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TRENDING TOPICS

REGULATION BEST INTEREST (REG BI)

Recently, the SEC adopted a package of rulemakings and interpretations that are designed to enhance the quality and transparency of **retail customers'** relationships with broker-dealers and investment advisers. These rules will bring the legal requirements and mandated disclosures in line with reasonable investor expectations, while preserving access (in terms of choice and cost) to a variety of investment services and products. Specifically, these actions include new Regulation Best Interest, the new Customer Relationship Summary (Form CRS), and separate interpretations under the Investment Advisers Act of 1940.

Regardless of whether a retail customer chooses a broker-dealer or an investment adviser (or both), the retail customer is entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that's in the customer's best interest and that doesn't place the interests of the firm or the financial professional ahead of the customer's interests. In other words, any strategy or product that firms or individuals recommend to retail customers must be in the customers' best interest (not just suitable).

Who's a Retail Customer? Currently, Reg BI only applies to retail customers. According to the regulation, a retail customer is defined as a natural person, or this person's *non-professional legal representative*, who:

- Receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and
- Uses the recommendation primarily for personal, family, or household purposes

Professional legal representatives (e.g., financial industry professionals) and other fiduciaries are not considered retail customers.

Client Relationship Summary (Form CRS) Along with the passage of Reg BI, the SEC adopted a new relationship summary disclosure document that broker-dealers must provide for retail customer—the *Client Relationship Summary (Form CRS)*. Form CRS must be no longer than two pages. The purpose of Form CRS is to provide retail investors with information about the nature of their relationship with their financial professional in a simple, easy-to-understand format.

- New retail investors must receive a copy of Form CRS by no later than the time they open a brokerage account, place an order, or receive a new recommendation for an account type, securities transaction, or investment strategy.
- All existing retail customers will receive Form CRS early in the summer of 2020.

Broker-dealers must file Form CRS with the Central Registration Depository (CRD), while registered investment advisers must file Form CRS with the Investment Adviser Registration Depository (IARD) as Part 3 of Form ADV.

General Obligations Brokerage firms must fulfill the following four specific obligations in order to satisfy their overall duty under Regulation BI:

1. Disclosure – Provide certain required disclosures regarding any recommendation made to a retail customer and the relationship between the firm and the customer before or at the time of the recommendation.
2. Care – Exercise reasonable diligence, care, and skill in making recommendations.

3. Conflicts of interest – Establish, maintain, and enforce written policies and procedures that are reasonably designed to address conflicts of interest.
4. Compliance – Establish, maintain, and enforce written policies and procedures that are reasonably designed to achieve compliance with Reg BI.

Broker-dealers are subject to Reg BI, whereas investment advisers are subject to the provisions of the Investment Advisors Act of 1940. Reg BI applies to any recommendations that are made to retail customers and extend beyond securities or portfolio recommendations, including whether an investor should roll over a 401(k) into an IRA or recommendations as to the type of account that a retail customer should open.

Suitability Since Reg BI serves to supplement FINRA's existing suitability rules, firms are required to comply with both rules. However, one change implemented by Reg BI applies to the difference between a "retail customer" (as used by Reg BI) and FINRA's use of the term "institutional customer." FINRA's definition of an institutional customer includes a natural person who has total assets of at least $50 million; however, Reg BI doesn't establish a dollar limit. In other words, for a natural person who has assets exceeding $50 million, the provisions of Reg BI will apply, while for other institutional investors (e.g., banks, IAs, investment companies), FINRA's suitability rules apply.

Titles Under Reg BI, unless a broker-dealer is also a registered investment adviser (i.e., the firm is dually registered as a broker-dealer and an adviser), the SEC has stated that it's a violation of the disclosure obligation to use either the term "adviser" or "advisor" in its title. From a practical standpoint, if a registered representative is neither Series 65 or Series 66 registered and currently uses either of these terms in her title, her firm must provide her with a different title that she can use on all of her marketing materials. To use either term, the representative must take and pass either the Series 65 or Series 66 Exam.

