Portfolio Management (Study Session 12)

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The focus of this topic is on the understanding of the asset allocation decision and together with it, the portfolio management process. Having understood the required steps essential for building up the financial model to address the client's stated goals and objectives, the student is introduced to the concept of diversification and the use of the Capital Asset Pricing Model (CAPM) to determine the required rate of return on any asset.

The first part of the syllabus requires the student to know the 6-step process of portfolio management. This whole process of understanding the goals of the client, his risk tolerance and return expectations are the building blocks for making the asset allocation decision. This process of deciding what percentage of a portfolio to devote to various asset classes is not about stock selection. Additionally, a good portfolio management process would take into consideration the different phases of an investor's life cycle. All the fact-finding workings and the final conclusion is then documented into an investment policy statement for execution between the relevant parties.

The second part of the syllabus requires the student to know the assumptions and build-up of the Markowitz's efficient frontier. The latter, which is a curved line, becomes a straight line with the introduction of a risk-free asset. Students should be well versed with the comparison between the CML and the SML. Favourite questions usually centre on asking students to ascertain whether a security is over, under or fairly priced using the SML. Fairly recently, the syllabus was modified to test students on the effects of relaxing certain assumptions of the CAPM.