STUDY SESSION 1

Ethical and Professional Standards

The CIPM Level I curriculum introduced ethical reasoning and presented the provisions of the CFA Institute Code of Ethics and Standards of Professional Conduct. At Level II, you are expected to demonstrate your ability to recognize ethical issues that you may encounter and to apply the ethical principles and standards governing your professional conduct.

Note: This study session makes use of the 11th edition of the CFA Institute *Standards of Practice Handbook* (SOPH) to focus on applications of the Code and Standards and recommended procedures for complying with them.[1] The guidance, recommendations, and applications provided in SOPH supplement the CFA Institute Code and Standards. Recognizing that the following list is not exhaustive, the following exchanges may help with your understanding the reading:

SOPH Terminology		
CFA Institute	→	CIPM Association
CFA	→	CIPM
Members and Membership	→	Pertains to the CIPM Association and CFA Institute
Program, Candidates and Candidacy	→	Pertains to the CIPM Program and the CFA Program
Designation	→	Pertains to the Certificate in Investment Performance Measurement (CIPM) designation and the CFA designation
Exams	→	CIPM and CFA exams
CFA marks	→	CIPM marks ("Certificate in Investment Performance Measurement" or "CIPM")
Charter/Charterholders	→	Certificate/Certificants or Certificate Holders

1 Until October 1, 2019, existing CIPM certificants may be members of either the CIP Association or CFA Institute. While the Code and Standards for each organization are substantially similar, each certificant will be held to the Code and Standards of the organization of which they are a member. New CIPM certificants will join CFA Institute, thus this material is focused on the CFA Institute Code of Ethics and Standards of Professional Conduct.

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READING ASSIGNMENTS

1 CFA Institute Code of Ethics and Standards of Professional Conduct

2 *Standards of Practice Handbook*, Eleventh Edition

LEARNING OUTCOMES

READING 1. CFA INSTITUTE CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

The candidate should be able to:

a evaluate procedures for complying with the CFA Institute Standards of Professional Conduct;

b explain the individual's responsibilities as a candidate or member, including references to membership in CFA Institute, the CIPM designation, and candidacy in the CIPM program;

c evaluate circumstances, identify violations, and formulate appropriate corrective actions based on the CFA Institute Code of Ethics and Standards of Professional Conduct.

READING 2. STANDARDS OF PRACTICE HANDBOOK , ELEVENTH EDITION

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STUDY SESSION 2

Performance Measurement

The CIPM Level I curriculum presented the calculation of time-weighted and money-weighted rates of return, including methods for estimating time-weighted returns for periods in which external cash flows occur. This study session reviews certain relatively advanced topics.

The first reading in this study session addresses the measurement of portfolio returns in several practically important cases; specifically, when portfolios contain short positions or make use of derivatives contracts, or when positions are held in multiple currencies other than the base currency. The second reading considers the factors that give rise to prior period adjustments and the related performance measurement policy issues.

READING ASSIGNMENTS

3 Topics in Return Measurement
by Carl R. Bacon, CIPM, Bruce J. Feibel, CFA, and Bernd R. Fischer, PhD

4 Adjustments to Prior Period Returns
by David D. Spaulding, DPS, CIPM, and Stefan J. Illmer, PhD

LEARNING OUTCOMES

READING 3. TOPICS IN RETURN MEASUREMENT

The candidate should be able to:

a calculate and interpret rates of return of long–short, short extension, and market-neutral investment portfolios;

b determine the effects on portfolio return of specified positions in forwards, futures, swaps, and options;

c define economic (notional) exposure and notional return;

d describe the notional market value approach to calculating returns to portfolios including forwards, futures, swaps, or options;

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e calculate and interpret economic exposures and notional returns of portfolios including forwards, futures, swaps, or options;

f calculate and interpret the returns to unhedged and partially hedged multicurrency portfolios;

g describe the problem of zero or near-zero market value denominators (e.g., in currency overlay portfolios).

READING 4. ADJUSTMENTS TO PRIOR PERIOD RETURNS

The candidate should be able to:

a identify and describe common causes of discrepancies between managers' and custodians' accounting data;

b explain the issues that affect prior period adjustments.