Sales Contests Regulation BI effectively bans all sales contests, quotas, bonuses, and other non-cash compensation that are tied to sales of specific securities or specific types of securities within a limited period. However, compensation that's based on other metrics, such as total sales, asset growth or accumulation, or customer satisfaction is still permitted. Training and education meetings are also permitted as long as attendance is not based on selling certain products within a limited period. Current SRO rules on non-cash compensation were updated to reflect that the rules must be consistent with Reg BI.

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The Crunch Time Facts are a collection of statements we believe are valuable as you engage in the final preparation to sit for your examination. These facts are not designed to raise questions, but instead to be part of your final review and used with any notes you created during your studies.

CHAPTER 1 LAWS, REGULATIONS, AND GUIDELINES OVERVIEW

- The definition of a person doesn't include a minor or an individual who is mentally incompetent.
- An agent of an issuer who is compensated for selling securities publicly must be registered.
- An agent of an issuer of exempt securities is not subject to registration.
- An agent of a broker-dealer who is involved in the purchase or sale of an exempt security is subject to registration.

CHAPTER 2 STATE REGISTRATION OF SECURITIES

- An agent whose securities registration is pending is able to sell fixed annuities since fixed annuities are not securities.
- Fixed annuities are not subject to the USA because they're not securities.
- Universal life insurance is not a security.
- Federal covered securities are exempt from state registration.
- The four-part Howey Test is used to define whether an investment is a security.
- Viatical investments are securities.
- Investment company shares and securities that are issued under Rule 506 of Reg. D are subject to Notice Filing.
- Registration by Filing is not used for IPOs and is not accepted by all states.
- Registration by Coordination is used for interstate offerings.
- Registration by Qualification is used for intrastate offerings and requires the most documentation.
- Securities that are issued by insurance companies are exempt from registration, but variable annuities are not exempt.

CHAPTER 3 STATE REGULATIONS GOVERNING BROKER-DEALERS AND AGENTS

- An agent of an issuer is an individual who represents an issuer in the sale of its securities to the public.
- An individual who represents an issuer in effecting or attempting to effect transactions in certain securities, through exempt transactions, or those effecting transactions with existing employees, partners, or directors of the issuer if no commission or other remuneration is paid need NOT register as an agent.
- An individual who represents a broker-dealer in effecting or attempting to effect transactions in securities must register as an agent (no exceptions).
- An agent's assistant who takes phone messages to buy or sell securities is not an agent.
- A person who simply provides quotes is not required to be registered as an agent.
- A broker-dealer must register in every state in which it has an office.
- If a broker-dealer ceases operations, it must maintain a surety bond for three years thereafter.
- A broker-dealer that sponsors a wrap program must register as an investment adviser.

- Custody includes holding third-party checks for more than three business days.
- Limited registration is granted to broker-dealers and agents of Canada, but not to broker-dealers and agents Mexico.
- A broker-dealer is not required to register in a state if it has no place of business in the state and deals only with institutional clients or existing retail clients who are non-residents of the state.
- A broker-dealer is required to register if it has no place of business within a state, but deals with wealthy retail clients who are accredited investors. Retail investors are not institutional clients.
- A Consent to Service of Process is filed by broker-dealers, agents, IAs, and IARs.
- Agents may split commissions with other agents of the same broker-dealer if the agents and broker-dealer are both registered in the same state.
- Agents register by filing Form U4.
- An agent may transact business with existing clients who are temporarily in another state without being registered in that state.

CHAPTER 4 STATE REGULATIONS GOVERNING INVESTMENT ADVISERS AND IA REPRESENTATIVES

- An IA with full power of attorney may pay a client's bills.
- Lawyers, accountants, teachers, and engineers are excluded from the IA definition IA if their advice is incidental and there are no fees being charged for investment advice.
- An IAR of a state-registered adviser must register in all states in which the IAR has a place of business or has more than five non-institutional clients.
- An adviser's net worth doesn't include his home, furnishings, or automobiles—only business assets.
- Form ADV-E is filed by the auditor of an IA that maintains custody of client funds or securities; it must be filed within 120 days of the audit.
- According to the IA Act of 1940, advisory clients must receive a brochure by no later than the time of entering into a contract.
- According to the USA, advisory clients must receive a brochure at least 48 hours before signing a contract OR at the time of the contract being signed. However, if provided at the time of signing, the client must be able to cancel it without a penalty within five days.
- A brochure is not required for contracts with registered investment companies or when impersonal advisory service is being provided which costs less than $500 per year.
- IARs register by filing Form U4.

