247-50 vield 231, 232 yield measures 252-3 yield volatility 233 yield-curve risk 233 zero coupon 228 book value of equity 217, 222 book value per share 170 bootstrapping 254 BOP see balance of payments borrowed costs 134 breakeven point of production 60 breakeven price of option 286 breakeven quantity of sales 169 budget constraint 56, 57 business cycles sample question/answer 76, 301 business risk 168

CAL see capital allocation line calculators 17

callable bonds 233, 258 capital allocation line (CAL) 184, 189, 190, 192-3 capital asset pricing model (CAPM) 164, 184. 193-4 capital budgeting calculating 159-60 evaluation/selection of projects/ methods 161 NPV, company value, share price relations 162 popularity of methods 162 principles 160-1 process/categories 160 sample question/answer 162, 306 capital estimation sample questions/answers 167, 306-7 capital gain or loss 256 capital market line (CML) 192-3 capital rationing 161 CAPM see capital asset pricing model cash dividend 171 cash flow 14, 17, 18 effect on options 278-9 effects on net daily cash position 176 estimation 160-1 present-value model 222 cash flow statements 94, 99 accounting shenanigans 153 CFO, CFI, CFF 116-17 common-size 120 direct/indirect 117-19 firm, equity, performance ratios 119-20 non-cash investment/finance activities 120 sample questions/answers 120-1, 153, 303-4, 306 cash settlement 268-9 CBOs see collateralized bond obligations CDOs see collateralized debt obligations central banks 79 central limit theorem 37-8 central tendency, measures of 22 certificate of deposit (CD) 239 CFA Institute 3 chart patterns, common 46 Chebyshev's inequality 23 clean price 229 closed-end fund 290 closely held companies 293, 294 CML see capital market line CMO see collateralized mortgage obligations Code of Ethics 182 difference with Standards of Professional Conduct 2 ethical responsibilities 5 fundamental to values of CFA Institute 3 key points 2 knowledge learning outcome statements 3-5 reciting/understanding 1-2 sample questions/answers 7, 297 six components 3-4

violations/sanctions 3 see also ethics; Standards of Professional Conduct coefficient of variation 23 collateral yield 295 collateralized bond obligations (CBOs) 239 collateralized debt obligations (CDOs) 239 collateralized mortgage obligations (CMO) 237 combination notation 29 commercial paper 239 commodities 208, 288 index strategy 296 investment 295-6 return and risk 295 sample question/answer 296, 315 spot rates/expected future prices 295 common markets 84 common stock 215 common-size balance sheet 112-13 common-size cash flow statement 120 common-size income statement 109 company analysis see industry and company analysis company comparisons 155company disclosures 104 company value 162 comparable method 294 comparative advantage 83 compliance benefits 9 claiming 8-9 composite; 9 compound rate 16 comprehensive income 111 concentration measures 66 conditional/unconditional probability 28 confidence interval estimate 37, 38-9 relation with hypothesis test 41 constant-cost 61 consumer choice theory 56 consumer demand sample question/answer 30, 57 consumer surplus 53 contango 295 contingent claim, definition 266 continuous compound rates of return 36 continuous random variable 35 continuous uniform distribution 35 convexity 257-8, 260 modified/effective 261 corporate bonds 239 corporate finance 157 capital budgeting 159-62 cost of capital estimation 163-7 dividends/share repurchases 170-2 financial statement analysis 178-9 governance of listed companies 180-2 measures of leverage 168-9 overview 158 sample questions/answers 162, 167, 169, 172, 177, 179, 182, 306-8