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STUDY SESSION

3

Performance Attribution

This study session addresses advanced topics in performance attribution, beginning with a reading on the use of strategy benchmarks (also known as custom benchmarks) in the evaluation of managers' investment processes. The second reading of the study session addresses return attribution in several practically important cases: portfolios with short positions, derivatives exposures, and/or multicurrency exposures. The third reading in the study session focuses on fundamental concepts in fixed-income attribution.

READING ASSIGNMENTS

5 Strategy Benchmarks: From the Investment Manager's Perspective
by David E. Kuenzi, CFA

6 Topics in Return Attribution
by Carl R. Bacon, CIPM

7 Introduction to Fixed-Income Attribution
by Claude Giguère, BScA, and Andrew Kophamel, FRM, CFA, CIPM

LEARNING OUTCOMES

READING 5. STRATEGY BENCHMARKS: FROM THE INVESTMENT MANAGER'S PERSPECTIVE

The candidate should be able to:

a explain the concept of normal (neutral) weights;

b distinguish between published benchmark-centered investment disciplines and manager strategy investment disciplines;

c explain why strategy benchmarks are more appropriate for manager strategy investment disciplines;

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d describe benchmark selection/creation and risk of an institutional investment process;

e describe the impact of benchmark selection on attribution analysis and the calculation of tracking error and information ratios.

READING 6. TOPICS IN RETURN ATTRIBUTION

The candidate should be able to:

a calculate and interpret return attribution results for portfolios containing short positions;

b calculate and interpret return attribution results for portfolios containing futures or options;

c calculate and interpret the asset allocation, security selection, and currency allocation effects in a multi-currency portfolio using the Karnosky–Singer approach;

d calculate and interpret the asset allocation, security selection, and currency allocation effects in a multi-currency portfolio using a geometric methodology when returns are not continuously compounded;

e describe why interest rate differentials matter in multi-currency return attribution;

f contrast arithmetic and geometric multi-period attribution analysis;

g describe problems associated with multi-asset attribution analysis, including analysis of balanced portfolios and portfolios combining liquid and illiquid assets.

READING 7. INTRODUCTION TO FIXED-INCOME ATTRIBUTION

The candidate should be able to:

a describe the three major approaches to fixed-income attribution (exposure decomposition—duration based, yield curve decomposition—duration based, and yield curve decomposition—full repricing);

b compare the three major approaches to fixed-income attribution in terms of associated decision-making processes, typical users, operational considerations, and limitations;

c describe and evaluate the three major approaches to fixed-income attribution in terms of their implementation, output, interpretation, and appropriate applications by various users;

d analyze and interpret the output of a fixed-income attribution analysis.

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STUDY SESSION

4

Performance Appraisal

Recognizing that distinguishing between skill and luck is problematic, performance appraisal and manager selection address questions such as how to measure investment skill and whether a fund sponsor should hire, retain, or fire an investment manager.

The first reading presents various performance appraisal approaches and techniques that will help the evaluator materially improve the assessment of investment performance and presents a mini case to reinforce many of the reading's core ideas.

The second reading presents an approach to equity style analysis; equity style is often a major consideration in active equity manager selection.

READING ASSIGNMENTS

8 Topics in Performance Appraisal
by Mark M. Carhart, PhD, CFA, and Russ Wermers, PhD

9 Equity Style Analysis: Beyond Performance Measurement
by George Degroot, CFA, and Paul Greenwood, CFA

LEARNING OUTCOMES

READING 8. TOPICS IN PERFORMANCE APPRAISAL

The candidate should be able to

a Describe considerations in distinguishing investment skill from luck in an investment record;

b analyze mistakes in performance appraisal;

c demonstrate the use of quality control charts in performance appraisal;

d evaluate how benchmark and factor selection affect performance appraisal and the consequences of selecting an incorrect benchmark;

e evaluate how cash holdings can affect performance appraisal;

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f describe limitations of relying on historical performance data in performance appraisal;

g describe characteristics of superior active managers;

h justify the selection of one or more appraisal measures;

i describe techniques for evaluating strategies with non-linear returns;

j analyze the skill of an active manager.

