

# Career Employer

## Series 65 Cheat Sheet

### INVESTMENT ADVISER REGULATION

A **person** is described as someone who is not deceased, is not a minor, or has not been declared mentally incompetent.

An investment adviser (IA) is a person who meets the three prong test.

Registration as an IA is necessary if, for their business, a person compares the performance of advisers and receives compensation for doing so.

Financial planners, entertainment/sports representatives, and pension consultants were added by IA-1092.

SEC registration as a federal-covered adviser is necessary for AUM of \$110 million or more.

State registration is necessary if AUM < \$100 million.

When AUM drops below \$90 million for a federal-covered adviser, they must register with the state.

SEC registration is necessary if investment companies are clients of an IA.

The following are excluded from the definition of an investment adviser: engineers, teachers, lawyers, and accountants but only if they provide incidental advice. If they charge for their advice, the exclusion falls away. Under the de minimis rule (where they have 5 or fewer retail clients and no place of business in a state), state-registered IAs are exempt.

IAs don't need to register if they have no place of business in the state and they can have any number of institutional clients.

When dealing with vacationing clients, exemption from registration is provided by the **snowbird** rule.

If their principal business consists of providing investment advice and a large part of their advisory business includes investment supervisory services, the term investment counsel can be used by an IA.

As per the Uniform Securities Act (USA), registration or withdrawals of securities professionals are carried out at midday, 30 days after the application is completed.

On 31 December, all registrations of persons will expire following their initial registration therefore annual renewal is necessary.

Securities remain registered for a period of one year from their registration commencement date.

Fees won't need to be paid by the successor firm of an IA or broker-dealer (BD) until their registration is renewed.

As part of their registration, all securities professionals must file a consent to service of process.

When exercising discretion on a client account, \$10,000 net worth or a surety bond is necessary for an IA.

\$35,000 or a surety bond is needed if an IA maintains custody of client funds or securities.

When an IA that is state-covered meets the net worth or bonding requirements of their home state, that's enough for any other state in which they choose to register. SEC requirements only need to be met by Federal-covered IAs.

If they have an ownership level of 25% or more, a person is deemed to be in control of an IA under both state and federal law.

The principal office of an IA or BD must maintain various company records, for example, corporate charters. Following the termination of the enterprise, these should be kept for a period of three years.

### INVESTMENT ADVISER REPRESENTATIVE (IAR) REGULATION

These individuals are associated with IAs, as well as those that supervise IARs.

An IAR that works with a state-registered IA has the de minimis exemption available to them.

Those that work with a covered IA don't have the de minimis exemption available. Regardless of the number of clients, however, they will only register in states where they have places of business.

The USA states that registration as an IAR is necessary for any person who receives compensation as a solicitor for an investment advisory firm.

The USA states that should an IAR stop working for an IA, whether they are state or federally covered will influence the notice period. The administrator must be informed by the IA if they are state registered while if federal covered, that's the task of the IAR.

### BROKER-DEALER AND AGENT REGULATION

When having an office in a particular state, registration as a BD is a necessity.

Unless their net capital meets SEC requirements, should a BD maintain custody of customer securities and/or funds, or exercise discretion over accounts, a surety bond may need to be posted.

Agents cannot have custody but can exercise discretion and if they do, they may need to post a surety bond too.

Deposits of cash or securities can be accepted by the Administrator in lieu of a surety bond.

The requirements of the USA must be met by the surety bond so customers can collect against it.

Receipts must be issued as soon as possible should a customer deposit securities with a BD.

Agents ending their association with a BD must notify the administrator. The BD will have to as well as per the USA.

Registration is necessary for any individual representing a BD in a securities offer or sale.

A three-year period is how long BD records should be kept according to regulations. For IAs, the period is five years.

Changes to the registration of a BD must be reported as soon as possible.

## **SECURITIES AND ISSUER REGULATION**

As per regulations, these are not considered to be securities – IRA and Keogh retirement plans, fixed annuity, term, whole life, modified endowment, and other nonvariable insurance contracts, collectibles, currencies, personal use condominiums, and commodities.

The regulation of securities is carried out through the Securities Act of 1933.

Once a prospectus is effective, only then can nonexempt securities be sold.

While no money or orders are allowed, an indication of interest is acceptable when the issue is in registration (before the effective date).

According to the USA, only with an active review of registration can a security registered by qualification become effective.