working capital management 173-7 corporate governance of listed companies board independence 182 code of ethics 182 definition 182 evaluation of committees 181 qualifications of board members 182 rules 180-1 sample question/answer 182, 308 shareowner perspective 182 correlation 28, 29, 34 cost method 291, 294 costs 59-61 borrowing 134 capitalized/expensed difference 133-4 inventories 129-30, 132 long-lived assets 133-4 counting problems 29 sample question/answer 29, 299 country risk premium 166 coupon paying 248 coupon rates 227-8, 231, 232 coupon strips 236-7 covariance 28-9, 188 covenants, affirmative/negative 229 covered call 285-6 credit analysis 123-4 credit ratings 234 credit risk 234, 272, 273 credit spread 242 creditors 145 cross-price elasticity of demand 53 cross-rate 87 cross-sectional data 39 cumulative relative frequency 24 currency exchange rates sample question/answer 88, 302 currency forward contract 271 currency swap 283 current/non-current assets 114 customer bargaining power 219 cycles 46 data set 24 data-mining bias 39 dealer 270 debt 91 break-points 167 corporations 239 covenants 145 de-recognition 145 financial statement presentation/ disclosure 145 investment 155 obligations 239 debt securities bonds, coupon rate structures, floatingrate 227-8 embedded options 228 features 227-30 sample question/answer 230, 251, 311, 312 valuation 247-50 debt-rating method 164

deciles 24 decision making 57, 84 decision rule 41 declaration date 171-2 decreasing-cost 61 deferred tax assets/liabilities 140-1 defined benefit pension plans 146, 147 defined contribution 146, 147 deflation 75 demand and supply aggregation 54, 70-1 application of LOS 51-4 auctions 55 consumer demand 56-7 consumer, producer, total surplus 53 curves 52, 54, 70-1 elasticities 53-4, 63, 66 equilibria 54 excess 52 the firm 58-61 government regulation 55 imbalance 52 inverse 52 market interference 52 market types 54 principles 51 sample questions/answers 55, 57, 61, 300 - 1depositary receipts 216 depreciation 110, 118 calculation 134-5 derivatives definitions 265 forwards 264, 268-71 futures 264, 272-3 instruments 265-7 options 264, 276-80 overview 263-4 purposes/criticisms 266 risk management of option strategies 285 - 6sample questions/answers 267, 271, 275, 281, 284, 312-14 swaps 264, 282-3 descriptive statistics 24 developing market 166 dilutive/anti-dilutive securities 109 diminishing marginal returns 59 direct/indirect foreign exchange 86-7 dirty price 229 disclosures 132, 136, 141, 146 discount rate 17, 249, 250 discount-basis yield 175 discounted after-tax cash flow (ATCF) method 291 discounted cash flow sample question/answer 21, 298 discounted payback period 160 discrete compound rates of return 36 discrete random variable 35 discrete uniform random variable 34 disinflation 75 Dividend Discount Model 165, 222 dividend growth models 223

cash dividends equivalence 171 comparison of methods 172 definitions 171 earnings per share 170 payment chronology 171-2 sample question/answer 172, 307 dollar duration of a bond 234 DuPont formula 123 duration of a bond 234 definitions 261 effective 261 measurement 258-60 earnings per share (EPS) 108-9, 170 EBIT (or operating profit) 110 economic growth 69, 72 economic indicators 75 economic profit 58 economic rent 59 economic unions 84 economics aggregate output 69-72 business cycles 73-6 currency exchange rates 86-8 demand and supply 51-61 economic growth 69-72 firm/market structures 62-6 international trade/capital flows 83-5 macroeconomics 50 microeconomics 50 monetary/fiscal policy 77-80 overview 50 prices 69-72 sample questions/answer: 55, 57, 61, 66, 72, 76, 80, 85, 88, 300-2 economy well-being 242 effective annual yield 20 efficient frontier 190 Efficient Market Hypothesis 266-7 market pricing anomalies 210 na:ket value/intrinsic value difference 210 psychological factors 211 sample question/answer 211, 309 weak, semi-strong, strong 209-10 elasticities 53-4, 63, 66 Elliott Wave Theory 46 embedded options 226, 232, 242 empirical probability 28 end user 270 EPS see earnings per share equilibrium 54, 57, 63, 66 equity 96, 99, 199, 213 analysis 123-4, 206-11, 213, 215-17 balance sheet 113, 114, 115 comparisons, calculations, interpretations 202-4 financial intermediaries 202 forward contract 270 functions/characteristics of financial system 201-2 indices 208

