Equity Investments

LEARNING OUTCOMES

Market Organization and Structure

The candidate should be able to:

- □ explain the main functions of the financial system
- □ describe classifications of assets and markets
- □ describe the major types of securities, currencies, contracts, commodities, and real assets that trade in organized markets, including their distinguishing characteristics and major subtypes
- □ describe types of financial intermediaries and services that they provide
- □ compare positions an investor can take in an asset
- □ calculate and interpret the leverage ratio, the rate of return on a margin transaction, and the security price at which the investor would receive a margin call
- □ compare execution, validity, and clearing instructions
- □ compare market orders with limit orders
- □ define primary and secondary markets and explain how secondary markets support primary markets
- □ describe how securities, contracts, and currencies are traded in quote-driven, order-driven, and brokered markets
- □ describe characteristics of a well-functioning financial system
- □ describe objectives of market regulation

Security Market Indexes

The candidate should be able to:

- □ describe a security market index

- □ calculate and interpret the value, price return, and total return of an index
- □ describe the choices and issues in index construction and management
- □ compare the different weighting methods used in index construction
- □ calculate and analyze the value and return of an index given its weighting method
- □ describe rebalancing and reconstitution of an index
- □ describe uses of security market indexes
- □ describe types of equity indexes
- □ compare types of security market indexes
- □ describe types of fixed-income indexes
- □ describe indexes representing alternative investments

Market Efficiency

The candidate should be able to:

- □ describe market efficiency and related concepts, including their importance to investment practitioners
- □ contrast market value and intrinsic value
- □ explain factors that affect a market's efficiency
- □ contrast weak-form, semi-strong-form, and strong-form market efficiency
- □ explain the implications of each form of market efficiency for fundamental analysis, technical analysis, and the choice between active and passive portfolio management
- □ describe market anomalies
- □ describe behavioral finance and its potential relevance to understanding market anomalies

Overview of Equity Securities

The candidate should be able to:

- □ describe characteristics of types of equity securities
- □ describe differences in voting rights and other ownership characteristics among different equity classes
- □ compare and contrast public and private equity securities
- □ describe methods for investing in non-domestic equity securities
- □ compare the risk and return characteristics of different types of equity securities
- □ explain the role of equity securities in the financing of a company's assets
- □ contrast the market value and book value of equity securities
- □ compare a company's cost of equity, its (accounting) return on equity, and investors' required rates of return

Introduction to Industry and Company Analysis

The candidate should be able to:

- □ explain uses of industry analysis and the relation of industry analysis to company analysis
- □ compare methods by which companies can be grouped
- □ explain the factors that affect the sensitivity of a company to the business cycle and the uses and limitations of industry and company descriptors such as "growth," "defensive," and "cyclical"
- □ describe current industry classification systems, and identify how a company should be classified, given a description of its activities and the classification system
- □ explain how a company's industry classification can be used to identify a potential "peer group" for equity valuation

- describe the elements that need to be covered in a thorough industry analysis
- describe the principles of strategic analysis of an industry
- explain the effects of barriers to entry, industry concentration, industry capacity, and market share stability on pricing power and price competition
- describe industry life-cycle models, classify an industry as to life-cycle stage, and describe limitations of the life-cycle concept in forecasting industry performance
- describe macroeconomic, technological, demographic, governmental, social, and environmental influences on industry growth, profitability, and risk
- compare characteristics of representative industries from the various economic sectors
- describe the elements that should be covered in a thorough company analysis

Equity Valuation: Concepts and Basic Tools

The candidate should be able to:

- evaluate whether a security, given its current market price and a value estimate, is overvalued, fairly valued, or undervalued by the market
- describe major categories of equity valuation models
- describe regular cash dividends, extra dividends, stock dividends, stock splits, reverse stock splits, and share repurchases
- describe dividend payment chronology
- explain the rationale for using present value models to value equity and describe the dividend discount and free-cash-flow-to-equity models
- explain advantages and disadvantages of each category of valuation model
- calculate the intrinsic value of a non-callable, non-convertible preferred stock
- calculate and interpret the intrinsic value of an equity security based on the Gordon (constant) growth dividend discount model or a two-stage dividend discount model, as appropriate
- identify characteristics of companies for which the constant growth or a multistage dividend discount model is appropriate
- explain the rationale for using price multiples to value equity, how the price to earnings multiple relates to fundamentals, and the use of multiples based on comparables
- calculate and interpret the following multiples: price to earnings, price to an estimate of operating cash flow, price to sales, and price to book value
- describe enterprise value multiples and their use in estimating equity value
- describe asset-based valuation models and their use in estimating equity value