Exempt transactions that are most common include:

- Transactions by fiduciaries
- Isolated nonissuer transactions
- Transactions between underwriter and issuer
- Unsolicited orders
- Transactions with institutions
- Private placements

The agent of a BD will need to be registered properly, even if the transaction or the security is exempt.

Because it is an exempt transaction, an unsolicited order for a nonexempt unregistered security can be accepted by a registered agent.

The right to have clients agree that the order was unsolicited lies with the administrator.

## **ADMINISTRATIVE PROVISIONS AND REMEDIES**

Within three years of the alleged infraction, under the terms of the USA, a civil suit will need to be filed within that period or within two years of the violation being discovered (whatever comes first). It is one year from discovery in terms of federal law, however.

The offer to return a customer's money including interest is termed rights of rescission. Any income the investment made is taken off when a sale has violated the USA. Within 30 days of receiving the offer, the client must either accept or reject it.

When the buy or sell offers originate in, are directed to, or accepted in the state of the administrator, under the terms of the USA, they have jurisdiction over them. A violation can result in more than one administrator taking action.

While it is not a sale until the transaction takes place, an offer, according to the USA is an attempt to make a sale.

In terms of gifts, nonassessable stock is not seen as one, while assessable stock is considered to be a gift when given to someone.

A bonus is considered to be a sale if given by the BD in the form of a security attached to another purchase, for example, other stock, a car, or a house, for example.

If there is no cost involved, a stock dividend or split stock is not considered a sale.

### **Stop orders**

In general, this is linked to a securities registration. An appeal against a stop order is possible within a 60-day period of it having been received.

### **Cease and desist order**

It is with or without a prior hearing that a cease and desist order can be issued by an administrator.

A court-imposed injunction can occur if this order is not adhered to.

### **Summary action**

As long as a hearing is held within a 15-day period after receipt of a written request, the administrator can summarily suspend the registration of both a security and a person.

Under the USA, the maximum fine that can be levied is \$5,000 while a prison sentence term is three years. Under federal law, it's \$10,000 and/or five years in jail.

## **COMMUNICATION WITH PROSPECTS AND CLIENTS**

All electronic communication is considered written communication. It's not the method of delivery, but the content that's the critical factor when talking about social media.

Training in the use of social media is critical and firms should have control measures in place when it comes to the use of office equipment as well as personal equipment for business purposes.

In an **agency cross transaction**, both sides are represented by the IA, who receives compensation from each. If an IA recommended the transaction to a seller and buyer, an agency cross transaction cannot take place with them in the role of the IA in it.

At least 48 hours before entering into a contract, the IA's brochure (Form ADV Part 2A and supplement Part 2B) should be delivered. If not, clients can terminate without penalty within five business days.

It is by no later than the commencement of the agreement that federal and state-registered IAs must deliver the brochure (ADV Part 2A and Part 2B). Annual delivery of a "summary of material changes" must then be provided within 120 days of the end of the fiscal year. If requested by a client, the brochure must also be provided.

How the adviser will be compensated is specifically required in Form ADV. An IA can charge different fees if fees are negotiable.

Under the USA, "guaranteed" means the principal, interest, or dividends are guaranteed by someone who is not the issuer. This does not apply to capital gains, however.

Any website a BD might have online is seen as a form of advertising under the regulations. For this reason, records of the website must be kept for a period of three years. If changes are made, they will need to be kept for three years too.

Any potential conflicts of interest must be disclosed to clients as well as all BD fees.

For certain services such as account transfers, appraisals, collections of interest and/or dividends, or safekeeping assets, BDs are allowed to charge reasonable rates. If they offer free services through advertising, there must not be any hidden obligations.

Advertising for IAs cannot include testimonials of any kind, while a disclaimer relating to difficulties of use as well as limitations must be given when using charts in adverts.

Literature that includes past recommendations' performance must show both the good and bad performance for at least the past year.

If they have an undisclosed interest in certain securities, it is unethical for an IA to suggest

to a client that they should trade in them, especially if the value of said securities increases, which then benefits the adviser.

### **FIDUCIARY OBLIGATIONS AND ETHICAL PRACTICES**

The ability to select assets, amounts, or action for clients is known as investment discretion.

Split commissions between agents are allowed as long as they are of the same or affiliated BDs. In this case, it's not necessary to inform clients.