dividends/share repurchases

book value per share 170

industry/company analysis 200, 218-20 investment 155, 292 markets 200 overview 200 ratio 119 real estate 293 sample question/answer 205, 309 securities 200 shareholders' 114 statement of changes in 94 valuation 200, 221-4 equity markets and analysis 206 index construction/management 206-7 market efficiency 209-10 psychological factors 211 rebalancing/reconstitution of index 207 sample questions/answers 208, 211, 309 security market index calculation/ interpretation 206, 208 types of indices 208 equity securities characteristics/role 215 market value/book value difference 216 - 17non-domestic 216 public/private 215-16 risk/return characteristics 216 sample question/answer 217, 310 equity swap 283 equity valuation asset-based valuation models 223 cash flow models 222 categories 223 concepts/basic tools 221-4 dividend discount model 220 estimations 223 multiplier model 222-3 non-callable/non-convertible preferred stock 224 peer group 220 sample question/answer 224, 310-11 estimation 37-9 estimator 37 ETFs see Exchange Traded Funds ethics, importance of 1 see also Code of Ethics: Standards of Professional Conduct Euribor 270 Eurodollar 270 European options 277, 278-9 event risk 235 events 28 exhaustive 28 (in)dependent 28 joint probability 28 mutually exclusive 28 probability of for/against 28 ex-dividend date 171-2 exchange rate risk 235 Exchange Traded Funds (ETFs) 292 exchange-traded derivatives 265 exchange-traded options 279 expense recognition 110 expenses 96, 129

319

external credit enhancements 237-8 external efficiency 202 factorial notation 29 factors of production 60 FASB see Financial Accounting Standards Board FCFF see free cash flow to the firm Fibonacci numbers 46 FIFO (first in, first out) 130, 132 Financial Accounting Standards Board (FASB) 102 financial analysis techniques sample question/answer 125, 304 financial information 103 financial leverage 169 financial notes/supplementary information 94 financial ratios 90, 109 financial reporting and analysis 89, 94, 107, 149 balance sheets 112-15 cash flow statements 116-21, 153 financial statements 89, 90, 93-5 income statements 90, 107-11 income taxes 138-41 inventories 129-32 long-lived assets 133-7 mechanics of reporting 96-100 non-current (long-term) liabilities 142 - 7overview 90 quality 91, 151-2 red flags/accounting warning signs 151 - 2sample questions/answers 100, 152, 302, 306 specific accounting issues 90-1 standards 101-4 techniques 122-5 financial reporting standards 101 company disclosures 104 comparison of concepts (03 framework characteristics 103-4 global convergence/barriers 102-3 importance 102 intangible assets 134 monitoring developments 104 requirements 103 roles/attributes 102 sample question/answer 104, 303 financial risk 168 financial statement analysis accounting equation 97-8 accruals/adjustments 98 balance sheet statement 178-9 cash flows/owners' equity link 99 comparisons with another company 155-6 credit quality of potential debt investment 155 five elements 96-7 future net income/cash flow 155 income/balance sheet link 99

intangible assets 136 inventories 132 past performance 154 pro forma income 178-9 sample questions/answers 95, 156, 302, 306 screening potential equity investments 155 financial system 201-2 The Firm costs 59, 61 demand and supply 58-61 diminishing marginal returns 59 diseconomies of scale 60 exit/entry 66 labor 59 market structures 62-6 output 60 production 60 profit 58, 61 resources 60 revenue 59 sample questions/answers 61, 66, 301 firm ratio 119 fiscal balance 69-70 fiscal policy sample question/answer 80\_301-2 Fisher effect 78 fixed income 225, 245 bond sectors/instruments 236-9 debt securities 227-30 forward rates 2:2-6 interest rate risk 257-61 overview 226 risk associated with bond investment 231-5 risks 226 sample questions/answers 230, 235, 240, 244, 251, 256, 261, 311-12 spot rates 252-6 valuation of debt securities 247-51 vield measures 252-6 vield spreads 241-3 fixed income indices 208 fixed rate bonds 252-3 fixed rate debt capital 164 float-adjusted market capitalization weighting 207 floating rate securities (or variable rate securities) 228 flotation costs 167 flow-of-funds indicators 45 forward discount (or premium) rate 87-8 forward exchange rate 86, 87, 88 forward rate 226, 255-6 forward rate agreement (FRA) 268, 269, 279-80 forwards 264 contract 270 dealer/end user difference 270 default risk 268-9 definition 266 delivery/settlement 268-9 equity forward contract 270