READING 9. EQUITY STYLE ANALYSIS: BEYOND PERFORMANCE MEASUREMENT

The candidate should be able to:

a describe how characteristic-based analysis provides a deeper understanding of a manager's strategy;

b explain how characteristic-based analysis can be used to evaluate a manager's investment philosophy and risk tolerance;

c explain how characteristic-based analysis can be used to compare the performance of large cap growth managers;

d explain how characteristic-based analysis can be used to assess how a manager's strategy will perform in different market environments;

e describe how characteristic-based analysis can be used to assess how a manager performed across multiple time periods.

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STUDY SESSION

5

Manager Selection

This study session addresses important topics in investment manager selection. The first reading provides a framework that introduces and describes the important elements of the manager selection process. The second reading explores important principles of investment manager selection including distinctive due diligence concerns for investment managers of traditional and alternative investments, the manager interview process, considerations in forming a portfolio of managers, and manager monitoring and continuance. The third reading in the sequence illustrates many of these principles via a series of case studies. The fourth reading takes a generally quantitative approach to determining allocations to passive and active managers.

The final reading in this study session examines various foundational issues in manager selection, arguing the importance of using measures of active return and active risk purged of any systematic risk influences. The reading also describes considerations in constructing an optimal portfolio of managers.

READING ASSIGNMENTS

10 Investment Manager Selection: An Introduction
by Jeffrey Heisler, CFA, and Donald Lindsey, CFA

11 Topics in Investment Manager Selection
by Jeffrey C. Heisler, PhD, CFA, Jeffrey R. Nipp, CAIA, CFA, Morgan Webber, Ross Morrison, and Steven G. Bloom, CFA

12 Cases in Investment Manager Selection
by Jeffrey C. Heisler, PhD, CFA, Jeffry R. Nipp, CAIA, CFA, Morgan Webber, Ross Morrison, and Steven G. Bloom, CFA

13 Setting Weights for Active and Index Managers
by Scott D. Stewart, PhD, CFA

14 The Dimensions of Active Management: Why Alpha and Active Risk Are the Only Things That Matter
by M. Barton Waring and Laurence B. Siegel

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LEARNING OUTCOMES

READING 10. INVESTMENT MANAGER SELECTION: AN INTRODUCTION

The candidate should be able to:

- **a** describe how investment manager selection takes place in the context of the client's investment policy statement;
- **b** describe qualitative considerations in evaluating investment managers;
- **c** describe the components of a manager selection process, including due diligence;
- **d** contrast Type I and Type II errors in manager hiring and continuation decisions;
- **e** describe uses of style analysis in investment manager selection;
- **f** compare returns-based and holdings-based style analysis, including the advantages and disadvantages of each;
- **g** describe uses of the upside capture ratio, downside capture ratio, maximum drawdown, drawdown duration, and up/down capture in evaluating managers;
- **h** describe uses of the "batting average" in evaluating managers;
- **i** evaluate a manager's investment philosophy and investment decision-making process;
- **j** evaluate the costs and benefits of pooled investment vehicles and separate accounts;
- **k** compare types of investment manager contracts, including their major provisions and advantages and disadvantages;
- **l** describe the three basic forms of performance-based fees;
- **m** analyze and interpret a sample performance-based fee schedule.
- **n** evaluate a manager's adherence to a stated investment philosophy and investment decision-making process.

READING 11. TOPICS IN INVESTMENT MANAGER SELECTION

The candidate should be able to:

- **a** describe portfolio considerations in selecting investment managers;
- **b** describe points to cover in an investment manager interview and during an on-site visit to the investment manager's firm;
- **c** describe special considerations in the selection of equity portfolio managers;
- **d** describe special considerations in the selection of fixed-income portfolio managers;
- **e** describe special considerations in the selection of passive investment managers;
- **f** describe special considerations in the selection of hedge fund managers;
- **g** describe special considerations in the selection of private equity managers;
- **h** describe special considerations in the selection of real estate managers;
- **i** describe considerations in monitoring investment managers;
- **j** define style drift and judge whether style drift has occurred;
- **k** describe costs and other considerations in terminating and replacing investment managers.