The appropriate supervisor should be notified when any written customer complaint is received.

Under an IRS or court order, an adviser can divulge the name of current clients. This is also true if they receive their permission or that of the joint owner of an account.

When it comes to third-party research reports, certain rules govern their use. For example, attribution should be given if it is distributed. No mention is necessary, however, if it is used as the basis for the IA's report.

Only if a client is a qualified investor that meets certain minimum net worth requirements, holds a certain amount of AUM with an adviser, or is an investment company can performance-based compensation be received. The client must be with a spouse if joint assets are used.

Under the USA, all IA fees charged must be competitive.

If projected to be more than the expected returns of the portfolio consistently, then IA fees are considered to be unreasonable.

Each client should pay an "averaged" price should an IA buy the same security at different prices for several clients using one order.

If a client or executing BD accidentally mails a stock certificate or money to an IA, unless they are authorized to maintain custody thereof, it should be returned within three business days.

Three business days is also the period that all third-party checks must be forwarded.

Quarterly statements must be sent to clients when the IA holds their funds. Any changes in location should be sent as soon as possible, however.

The following are considered as prohibited practices:

- Unless the client is a BD, an IA affiliate, or a financial institution that loans funds, money, or securities cannot be borrowed from them.
- Unless the IA is a financial institution that makes loans, or the client is an affiliate of the IA, money cannot be loaned to them
- Providing all clients with the same blanket security recommendation

The annual financial examination of an IA is through Form ADV-E. Although completed by an IA, it is an independent account that must submit it. This is only a requirement for IAs that hold custody of client assets or money.

IAs can accept compensation from BDs in the form of research, customer-related software, and seminar registration fees under the safe harbor provisions of the Securities Exchange Act of 1934 (Section 28 (e)). This provision does not cover travel or transport reimbursement, furniture, rent, or computers/software that is non-customer related.

### **CONCEPTS: BASIC ECONOMICS**

When discussing government policies regarding the economy, there are two - fiscal and monetary.

Fiscal deals with budgets and taxation and is set by Congress and the president.

Monetary policy is controlled by the Federal Reserve Board and relates to discount rate, reserve requirements, and open-market operations, but it has nothing to do with the prime rate.

**Top-down analysis:** This looks at the economy and tries to profit by finding the sectors that are best performing and then buying stocks in that sector.

**Bottom-up analysis:** Instead of looking at sectors, this looks at individual companies within a specific industry and finding those that will outperform others.

When it comes to exports and imports, a weakened dollar sees increased exports and decreased imports. A stronger dollar then means a role reversal.

**A trade deficit/negative balance of payments** results when exports are lower than imports, and as a result, the dollar will weaken.

Balance of payments: Net exports mean a stronger dollar, while net imports mean a weaker dollar.

The cycle of a business is as follows: expansion, peak, contraction, and trough.

### **FINANCIAL REPORTING**

In the footnotes of the annual report, or financial statements, it must be revealed if a corporation has "off-book" debts or pending litigation against it.

There is no change to net worth when a company redeems bonds at par. Net worth is reduced if bonds are redeemed at a premium and increases if at discount.

In all of these situations, working capital will go down.

**Compute cash flow from operations (CFO):** To start, begin with net income, and from that, add depreciation along with all other noncash charges.

It is not necessary for a corporation that has securities registered with the SEC to file a Form 8-K should a subsidiary relocate to another state.

### **ANALYTICAL METHODS**

The following is necessary to compute **future value**:

- Current amount invested
- Expected earnings rate
- Length of time money will be invested

The following is necessary to compute present value:

- Future amount needed
- Expected earnings rate
- Length of time money will be invested

The time value of money is taken into consideration by the **internal rate of return (IRR)**.

Due to the uneven cash flow and no maturity date and price, IRR is not practical when it comes to common stock.

The inflation rate is the variable that's not necessary when computing net present value (NPV).

It's the movement of the overall market that stock with a beta of 1.0 mirrors. Lower beta = less movement and vice versa.

Whenever a stock/portfolio performs better than its beta would predict, it has a positive alpha.

Portfolios with the lowest standard deviation are the least volatile.

The movement of one security in relation to the other is measured through correlation.

No correlation = 0. Perfect correlation is +1.0 and noncorrelation is at -1.0.

Portfolios that are most diversified have some negative correlation.