sample question/answer 271, 313 fraud 151-2 free cash flow to the firm (FCFF) 119-20 free and clear equity 293 frequency distribution 24 frequency polygon 24 full valuation method 260-1 fund of funds 293 future net income 155 future value (FV) 14, 16 futures 264 characteristics 272 definition 266 margin 272, 273-4 sample question/answer 275, 313 termination at or prior to expiration 273-4 FV see future value GDP see gross domestic product geometric mean 20, 22, 23 sample question/answer 25, 298 Giffen goods 57 GIPS see Global Investment Performance Standards Global Depositary Receipts (GLR) 216 Global Investment Performance Standards (GIPS) basic idea 2 beneficiaries 2 benefitting from compliance 9 characteristics, scope, implementation 11 claiming compliance 8-9 composites 9 key elements 2 nine major sections 11 reasons for creation 8 sample questions/answers 10, 12, 297 verification 9 GLR see Global Depositary Receipts good-till-cancelled (GTC) vs time limited orders 204 goodwill 134 Gordon's Growth Model 165, 222 governance, corporate see corporate governance of listed companies government regulation/intervention 55 government securities 238 gross domestic product (GDP) 50, 71-2 gross profit 130-1 gross return 188 gross vs net reporting 108 GTC see good-till-cancelled harmonic mean, median, mode 22, 23 head and shoulders reversal 46 Heckscher-Ohlin model 83 hedge funds 208, 293 hedonic price estimation 291 hidden orders 204 histogram 24 historical simulation 36 holder-of-record 171-2

holding period return 20, 36 holding period yield 14, 20 hypothesis testing population means 42-3 relation with confidence interval 41 sample question/answer 44, 300 IASB see International Accounting Standards Board IFRS see International Financial Reporting Standards impairment of assets 135-6 income effect 56 income elasticity of demand 53 income method 291, 294 income statements 90, 107 sample question/answer 111, 303 income taxes 90 calculation 139 deferred items 140 deferred liabilities 139 disclosures 141 key provisions under IFRS/US GAAP 141 kev terms 140 profit/taxable income difference 140 sample question/answer 141, 305 tax base of assets/liabilities 139 tax rate changes 140 temporary/permanent pre-tax accounting/taxable income 140 valuation allowance 141 indices 73 indifference curves 57, 189 industry and company analysis 218 business cycle 219 classifications 219, 220 elements/characteristics 219 external factors 220 internal factors 219 life cycle phase 219 sample question/answer 220, 310 uses of/relation to company analysis 219 inferential statistics 24 inferior goods 57 inflation 75 calculating 73 premium 17 risk 235 initial margin 273-4 input level 59 installment sales 108 interest rate caps, floors, collars 279-80 interest rate options 277 interest rate risk 232-3 measurement 257-61 interest rate swaps 282-3 intermarket analysis 46 internal control 95 internal efficiency 202 internal rate of return (IRR) 14, 19, 158, 159, 161, 162 internally developed intangible assets 134 International Accounting Standards Board (IASB) 102-3 International Financial Reporting Standards (IFRS) 90, 102, 103, 109, 120, 134, 136, 141 International Monetary Fund (IMF) 85 International Organization of Securities Commissions (IOSC) 102 international trade 83-5 sample question/answer 85, 302 intrinsic value 210, 280 inventories 90, 119, 175 closing (or ending) 130 cost formulas 130, 132 costs included/costs as expenses 129 - 30financial statement presentation/ disclosure 132 impairment 131 levels 74 measurement 131 perpetual/periodic systems 130 ratios 131 sample question/answer 132, 304 valuation methods 130-1 investment 69-70 constraints 197 debt 155 equity 155 portfolio method 185 property 136-7 short-term policy guidelines 174-5 strategies 175 investment policy statement (IPS) 196. 197 investments savings (IS) curve 70 Investor Relations statement 95 investors 185-6 bond market 229 major asset classes 190 positions in an asset 202 psychological behaviour 211 isk-averse 188, 193 IPS see investment policy statement IRR see internal rate of return IS curve see investments savings (IS) curve joint probability function 28 kurtosis 24, 188 leases 91 advantages 145 disclosure 146 finance/operating 146 leverage, measures of see measures of leverage leveraged equity 293 leveraged returns 188 liabilities 96, 98, 113 LIBOR 243, 269-70

