

STUDY SESSION

12

Equity Portfolio Management

Because equity securities represent a significant portion of many investment portfolios, equity portfolio management is often an important component of overall investment success. This study session focuses on the role of equities in an investment portfolio, three major approaches (passive, active, and semi-active) used to manage equity portfolios, and the evaluation of equity managers.

READING ASSIGNMENT

Reading 25

Equity Portfolio Management
by Gary L. Gastineau, Andrew R. Olma, CFA, and Robert G.
Zielinski, CFA

LEARNING OUTCOMES

READING 25. EQUITY PORTFOLIO MANAGEMENT

The candidate should be able to:

- a** discuss the role of equities in the overall portfolio;
- b** discuss the rationales for passive, active, and semi-active (enhanced index) equity investment approaches and distinguish among those approaches with respect to expected active return and tracking risk;
- c** recommend an equity investment approach when given an investor's investment policy statement and beliefs concerning market efficiency;
- d** distinguish among the predominant weighting schemes used in the construction of major equity market indexes and evaluate the biases of each;

- e** compare alternative methods for establishing passive exposure to an equity market, including indexed separate or pooled accounts, index mutual funds, exchange-traded funds, equity index futures, and equity total return swaps;
- f** compare full replication, stratified sampling, and optimization as approaches to constructing an indexed portfolio and recommend an approach when given a description of the investment vehicle and the index to be tracked;
- g** explain and justify the use of equity investment–style classifications and discuss the difficulties in applying style definitions consistently;
- h** explain the rationales and primary concerns of value investors and growth investors and discuss the key risks of each investment style;
- i** compare techniques for identifying investment styles and characterize the style of an investor when given a description of the investor’s security selection method, details on the investor’s security holdings, or the results of a returns-based style analysis;
- j** compare the methodologies used to construct equity style indexes;
- k** interpret the results of an equity style box analysis and discuss the consequences of style drift;
- l** distinguish between positive and negative screens involving socially responsible investing criteria and discuss their potential effects on a portfolio’s style characteristics;
- m** compare long–short and long-only investment strategies, including their risks and potential alphas, and explain why greater pricing inefficiency may exist on the short side of the market;
- n** explain how a market-neutral portfolio can be “equitized” to gain equity market exposure and compare equitized market-neutral and short-extension portfolios;
- o** compare the sell disciplines of active investors;
- p** contrast derivatives-based and stock-based enhanced indexing strategies and justify enhanced indexing on the basis of risk control and the information ratio;
- q** recommend and justify, in a risk-return framework, the optimal portfolio allocations to a group of investment managers;
- r** explain the core-satellite approach to portfolio construction and discuss the advantages and disadvantages of adding a completeness fund to control overall risk exposures;
- s** distinguish among the components of total active return (“true” active return and “misfit” active return) and their associated risk measures and explain their relevance for evaluating a portfolio of managers;
- t** explain alpha and beta separation as an approach to active management and demonstrate the use of portable alpha;
- u** describe the process of identifying, selecting, and contracting with equity managers;
- v** contrast the top-down and bottom-up approaches to equity research.