

Answer 1:

A is correct.

Jacques does not have a particularly high income, his income is unstable, and he has reasonably high outgoings for his mortgage and maintenance payments. His investment time horizon is approximately two to six years given the ages of his children and his desire to support them at university. This finely balanced financial situation and short time horizon suggests a low ability to take risk. In contrast, his expectations for financial market returns and risk tolerance questionnaire answers suggest a high willingness to take risk. The financial adviser may wish to explain to Jacques how finely balanced his financial situation is and suggest that, despite his desire to take more risk, a relatively cautious portfolio might be the most appropriate approach to take.

Answer 2:

B is correct. The reference to the DAX marks this response as a relative risk objective. Value at risk establishes a minimum value of loss expected during a specified time period at a given level of probability. A statement of maximum allowed absolute loss (€2.5 million) is an absolute risk objective.

Answer 3:

C is correct. Measuring willingness to take risk (risk tolerance, risk aversion) is an exercise in applied psychology. Instruments attempting to measure risk attitudes exist, but they are clearly less objective than measurements of ability to take risk. Ability to take risk is based on relatively objective traits such as expected income, time horizon, and existing wealth relative to liabilities.

Answer 4:

A is correct. The volatility of the client's income and the significant support needs for his mother and himself suggest that the client has a low ability to take risk. The client's trading experience and his responses to the risk assessment questionnaire indicate that the client has an above average willingness to take risk.

Answer 5:

B is correct. On the one hand, the client has a stable, high income and no dependents. On the other hand, she exhibits above average risk aversion. Her ability to take risk is high, but her willingness to take risk is low.

Answer 6:

A is correct. The client's financial objectives are long term. Her stable employment indicates that her immediate liquidity needs are modest. The children will not go to college until 10 or more years later. Her time horizon is best described as being long term.

Answer 7:

B is correct. Tactical asset allocation allows actual asset allocation to deviate from that of the strategic asset allocation (policy portfolio) of the IPS. Tactical asset allocation attempts to take advantage of temporary dislocations from the market conditions and assumptions that drove the policy portfolio decision.

Answer 8:

The steps in managing a portfolio are:

1. The Planning Step
 - Understanding the client's needs
 - Preparation of an investment policy statement (IPS)
2. The Execution Step
 - Asset allocation
 - Security analysis
 - Portfolio construction
3. The Feedback Step
 - Portfolio monitoring and rebalancing
 - Performance measurement and reporting

Top down approach: A top-down analysis begins with consideration of macroeconomic conditions. Based on the current and forecasted economic environment, analysts evaluate markets and industries with the purpose of investing in those that are expected to perform well. Finally, specific companies within these industries are considered for investment.

Bottom up approach: Rather than emphasizing economic cycles or industry analysis, a bottom-up analysis focuses on company-specific circumstances, such as management quality and business prospects. It is less concerned with broad economic trends than is the case for top-down analysis, but instead focuses on company specifics.

Answer 9:

The open-end fund structure makes it easy to grow in size but creates pressure on the portfolio manager to manage the cash inflows and outflows.

One consequence of this structure is the need to liquidate assets that the portfolio manager might not want to sell at the time to meet redemptions.

Conversely, the inflows require finding new assets in which to invest.

As such, open-end funds tend not to be fully invested but rather keep some cash for redemptions not covered by new investments. Closed-end funds do not have these problems, but they do have a limited ability to grow.

Considering the restrictive structure of closed-end funds, I would prefer managing open end funds in spite of the disadvantages it has. (Can also accept closed end funds, if a sensible reason is given.)



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