life cycle models 219

LIFO (last in, first out) 130, 132

limit order 204 liquidity 197, 202, 239 measures 173 preference theory 243 ratio 113, 122 risk 234-5 sources 176 liquidity/money supply (LM) curve 70 listed company governance see corporate governance of listed companies LM curve see liquidity/money supply (LM) curve lognormal distribution 36 long position 202-3, 268-9 long-lived assets amortization methods 135 capitalized/expensed costs difference 133 - 4de-recognition 136 depreciation 134-5 financial statement presentation 136 impairment 135-6 intangible assets 134 investment property 136-7 revaluation model 135 sample question/answer 137, 305 long-term contracts 108 look-ahead bias 39 Macaulay duration 261 macroeconomics 50 MAD see mean absolute deviation maintenance margin 273-4 major asset classes 190 Management Discussion and Analysis statement 95 margin 272 buying 229 securities market/future market difference 273-4 marginal cost of capital (MCC) 166, 167 marginal product 59 marginal revenue 59 mark to market accounting 135, 273 market interference 52 model 194 order 203 regulation 204 returns 22-5 types 54 value 210 market efficiency see Efficient Market Hypothesis market pricing anomalies calendar effects 210 closed-end investment fund discounts 210 momentum and overreaction 210 size/value effect 210 market segmentation theory 243 market structures 50 characteristics 62-3 concentration measures 66

321

market structures (continued) monopolistic competition 64 monopoly 65-6 oligopoly 64-5 perfect competition 63 sample question/answer 66, 301 market value-weighted indices 207 MCC see marginal cost of capital mean absolute deviation (MAD) 23 mean of asset returns 188 meaningful result 43 measurement scales 24 measures of central tendency 22 measures of leverage calculating/interpreting 169 definition/explanation 168 effect of financial leverage 168-9 sample question/answer 169, 307 medium term notes (MTN) 239 microeconomics 50 minimum-variance portfolio 189 momentum oscillator indicators 45 ROC, RSI, MACD 45 monetary policy sample question/answer 80, 301-2 money, time value of see time value of money money-market yield 14, 20, 175 money-weighted rate of return (MWRR) 14,20 monopolist 66 monopolistic competition 64 monopoly 65-6 Monte Carlo simulation 36 mortgaged-backed securities 237 mortgages 293 MTN see medium term notes multi-factor models 194 multiplier model 222-3 multivariate distribution 34 mutual funds 186 mutually exclusive projects 161 MWRR see money-weight a rate of return national income identity formula 84 NAV see net asset value negotiable CDs 239 net asset value (NAV) 290 net operating cycle 174 net operating income (NOI) 291 net present value (NPV) 14, 19, 158, 159, 161, 162, 292 net realizable value 131 net return 188 new entrants 219 NOI see net operating income nominal exchange rate 86 nominal spread 254 non-callable/non-convertible preferred stock 164, 224 non-current (long-term) liabilities 90, 142 debt 145 defined contribution/benefit pension plans 146-7

sample question/answer 147, 305 non-domestic equity securities 216 non-equilibrium price 52 non-recurring items 110 normal distribution 34 normal goods 57 normal profit 58 NPV see net present value null hypothesis 41 OAS see option-adjusted spread oligopoly 64-5 one-tailed tests of hypothesis 41 open position 273 open-end fund 290 operating leverage 169 operating profit (or EBIT) 110 operating risk 168 operating/non-operating income statement 110 opportunity cost 17 opportunity sets 57 optimal portfolio 190 option-adjusted spread (OAS option-free bonds 258 options 264 cost 255 definition 265 European and American 277, 278-9 exchange-traded cf over-the-counter 279 interest rate 277 moneyness 277 payoffs 277 put-call 276, 277 risk management application of strategies 285-6 sample questions/answers 281, 314 synthetic 278-9 value estimates 276 options, embedded accelerated sinking fund 228 call and refunding 228 cap on a floater 228 conversion 228 floor on a floater 228 prepayment 228 put provision 228 order, types of 203-4 outcome 28 over-the-counter (OTC) derivatives 265 over-the-counter (OTC) options 279 p-value 43 parameter 24 parametric/non-parametric tests 44 past financial performance 154 payback period 160 payment date 171-2 payoff 269 peer group 220