Fundamental analysis computes financial ratios by using financial statements including:

- Price-to-earnings (P/E) ratio
- Price-to-book ratio
- Current ratio
- Gross margin

Inventory is excluded from the acid-test (or quick) ratio.

### **RISK TYPES**

**Market (systematic risk)** holds that there could be adverse effects on individual securities due to changes in the market and the overall circumstances of the company play no role in this. Diversification cannot help make this risk any less.

**Interest rate risk** relates to changes in interest rates and how that affects interest-sensitive securities, such as debt securities and preferred stock. Prices drop when rates climb and vice versa. Greater risk results from longer duration.

**Inflation (purchasing power) risk** deals with the value of the currency unit, which, if it falls, means that the purchasing power of the principal decreases when it is returned to the investor. Fixed-income securities are particularly susceptible to this.

**Unsystematic (nonsystematic) risks** are the risks unique to each security. An example is business risks associated with the company that a client has invested in. This risk is based on decisions management makes, competition, or even deficiencies in products, among other factors.

**Regulatory risks** deal with regulation changes within an industry that could lead to financial distress and lower corporate earnings.

**Legislative risk** deals with legal changes, for example, to tax laws that lead to tax increases. This can affect corporations and individuals.

**Political risk** deals with political instability or nationalization of an industry which can affect investment.

**Sovereign risk** relates to governments defaulting on their obligations.

**Liquidity risk** relates to investments that are difficult to turn into cash quickly and are

therefore illiquid. If they are turned quickly, it's usually at a significant loss.

**Currency risk** holds that the value of an investment can change due to foreign exchange rate fluctuations. American depositary receipts are an example of an investment subject to currency risk.

### **EQUITY SECURITIES: TYPES AND CHARACTERISTICS**

It is the issuer's ability to pay dividends that will most concern an investor in preferred stock.

ADRs have currency risk but allow trading in foreign securities and are issued by American banks (domestic branches).

If it's expected that the dollar will weaken, allocating more of their portfolio to ADRs is something investors should consider.

In exchange for some potential appreciation, convertible preferred stock or bond investors will sacrifice some income.

There are two types of employee stock options: incentive and nonqualified.

The method used for valuing stock by working out the present value (PV) of future dividends on a given stock, assuming that the dividend rate is constant is called the dividend discount model.

The method for valuing stock by working out the present value (PV) of future dividends on a given stock, assuming that it's by a stated percentage that they will grow is called the dividend growth model.

Securities analysis can be carried out by fundamental or technical analysts. The first will look at the books of the company while the latter charts price and volume over a certain time period.

### **FIXED-INCOME SECURITIES: TYPES AND CHARACTERISTICS**

**Tax-equivalent yield (TEY) formula** is as follows:  $\text{Municipal bond coupon} - (100\% - \text{investor's tax bracket})$

Priority for liquidation is as follows: secured bondholders, general creditors (debentures included), subordinated debentures, preferred stock, and common stock.

**Current yield formula** is as follows:  $\text{Interest (bond) or annual dividend (stock)} / \text{current market price}$ .

When compared to a coupon, a bond selling at discount will always have a higher yield. When compared to a coupon, a bond selling at premium will have a lower yield. A bond

selling at discount sees the yield to maturity lower than the yield to call.

Higher-coupon bonds are less volatile because they have a shorter duration while the duration of a zero-coupon bond is equal to their maturity.

The best way to gauge the sensitivity of a bond to interest rates is through convexity.

Valuing a fixed-income security through discounted cash flow is carried out by working out the PV. This can be achieved by taking the future cash flow (interest payments and principal returned) and then discounting it.

It's critical to know the average maturities when carrying out a cash-flow analysis on a mortgage-backed pass-through security.

While they are dollar denominated, Eurodollar bonds are issued outside of the United States.

Denominated in U.S. dollars, Yankee bonds are issued in the United States by foreign entities.

In the money market, commercial paper (CP) is traded at a discount.

Without a prepayment penalty, negotiable (jumbo) CS are issued at face value.

The most widely used benchmark worldwide for short-term interest rates is the LIBOR.

Demand deposit accounts (DDAs) usually take the form of a checking account at a bank.

### **POOLED INVESTMENT: TYPES AND CHARACTERISTICS**

There are three types of investment companies that the exam covers:

- Face-amount certificates
- Unit investment trusts
- Management companies

It's on secondary markets, like the NYSE, that closed-end funds trade while open-end (mutual) funds won't trade here.

