

STUDY SESSION

13

Equity

Market Organization, Market Indices, and Market Efficiency

This study session explains important characteristics of the markets in which equities, fixed-income instruments, derivatives, and alternative investments trade. The reading on market organization and structure describes market classifications, types of assets and market participants, and how assets are traded. The reading on security market indices explains how indices are constructed, managed, and used in investments. The reading on market efficiency discusses the degree to which market prices reflect information. It also explains implications of different degrees of market efficiency for security analysis and portfolio management.

READING ASSIGNMENTS

Reading 45	Market Organization and Structure by Larry Harris, PhD, CFA
Reading 46	Security Market Indices by Paul D. Kaplan, PhD, CFA, and Dorothy C. Kelly, CFA
Reading 47	Market Efficiency by W. Sean Cleary, PhD, CFA, Howard J. Atkinson, CIMA, ICD.D, CFA, and Pamela Peterson Drake, PhD, CFA

LEARNING OUTCOMES

READING 45. MARKET ORGANIZATION AND STRUCTURE

The candidate should be able to:

- a** explain the main functions of the financial system;

- b** describe classifications of assets and markets;
- c** describe the major types of securities, currencies, contracts, commodities, and real assets that trade in organized markets, including their distinguishing characteristics and major subtypes;
- d** describe types of financial intermediaries and services that they provide;
- e** compare positions an investor can take in an asset;
- f** 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;
- g** compare execution, validity, and clearing instructions;
- h** compare market orders with limit orders;
- i** define primary and secondary markets and explain how secondary markets support primary markets;
- j** describe how securities, contracts, and currencies are traded in quote-driven, order-driven, and brokered markets;
- k** describe characteristics of a well-functioning financial system;
- l** describe objectives of market regulation.

READING 46. SECURITY MARKET INDICES

The candidate should be able to:

- a** describe a security market index;
- b** calculate and interpret the value, price return, and total return of an index;
- c** describe the choices and issues in index construction and management;
- d** compare the different weighting methods used in index construction;
- e** calculate and analyze the value and return of an index given its weighting method;
- f** describe rebalancing and reconstitution of an index;
- g** describe uses of security market indices;
- h** describe types of equity indices;
- i** describe types of fixed-income indices;
- j** describe indices representing alternative investments;
- k** compare types of security market indices.

READING 47. MARKET EFFICIENCY

The candidate should be able to:

- a** describe market efficiency and related concepts, including their importance to investment practitioners;
- b** distinguish between market value and intrinsic value;
- c** explain factors that affect a market's efficiency;
- d** contrast weak-form, semi-strong-form, and strong-form market efficiency;
- e** explain the implications of each form of market efficiency for fundamental analysis, technical analysis, and the choice between active and passive portfolio management;

- f** describe market anomalies;
- g** describe behavioral finance and its potential relevance to understanding market anomalies.