CHAPTER 5 FEDERAL REGULATIONS GOVERNING INVESTMENT ADVISERS

- Federal covered securities include those that are sold to qualified purchasers (those who own at least $5 million of securities).
- Investment advisers may charge performance-based fees (compensation that's based on a share of capital gains or capital appreciation in client accounts) to qualified clients (those with at least $1 million under management or more than $2.1 million in net worth).

- If an IA that's established as a partnership changes its partners, it must notify the Administrator and its clients.
- An IAR of a federal covered adviser must register only in any state(s) in which she has a place of business.
- IAs register by filing Form ADV.
- IAs that manage less than $100 million in assets must register with the state.
- IAs that manage $100 up to $110 million in assets may register with the SEC or state.
- IAs that manage $110 million or more in assets must register with the SEC.
- Advisers to investment companies must register with the SEC regardless of their level of assets under management.
- If a client provides her IAR with a user name and password so the IAR has the ability to enter trades or to rebalance her account, this activity doesn't require the IA to maintain custody. The IAR is considered to have **limited discretion** over the account.
- If a client authorizes an IAR to withdraw funds and/or securities from his account, the IAR is considered to have **full discretion** over the account. With full discretion, the IA is considered to have custody over the customer's funds and/or securities and must follow custody rules.
- Advisers to private funds with less than $150 million in assets under management (AUM) are classified as exempt reporting advisers (ERAs).
- Exempt reporting advisers are exempt from SEC registration, but must notice file with the state Administrator(s) and pay a filing fee.
- Private funds are also referred to as hedge funds and are exempt from registration under the Investment Company Act of 1940.
- Private funds can be exempt under Section 3(c)(1) (i.e., less than 100 investors) or Section 3(c)(7) (i.e., only sold to qualified clients with $5 million of investable assets) of the Investment Company Act of 1940.
- If an IAR leaves her advisory firm to go to another firm, it doesn't constitute assignment of client contracts.
- Performance-based advertisements are allowed as long as they're not misleading and are justified with appropriate records.
- Books and records may be stored using cloud services as long as regulators are given notice within 24 hours and have cost-free access.

CHAPTER 6 INVESTMENT ADVISORY PRACTICES

- Soft dollars may be used only to acquire services that benefit advisory clients.
- Soft dollars may be used to acquire research and analysis, not advertising, travel, meals, or entertainment.
- The Uniform Prudent Investor Act (UPIA) is a key feature of modern portfolio theory with emphasis on the trade-off between a portfolio's risk and reward.
- A wrap account with very little trading suggests the possibility of reverse churning.
- The UPIA doesn't categorically restrict any investment within a portfolio.

CHAPTER 7 PROHIBITED AND ETHICAL BUSINESS PRACTICES UNDER THE USA

- Broker-dealers may use testimonials; however, IAs may not.
- Agents may not solicit orders for unregistered, non-exempt securities; however, they may accept unsolicited orders for these securities.
- When an IA executes an agency cross transaction, one side of the trade must be unsolicited.
- Front-running is entering a trade based on the knowledge of a pending large order, while insider trading is trading in advance of material, non-public information about an issuer of securities.
- A sign of churning is the frequency of trades.
- An agent may not execute personal trades in a security prior to his firm releasing a research report (trading ahead).
- Stating that a security has been approved of by a regulator is prohibited.
- Broker-dealers may commingle customer cash, but must segregate customer securities.
- In a principal transaction, an IA may be buying or selling securities for its own account at its own risk.
- An order memorandum (order ticket) contains the name of the security, the agent, whether the order was solicited, whether discretionary is being utilized, and the type of order.
- An agent is allowed to share directly or indirectly in the profits or losses in a customer's account IF she has the written authorization of her customer and the permission of her employing broker-dealer.
- IA's must have a written code of ethics that includes provisions for access persons of an IA.
- An *access person* is an officer, director, or partner of an investment advisor, as well as any person who has access to non-public information regarding securities or advisory clients' information.
- IAs must report an access person's personal holdings and securities transactions to the IA's chief compliance officer.
- Access persons must submit a *holdings report*:
  - By no later than 10 days after becoming an access person, and the information must be current as of a date that's no more than 45 days prior to the date on which the person becomes an access person
  - Thereafter, a report must be submitted at least once each 12-month period on a date that's chosen by the IA, and the information must be current as of a date that's no more than 45 days prior to the date on which the report was submitted.
- Access persons must also submit a *transaction report*:
  - By no later than 30 days after the end of each calendar quarter