It's not NAV but supply and demand that the price of a closed-end fund is based on.

Potential negative consequences to performance can result when net redemptions for a mutual fund cause portfolio managers to change their investment strategies.

Breakpoint sales are not allowed and are a regulation violation.

A percentage of the fund's NAV used for share distribution is a 12b-1 fee.

CDs, Treasury bills, CP, and repurchase agreements form part of a money market fund's portfolio.

Venture fund capital managers look for companies that can provide a high return (but at high risk) and low liquidity. This is usually found in new companies that show promise.

It's usually as a partnership that hedge funds are organized. This sees the securities issuer management investing alongside investors.

90% of the income of REITs must be distributed according to regulations.

### **INSURANCE-BASED PRODUCTS**

Fixed annuities are not securities. Securities fraud therefore cannot result from a seminar that deals only with them.

Because of their surrender charges, when it comes to short-term investing, variable securities are generally not suitable.

A tax-deferred way for an investor to take part in the equities market is through variable annuities.

When compared to mutual funds with similar objectives, variable annuities have higher expenses.

Index annuities' participation rate is more often than not limited by a cap.

While having no cash value, term insurance provides pure protection. It is upon renewal that the premium increases.

Cash value with policy loans is built and guaranteed with whole life.

Flexible premiums are offered by universal life. Policy lapse may result, however, if there are insufficient payments.

A separate account, guaranteed minimum death benefit but a non-guaranteed cash value are part of variable life policies. After three years, 75% of the cash value can be borrowed.

Within the first 24 months, variable life also has an exchange privilege to a new permanent plan life insurance.

### **DERIVATIVE SECURITIES: TYPES AND CHARACTERISTICS**

It's an obligation that holders of futures and forward contracts have.

With an option, the holder, who has a long position, has no obligation. The option seller,

however, who holds a short position, must perform should it be exercised.

### **ALTERNATIVE INVESTMENTS**

In a DPP, general partners have unlimited liability while limited partners have limited liability.

It's to their basis that the limited partner can suffer loss in a limited partnership program. This includes the funds initially contributed as well as those committed for but that haven't been contributed yet.

When a life insurance policy is sold on the secondary market, this is a life (viatical) settlement.

In reality, ETNs (ELNs) are debt instruments.

In terms of speculation, it's extremely high for both inverse and leveraged funds.

#### **Investment real estate**

- Active role
- No correlation with the stock market generally
- It could be an inflation hedge
- Risk and reward increased due to higher leverage

#### **Commodities**

- In general, commodities and the stock market are not correlated
- It could be an inflation hedge
- Popular commodity = agriculture
- Largest spread – precious metals (gold, silver, and platinum)

### **CLIENT TYPES**

There are three types of joint accounts. These are joint tenants with the right of survivorship (JTWROS), tenants in common (TIC), or tenants in entirety.

The last example is for married couples. Transactions carried out would require the consent of both parties.

Joint and individual accounts (but not a TIC account) can be opened with a TOD designation. In this way, probate is avoided on the first death.

All powers of attorney must be carried out in writing and include:

- Limited (trading only)
- Full (both trading and money)
- Durable

- Upon death of principal on account, all are terminated

A trust's grantor can be the trustee as well as the beneficiary.

When the final distribution of a trust takes place, the individual that receives the principal is called the remainderman.

The manner in which assets are distributed to descendants is described by the term per stirpes.

The potential conflict of interest must be disclosed if an IAR is appointed as a trustee and handles the account.

An administrator in intestacy handles the estate of someone who has died without a will, not an executor.

End-of-life wishes can be expressed through the use of a living will.

### **CLIENT PROFILE**

When clients have too much debt and therefore a negative net worth, if they receive a surprise inheritance, it should be used to pay off any high-interest debt that they have.

Income and expenses are not shown on a family balance sheet, only assets, and liabilities. When paid off, liabilities must be taken off the balance sheet.

Because it has no cash value, term insurance cannot be placed on the balance sheet as an asset.

Life insurance is useful because it can be used to cover estate tax liability or other final expenses instead of selling off income-producing assets to do so.

T-bills and other money market instruments are the perfect investment for clients that need cash in the near term.

Insured bank CDs are the best option for investment when it comes to capital preservation.

Municipal bonds are an investment option for those in high tax brackets. It's not suitable for clients in low tax brackets.