interest rate of bonds 143-4

leverage/coverage ratios 144

measurement of bonds 143

leasing assets 145-6

pensions 91, 146, 147 percentiles 24 perfect competition 63 performance ratio 119 permutation notation 29 perpetual/periodic systems 130 PI see profitability index plain vanilla interest rate swap 282 point estimate 37 polarity, change in 46 population 23, 24 population mean 22, 43-4 population variances 42-3 portfolio duration 259-60 performance 20 rates of return 20, 22 standard deviation 189 portfolio management 183 investment approach 185 investors 185-6 mutual funds 186 overview 184, 185-6 passive 210 planning and construction 196-8 process 186 risk and return 184, 187-95 sample question/answer 186, 308 portfolio planning and construction asset allocation 197 investment constraints 197 IPS 196 principles 197 risk/return objectives 197 sample question/answer 198, 309 power of a test 41 preference stock 215 prepayable bonds 258 prepayable security 17 present value (PV) 14, 16 price 69-72 discrimination 66 levels 75 return 206, 296 target 46 price earnings model (P/E ratio) 222 price elasticity of demand 53 price floor ceiling 52 price value of a basic point (PVBP) 260 price-based indicators 45 Bollinger Bands 45 moving averages 45 price-weighted indices 207 primary market 204, 239 principal strips 236-7 pro forma income 178-9 probability concepts sample question/answer 29, 299 probability distribution sample question/answer 36, 299 producer surplus 53 product of labor 59 product markets 50 production 60

profit 58 profit metrics 110 profit-maximization the Firm 63, 64, 65 level of output 35 short-run/long-run 61 profitability index (PI) 160 profitability ratio 122 project sequencing 161 protective put 285-6 psychological behaviour 211 public/private equity 215-16 purchased intangible assets 134 pure expectations theory 243 put-call parity 276, 278-9 putable bonds 258 PVBP see price value of a basic point quantitative methods 187-8, 189 application 31, 33-47 basic concepts 13-29 discounted cash flow applications 19 - 21market returns 22-5 overview 13-14 probability concepts 6-9 sample questions/answers 25, 298-9 statistical concepts 14, 22-5 technical analysis 14 time value of money 15-18 quartiles 24 quintiles 24 random variable 28, 34 rate of return 14, 17 discrete/continuous compound 36 rates of exchange see currency exchange rates ratios activity 122, 123 classify, calculate, interpret 122-4 equity 119 financial 90, 109 firm 119 gross profit margin 131 inventory 131 leverage/coverage 144 liquidity 122, 123, 173-4 model/forecast earnings 124-5 performance 119 price/earnings (P/E) 222 profitability 122, 123 relationship among 123 Roy's safety-first ratio 35 Sharpe ratio 23, 189 solvency 122, 123 valuation 122, 123 real estate 208 investment 293 valuation 291-2 yield on investment 292 real estate investment trusts (REITs) 293 real estate limited partnerships (RELPs) 293

real exchange rate 86 reinvestment risk 233 REITs see real estate investment trusts relative frequency 24 RELPs see real estate limited partnerships reported cash flow statement 120 repurchase agreements 229 resistance lines 46 resources 60 return on equity (RoE) 168-9 return-generating models 194 revaluation model 135 revenue 59, 96, 98 revenue recognition 108 Ricardian model 83 risk bond investment 226, 231-5 definitions 168 mortgage-backed securities 237 premium 17 systematic/non-systematic 193 risk management 264 option strategies 285-6 sample question/answer 286, 314 risk and return commodity investment 295-6 equity securities 216-17 objectives 197 overview 184 sample questions/answers 190-1, 195, 308.309 risk-averse 188, 188-9, 193 risk-free assets 192-3 risk-free rate 17 risk-neutral 188 risk-seeking 188 rivalry 219 roll vield 295 Roy's safety-first ratio 35 safety-first ratio 35 sales comperison 291 sample 23, 24 mean 22 selection bias 39 skewness 24 statistic 24 variance 23 sampling distribution 39 error 39 question/answer 39, 299-300 saving 69-70 scenario analysis method 260-1 SEC see Securities and Exchange Commission secondary market 204, 239 Securities and Exchange Commission (SEC) 102, 103 security analysis 100, 102 callable/prepayable security 233 overvalued, fairly valued, undervalued 223 reinvestment risk 233