CHAPTER 8 ADMINISTRATION OF THE USA

- The Administrator may issue a cease-and-desist order, but not an injunction.
- A gift of assessable stock is considered both an offer and a sale.
- The Administrator may not impose civil or criminal penalties.
- The Administrator has jurisdiction over an offer to buy or sell a security that's made or accepted in his state.
- An offer is made in a state if the offer originated in, or was directed to and received in, the state.
- Registration can be denied if an individual has been convicted of a securities violation in a foreign country within the past five years.

- The Administrator can subpoena witnesses both inside and outside the state.
- The Administrator can cancel a registration without a hearing if the registrant is deceased, missing, out of business, or deemed mentally incompetent.
- A letter of rescission is good for 30 days, after which a client cannot bring civil action.
- Willful violations of the USA are subject to criminal penalties of up to three years in prison and/or a $5,000 fine.
- For civil liabilities, a client must bring suit within three years from the date of the violation or two years of discovery of the violation, whichever comes first.

CHAPTER 9 FEDERAL SECURITIES ACTS

- A closed-end fund is priced independently of its NAV.
- A mutual fund must pay its shareholders within seven calendar days of redemption.
- Under the Act of 1933, a red herring may be given to potential investors during the cooling-off period; it contains a range of prices, but no final price or effective date.
- Information barriers (i.e., Chinese Walls) are compliance measures designed to ensure that underwriters don't share information with other departments of their broker-dealer or the public.
- Under Reg. D, securities may not be sold to more than 35 non-accredited investors.
- Under Reg. D, accredited investors include individuals with a net worth more than $1 million or an annual income of $200,000 or more ($300,000 for spouses).
- A no-load mutual fund may have a 12b-1 fee, but the fee may not exceed .25% of fund's average net assets per year.
- Under the Act of 1933, civil suits must be brought within three years from the date of the violation or one year of discovery of a violation, whichever comes first.
- Willful violations of the Act of 1933 may result in a fine of $10,000 and/or imprisonment for five years.
- Schedule 13D is filed by any person who acquires more than 5% of the voting stock of a company.
- Schedule 13F is filed quarterly by advisers that control more than $100 million in equity securities as of the last day of any month.
- Dark pools are marketplaces in which institutional investors can buy and sell stock anonymously.

CHAPTER 10 INVESTMENT ADVISORY CLIENTS

- Section 404(c) of ERISA requires a plan to offer at least three core investment options.
- The elements of a trust include the settlor's intention to create the trust, the subject matter, a trustee to act as fiduciary, and a beneficiary.
- The trust of a decedent is distributed by branch if each branch of the family is to receive an equal share of an estate.
- The trust of a decedent is distributed per capita if each beneficiary receives an equal percentage.
- In a Per Capita Trust, beneficiaries receive an equal percentage of the trust, whereas in a Branching Trust, they receive an equal share.
- If a leveraged firm earns more on its debt than it pays in interest, it has positive financial leveraging.
- The minimum work history for collecting full Social Security benefits is 40 calendar quarters.