Life expectancy is the time horizon for clients that are 5, 10, or 20 years from retirement.

To determine the coverage of future needs while ignoring market volatility, a capital needs analysis is used.

A growth of 8% is achieved by waiting until the age of 70 for Social Security payments.

## **PORTFOLIO MANAGEMENT**

**Asset allocation:** Reduces unsystematic risk. Different asset class diversification

Active management takes a tactical approach while it's more strategic when it comes to passive management.

**Rebalancing:** This passive strategy is carried out from time to time as a way to bring a portfolio in line with target allocation percentages.

**Growth:** As compared to value stocks, the manager of a portfolio will look for those that have a higher price-to-earnings and price-to-book ratio when trading. In this, earnings momentum is critical while there is a higher tolerance for risk needed as growth can be volatile.

**Value:** The idea here is to find stocks that trade at a lower P/E and price-to-book multiples, which means they are cheaper. The focus is on the financial statements of a company to look for those that pay higher dividend yields.

**Contrarian:** Here, the portfolio does the opposite of what most other managers are doing because he thinks their approach is wrong.

**Tangible assets:** This will reduce inflation risk when placed in a portfolio.

**Efficient market hypothesis (EMH):** This holds that when new information is available, security prices will quickly adjust to it and therefore, markets are always efficiently priced.

Technical analysis doesn't help much under weak EMH. Under semistrong EMH, neither technical or fundamental analysis helps. The market is efficient under strong EMH.

**Modern portfolio theory:** This holds that an efficient or optimal portfolio is one that provides the most return under given risk conditions.

Standard deviation is one of the risk strategies to know when working out the Capital Market Line.

Efficient set or efficient frontier is the term used for a collection of efficient portfolios.

**Dollar cost averaging:** Here investments using a fixed dollar amount are made regularly with purchases at varying prices.

To protect a short stock position (hedge), the best way to do so is by buying a call option.

To protect a long stock position (hedge), the best way to do so is by buying a put option.

## **CONSIDERATIONS RELATED TO TAX**

Distributable net income (DNI) distribution from a trust includes interest, dividends, and rent. It won't include any reinvested capital gains into the trust corpus.

With a simple trust, all income must be distributed each year. Income can be retained under a complex trust but must be reported using Form 1041.

Trusts that continue for more than a single generation are known as generation-skipping trusts.

Business information is filed by a sole proprietor using a Schedule C while a Schedule K-1 is used for limited partners, members of LLCs, and shareholders. For C corporations, a Form 1120 is used to report information.

Taxation of gifted stock holds that the donee (or recipient of the gift) gets it at the donor's basis.

Taxation of inherited stock holds that it is a stepped-up cost basis that the beneficiary receives.

After death, estate taxes, paid using Form 706, are due within nine months.

An alternative valuation date can be used by the executor. This is six months after death.

## **SECURITIES TRADING**

Leverage is used when trading on margin accounts. After the initial transaction, the margin agreement must be signed.

Credit and hypothecation agreements are mandatory when it comes to margin accounts while a client signing a loan consent is optional.

Before trading, investors will have to sign a risk disclosure document.

Regulation T covers the initial margin.

Whenever equity falls, a maintenance call must be made.

Long and short positions will be found in a mixed margin account.

Profits will exceed the cost of interest with a positive margin.

Under SRO regulations, clients must be sent a maintenance margin call when equity drops below 25%.

As set by the BD, house calls will be sent at higher levels.

**Specialist/designated market makers (DMMs):** Operate as a principal or agent on the NYSE floor handling orders

**Market makers (MMs):** Work over the counter. Investors can buy from their inventory at their designated bid price or sell to them at their designated asking price. The difference between their bid and ask price is the spread.

**Market order:** This is executed immediately at the best available price possible. This is the only order where execution is guaranteed.

**Limited order:** Here, the BD is instructed to buy or sell at or below a certain price for a particular security. This is known as the buy limit or sell limit (depending on the required action).

**Buy stop order:** When holding a short position in a stock, this is used to "stop loss". The direction of a bear market can be accelerated using this order type.

A block trade is a trade involving 10,000 shares or more.

Algorithmic trading by institutions is known as high-frequency trading (HFT).

## **PERFORMANCE MEASURES FOR PORTFOLIOS**

**Current return (yield):** Annual dividend (or interest) / current market price

**Yield to maturity (YTM):** The internal rate of return (IRR) of a bond. If coupons are reinvested at a rate higher than YTM, it will be lower than the holding period return.