security market index choices/issues in construction/ management 206-7 rebalancing/reconstitution 207 sample question/answer 208, 309 types 208 uses 208 value, price return, total return 206 weighting methods 207 security market line (SML) 184, 193-4 segment analysis 123-4 semiannual pay bond 254 sentiment indicators 45 margin debt 45 options volatility index (VIX) 45 put/call ratio 45 shorting interest 45 share price 162 share repurchases see dividends/share repurchases shareholders' equity 114 shareholders' wealth 171 Sharpe ratio 23, 189 short position 203, 268-9 short-term funding 176 shortfall risk 35 shutdown point of production 60 significance level 41 simple random sampling 39 skewness 24, 188 sample question/answer 25, 299 SML see security market line solvency ratio 113 sources of return 256 sovereign risk 235 special purpose vehicle 237-8 spot exchange rate 86 spot rate 226, 243, 255-6 standard deviation 23 standard error of the mean 37 Standards of Professional Conduct difference with Code of Ethics 2 ethical responsibilities 5 fundamental to values of CFA Institute 3 key points 2 reciting/understanding 1-2 sample questions/answers 5, 297 seven components 4 violations/sanctions 3 see also Code of Ethics; ethics statistical concepts 14 sample questions/answers 25, 298-9 statistical result 43 stock price 162 stocks 190, 193 stop 204 strategic analysis external factors 220 internal factors 219 stripped Treasury securities 236-7 structured notes 239 Student's t-distribution 38-9 subjective probability 28 substitution effect 56, 219

323

supplier bargaining power 219 support 46 surplus 53 survivor bias 39 swaps 264 characteristics 282 currency swap 283 definition 266 equity swap 283 interest rate swaps 282-3 sample question/answer 284, 314 termination 282 synthetic options 278-9 T-accounts 99 T-bills 190 tangible/intangible assets 134, 135 tax/es 91, 197 cost of capital 165 payable 140 real estate 292 technical analysis 13, 14 cycles 46 indicators 45 intermarket analysis 46 principles 45 sample question/answer 47, 300 term structure 242-3 test statistic 41 time deposit market 270 time horizon 197 time value 280 time value of money 14 annual rate 15-17 frequencies of compounding 16 sample questions/answers 18, 298 timeline 18 time-period bias 39 time-series data 39 time-weighted rate of return (TWRR 14,20

TIPS see Treasury inflation protected securities total cost 59 total leverage 169 total probability rule 28 total product 59 total return 206 total revenue 59 total surplus 53 trade balance 69-70 trading blocs 84 transparency 202 Treasury bills 238 Treasury bonds 238 Treasury inflation protected securities (TIPS) 238 tree diagram 27 trend 46 trial balance 99 two-tailed tests of hypothesis 41 TWRR see time-weighted rate of return Type I and Type II errors 41

uncertainty 13 unemployment 75 unimodal, nonsymmetrical distribution 24 univariate distribution 34 unweighted indices 207 US Department of the Treasury 238 US GAAP (US generally accepted accounting standards) 90, 100, 102, 109, 120, 31, 134, 135, 137, 141 utility 188-9 analyzis 57 theory 56 valuation 13 allowance 140-1 ratio 122 variable cost 59 variance 23

population means 42-3 variance of asset returns 188 variation margin 273 Veblen goods 57 venture capital investment 292 verification 9 voting rights 215 WACC see weighted average cost weighted average cost (WACC) 130, 132, 164, 166 weighted average or mean 22, 23 working capital management sample question/answer 177, 307-8 World Bank 85 World Trade Organization (WTO) 85 vield 14 curve 242–3 curve risk 233 measures 252-3 yield spreads 241 central bank interest rate policy 242 credit spread 242 embedded options 242 LIBOR 243 liquidity/issue size 243 measures 241 sample question/answer 244, 312 spot rate 243 taxable/tax-exempt bonds 242 vield curve 242-3 yield to call (YTC) 253 yield volatility 233, 261 yield-to-maturity (YTM) 164, 253-4 YTC see yield to call YTM see yield-to-maturity

zero coupon bond 243, 248 zero-volatility spread (z-spread) 254–5