READING 12. CASE STUDIES IN INVESTMENT MANAGER SELECTION

The candidate should be able to:

- **a** recommend and justify the selection of a passive investment manager for a given asset class;

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b recommend and justify the selection of an active investment manager for a given asset class;

c recommend and justify the selection of a hedge fund manager;

d recommend and justify the selection of a private equity manager;

e recommend and justify the selection of a real estate manager;

f evaluate how an investment manager has been selected;

g evaluate the selection of a replacement investment manager.

READING 13. SETTING WEIGHTS FOR ACTIVE AND INDEX MANAGERS

The candidate should be able to:

a describe the components of the investor's utility function for manager selection;

b explain why the investor's utility function for manager selection uses active return instead of total return;

c describe approaches to incorporating risk into the manager selection process;

d describe the optimal mix of managers;

e describe how search and monitoring costs affect the manager selection process.

READING 14. THE DIMENSIONS OF ACTIVE MANAGEMENT: WHY ALPHA AND ACTIVE RISK ARE THE ONLY THINGS THAT MATTER

The candidate should be able to:

a describe the components of total risk (market risk and pure active risk) and explain how these components are related to strategic asset allocation;

b explain misfit risk (i) for a single active manager and (ii) for a portfolio of active managers chosen by an investor (*net* misfit risk);

c explain the calculation of the pure information ratio (i) for a single active manager and (ii) for a portfolio of active managers;

d distinguish between active investment results that are under an investment manager's control and those that are under an investor's control;

e explain the limitations of historical alphas, style boxes, and traditional active risk concepts for building a portfolio of managers;

f describe how to estimate the inputs needed in the optimization process that leads to the efficient frontier of active managers;

g explain why the manager optimization process favors lower active-risk managers.

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STUDY SESSION

6

Investment Performance Presentation

At Level II, you will learn about the required and recommended provisions of the GIPS standards and how to apply them in practice. This study session presents and illustrates the application of the Standards.

READING ASSIGNMENTS

15 Overview of the Global Investment Performance Standards: CIPM Level II
by Philip Lawton, PhD, CFA, CIPM

16 Global Investment Performance Standards (GIPS)

LEARNING OUTCOMES

READING 15. OVERVIEW OF THE GLOBAL INVESTMENT PERFORMANCE STANDARDS: CIPM LEVEL II

The candidate should be able to:

a explain the fundamentals of compliance with the GIPS standards, including the definition of the firm, calculating total firm assets, and the conditions under which an investment management firm can claim compliance;

b determine whether a firm's input data use and record keeping procedures are consistent with the requirements and recommendations of the GIPS standards;

c compare fair value and market value of assets and show how to implement the valuation recommendations of the GIPS standards, including the valuation hierarchy;

d calculate composite returns in accordance with the GIPS standards;

e explain why the GIPS standards require the inclusion of returns from cash and cash equivalents in total return calculations;

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f explain and calculate the treatment of trading expenses and fees, including determining gross-of-fees and net-of-fees portfolio returns in accordance with the GIPS standards;

g evaluate the appropriateness of composite construction according to the GIPS standards, including (i) linked performance of model or simulated portfolios, (ii) inclusion of new portfolios and termination and switching of portfolios, and (iii) treatment of portfolios with external cash flows;

h evaluate the classification of portfolios as discretionary or non-discretionary in accordance with the GIPS standards;

i state the requirements and recommendations of the GIPS standards with respect to disclosures, presentation, and reporting;

j identify errors and omissions in disclosures, presentation, and reporting, and recommend changes that would bring them into compliance with the GIPS standards;

k determine the portability of performance track records from a past firm or affiliation in accordance with the GIPS standards;

l determine whether investments are subject to the provisions of the GIPS standards related to private equity;

m explain the GIPS standards related to real estate and private equity valuation;

n state the requirements of the GIPS Advertising Guidelines including the correct wording of the GIPS compliance statement for advertisements;

o determine whether an advertisement adheres to the requirements of the GIPS Advertising Guidelines;

p explain the purpose and scope of verification in accordance with the GIPS standards and state the correct wording of the GIPS compliance statement used for a firm that is verified;

q identify and define the terms presented in the GIPS Glossary.

READING 16. GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS)

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