**Total returns:** Annual dividend (or interest) + appreciation (-depreciation) / original investment

**Annualized return:** Over a 12-month basis, this is the total return

**After-tax return:** Total return less taxes

**Expected return:** Here, different probable outcomes are combined

**Real rate of return:** As based on the CPI, this adjusts for inflation levels.

For Treasury Inflation Protection Securities (TIPS) the inflation adjusted return is always the coupon rate.

There is no relationship between a portfolio's total return and its variability.

A measure of a stock's risk-adjusted return is known as the Sharpe ratio. To work this out, subtract the risk-free (90-day Treasury bill) from the actual return. Then divide standard deviation into the answer.

To work out the market capitalization of stock, the market value per share is multiplied by the shares outstanding.

#### **Market capitalization**

- \$300 to \$2 billion = small cap
- \$2 billion to \$10 billion = mid cap
- Over \$10 billion = large cap

Measuring against the Russell 200 is the way to track small securities.

Measuring against the S&P 400 is the way to track mid cap securities.

Measuring against the S&P 500 is the way to track large cap securities.

#### **RETIREMENT PLANS AND OTHER SPECIAL ACCOUNTS**

There are no required minimum distributions (RMDs) on a Roth IRA. It is the only individually funded plan that has this.

After-tax dollars are used when contributions to Roth IRAs are made. If proper conditions are met, the distribution will be tax-free. Beneficiaries can include minors.

In an IRA, no term or whole life policies are allowed.

Municipal bonds should not be included in an IRA.

While benefiting from participant or lineal family is not possible, one can invest in real estate.

Beneficiaries of IRAs can disclaim their proceeds.

A company's profit-sharing plan cannot be used by a CEO for a short-term loan to the company.

With no mandatory funding and the ability to be discriminatory, a deferred compensation plan is nonqualified.

While gender doesn't play a role in a defined benefit plan, critical factors to consider are age, annual earnings, and years to retirement.

Catch-up provisions for retirement plans for those over 50 are allowed thanks to the EGTRRA of 2001. It also allows for participants in a government employee 457 plan for rollovers to an IRA.

"Top heavy" tests are performed on 401 (k) plans to ensure that it's not highly compensated employees that benefits and contributions to but instead, to KEY.

A plan that does not have to undergo this testing is a safe harbor 401 (k) plan but only if every employee gets a minimum employer-sponsored contribution with immediate vesting.

Under Section 404 (c) of ERISA's safe harbor provisions, fiduciaries cannot be held liable if the plan suffers losses due to the selections of investments by the participant in their own account.

Participants can change their investments every quarter if the plan gives the participants at least three investment alternatives (but not a high-yield bond). Participants should also be able to access their accounts online or by phone.

It's under the Uniform Prudent Investor Act that fiduciaries must act. Trustees must exercise reasonable care, skill, and caution to ensure this standard is satisfied. While the amount and timing of distributions cannot be delegated, portfolio management can be.

Investment Policy Statements (IPS) are not compulsory but are recommended.

They should include the following:

- Investment philosophy and objectives
- Performance measurement methods
- How future cash flow needs will be met
- The investment parameters that portfolio managers will follow

An IPS will not include:

- Summary Plan Description (SPD) copy
- Selection of specific securities

It's for any level of education that ESA funds may be used.

It's in postsecondary education that a Section 529 may be used in full. For K-12, however, it is limited to \$10,000 per year.

Section 529 plans do not put an income limitation on contributions while ESA does.

With Section 529 plans, U.S. saving bonds are not available as an investment option.

Every 12 months, investors can switch 529 plans.

Attending certain foreign universities is possible with money from a 529 plan.

#### **Custodial accounts**

- UGMA: only for cash and securities. Transfer occurs at majority
- UTMA: This holds basically any type of asset. Transfer occurs at 21 or over
- The social security number of the minor must be on the account
- One minor – one custodian
- Basics cannot be funded through the fund, for example, food, clothing, or shelter. Vacations, however, can be funded.
- The greatest impact on college aid is from custodial funds

#### **Health savings accounts**

- For medical expenses. These allow for tax-deductible contributions
- Contributors are the individual, their employer, or both
- Must also have a high-deductible health plan (HDHP)

