Flashcards

Fold on the dotted line · cut on the dashed lines

Cut along each dashed line, fold along the centre so the answer is on the back. Answer aloud, then flip.

Q1 Module 3.1 · RBei Classes

What is the money-weighted return?

A1

The **IRR** of a portfolio's cash flows: the rate at which PV of inflows equals PV of outflows. It measures the return the **investor** earned.

Q2 Module 3.1 · RBei Classes

What is the time-weighted return?

A2

The **compound growth rate of $1** over the period, unaffected by the timing of deposits and withdrawals. It measures the **investment / manager**.

Q3 Module 3.1 · RBei Classes

In the account view, which cash flows are inflows and which are outflows?

A3

Inflows (+): beginning value and deposits.
Outflows (-): withdrawals, dividends taken out, and the ending value.

Q4 Module 3.1 · RBei Classes

Does flipping all the signs change the IRR?

A4

No. The account view and the investor view give the same IRR, as long as money in and money out have opposite signs.

Q5 Module 3.1 · RBei Classes

Why is the t = 1 cash flow +118 in the book's MWR example?

A5

She paid $120 for a share and received a $2 dividend at the same date. Cash flows at one date are **netted**: 120 - 2 = 118.

Q6 Module 3.1 · RBei Classes

List the three steps of the TWR.

A6

1. Form subperiods at each cash flow. 2. Compute each subperiod's HPR (with income). 3. Link: (1 + HPR) - 1, and annualize using the number of **years**.

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Q7 Module 3.1 · RBei Classes

Why did the book's example give MWR 13.86% but TWR 15.84%?

A7

More money was invested in Year 2 (return 10%) than Year 1 (22%). MWR weights by money, so it is pulled toward the weaker year.

Q8 Module 3.1 · RBei Classes

When is MWR higher than TWR?

A8

When money is added **just before a strong period** (e.g. buying the dip before a recovery). Before a weak period, MWR is lower.

Q9 Module 3.1 · RBei Classes

Which measure should evaluate a mutual fund manager? Why?

A9

TWR, because clients — not the manager — decide when money comes in or goes out. TWR removes that timing effect.

Q10 Module 3.1 · RBei Classes

When is MWR the more appropriate measure?

A10

When the **manager controls** cash flows: e.g. private equity with committed capital, closed-end or fixed-life funds, illiquid portfolios (GIPS exceptions).

Q11 Module 3.1 · RBei Classes

What is GIPS?

A11

Global Investment Performance Standards: voluntary CFA Institute standards for presenting performance. Firms claiming compliance must use TWR, except in specified cases.

Q12 Module 3.1 · RBei Classes

What does your mutual fund app's XIRR measure?

A12

A **money-weighted** return on your own cash flows (SIP instalments, lump sums, redemptions).

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Q13 Module 3.2 · RBei Classes

What is a security market index?

A13

A representation of the performance of an asset class, market or market segment, built as an imaginary portfolio of **constituent securities**.

Q14 Module 3.2 · RBei Classes

Price index vs return index?

A14

Price index uses prices only → **price return**. Return index adds income (dividends, interest) → **total return**.

Q15 Module 3.2 · RBei Classes

Name the five steps of index construction.

A15

Objective · Constituent securities · Weighting method · Calculations · Maintenance (rebalancing and reconstitution).

Q16 Module 3.2 · RBei Classes

How is a price-weighted index calculated, and which stocks dominate?

A16

Sum of prices ÷ divisor. The **highest-priced** stocks dominate, regardless of company size.

Q17 Module 3.2 · RBei Classes

When must a price-weighted index's divisor change?

A17

Stock splits, reverse splits, stock dividends, and changes in index composition — so the index is unaffected.

Q18 Module 3.2 · RBei Classes

What is the quick way to get an equal-weighted index return?

A18

Take the **simple average** of the constituents' percentage price changes.

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Q19 Module 3.2 · RBei Classes

Why does an equal-weighted index need frequent rebalancing?

A19

Price changes make weights drift away from equal. Rebalancing sells winners and buys losers, creating high transaction costs.

Q20 Module 3.2 · RBei Classes

How are weights set in a market-cap index?

A20

Each stock's market cap (price × shares) ÷ total market cap. It reflects aggregate investor wealth.

Q21 Module 3.2 · RBei Classes

Why doesn't a market-cap index adjust its divisor for splits?

A21

A split halves the price and doubles the shares, so **market cap is unchanged**.

Q22 Module 3.2 · RBei Classes

Market float vs free float?

A22

Market float excludes shares held by controlling shareholders. **Free float** also excludes shares unavailable to foreign investors.

Q23 Module 3.2 · RBei Classes

Main disadvantage of market-cap weighting?

A23

Weights rise with price, so possibly **overvalued** stocks get high weights and undervalued stocks low weights.

Q24 Module 3.2 · RBei Classes

What is fundamental weighting and its tilt?

A24

Weights based on earnings, dividends, cash flow, revenue or assets — independent of price. It has a **value tilt**.

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Q25 Module 3.2 · RBei Classes

Rebalancing vs reconstitution?

A25

Rebalancing restores weights to target. **Reconstitution** adds or deletes members (e.g. falls out of top 500, bankruptcy, maturity).

Q26 Module 3.2 · RBei Classes

What happens to prices when a stock is added to a major index?

A26

It tends to **rise** as index funds buy it; deleted stocks tend to fall as funds sell.

Q27 Module 3.2 · RBei Classes

Same three stocks: price-weighted 12.5%, equal 13.5%, cap 18.13%. Why different?

A27

Each method gives different stocks control: high-priced C dragged the price index; the biggest company B lifted the cap index.

Q28 Module 3.2 · RBei Classes

Which index type should a passive fund track, and which suits a value manager?

A28

Passive → **market-cap** (float-adjusted) index. Value manager → **fundamental-weighted** index.

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