

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

Company Analysis: Past and Present

The candidate should be able to:

- describe the elements that should be covered in a thorough company research report
- determine a company's business model
- evaluate a company's revenue and revenue drivers, including pricing power
- evaluate a company's operating profitability and working capital using key measures
- evaluate a company's capital investments and capital structure

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Industry and Competitive Analysis

The candidate should be able to:

- describe the purposes of, and steps involved in, industry and competitive analysis
- describe industry classification methods and compare methods by which companies can be grouped
- determine an industry's size, growth characteristics, profitability, and market share trends
- analyze an industry's structure and external influences using Porter's Five Forces and PESTLE frameworks
- evaluate the competitive strategy and position of a company

Company Analysis: Forecasting

The candidate should be able to:

- explain principles and approaches to forecasting a company's financial results and position
- explain approaches to forecasting a company's revenues
- explain approaches to forecasting a company's operating expenses and working capital
- explain approaches to forecasting a company's capital investments and capital structure
- describe the use of scenario analysis in forecasting

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