- Full retirement age for Social Security is between the ages of 66 and 67 depending on the year of the person's birth.
- If a person has reached full retirement age, has begun to collect Social Security benefits, and continues to work, the benefit amount will not be reduced by the person's earnings.
- If a person has NOT yet reached full retirement age, has begun to collect benefits, and continues to work, then $1.00 of the benefit payment is deducted for every $2.00 of earnings above an earnings limit.
- If a person is divorced, but her marriage lasted 10 years or longer, she may receive 50% of her ex-spouse's full retirement amount (assuming the benefit based on her work is less than the benefit based on her ex-spouse's work).
- The spousal collection of Social Security benefits will continue even if the main spouse remarries. However, if the collecting spouse remarries, the benefits collection will cease.
- A gift tax applies to gifts exceeding $10,000 per person, per year, adjusted for inflation. (Currently, the maximum is $15,000.)
- With a community property arrangement, if one spouse dies, the cost basis of assets held in the account will step-up to the market value at the time of the person's death.
- A Transfer on Death (TOD) account designation is used to avoid probate, not estate taxes.
- Qualified IRA investments include fixed or variable annuities, REITs, common stocks, corporate or government debt, U.S. gold minted coins, and real estate.
- When evaluating IRA holdings, municipal securities and other tax-advantaged investments will require immediate suitability consideration.
- In a qualified retirement plan, 100% of withdrawals are taxed as ordinary income.
- A Qualified Domestic Relations Order (QDRO) is created to divide a person's retirement account during a divorce.
- Spouses benefitting from a QDRO are not subject to early withdrawal penalties.
- In a non-qualified retirement plan, only the earnings are taxed as ordinary income at the time of withdrawal.
- Upon the sale of a primary residence, $250,000 of any gains are excluded from taxes if filing a single tax return, or $500,000 is excluded if filing a joint tax return.
- A SIMPLE 401(k) is an employer-sponsored retirement plan:
  - It's for businesses that that have no more than 100 employees
  - The employer cannot offer any other retirement plan
  - The plan is not subject to non-discrimination rules
- A company may choose to offer a deferred compensation plan as an incentive to retain employees.
- A Roth IRA may create a deductible loss when all Roth accounts are closed and the amount received is less than the investment, minus distributions.
- An individual can purchase real estate in an IRA as long as the property is not the primary residence, vacation home, or business location for the individual.
- Beneficiaries are taxed on income that's distributed by a trust, but not taxed on the principal that remains in the trust.
- Primary beneficiaries are the first to receive payments if an annuity owner dies or out of a trust account.
- Contingent beneficiaries will only be paid after the primary beneficiary dies.

- IRAs may be funded only by cash. They may not invest in collectibles, gold, or commodities (however, U.S. minted gold coins are permitted).
- Investing in gold will provide a person's portfolio with a hedge against inflation.
- Distributions from a 529 plan may pay for tuition at a foreign university.
- A 529 plan is also referred to as a Qualified Tuition Plan (QTP).
- A 529 plan is more effective in saving for college than a trust.
- 529 plan assets are not owned by the beneficiary.
- Individuals may take up to $10,000 in distributions annually from their 529 plans to pay for private school tuition and books for grades K through 12—in addition to using their account proceeds for college costs (this is a new provision under the Tax Reform Act).
- Individuals are permitted to withdraw up to $10,000 on a tax-free basis from their 529 plan to repay a qualified student loan.
- A person may front-load a 529 plan with an initial gift of $75,000 per beneficiary, which is treated as if $15,000 is being contributed each year over a five-year period. For a married couple, the amount is $150,000 per beneficiary.
- When assets are inherited, the recipient's basis is the market value at the time of donor's death. Any gains generated by the sale of the assets are treated as long-term capital gains.
- Under the UGMA, the custodian has custody of the assets, not the minor.
- In order to avoid taxation when distributing an estate, any amount that exceeds the estate tax exclusion should only be donated to charities. These donations are not governed by the annual gift rule.
- In a viatical settlement arrangement, the investor pays the insurance premiums.
- A general partner has a personal obligation to repay creditors of the partnership.
- A person's attitude toward money relates to whether a person is interested in investing the funds or making a personal purchase of a luxury item.
- Owners of an LLC are referred to as members and report income on Form K-1.

CHAPTER 11 INVESTMENT VEHICLES

- For a discount bond, the highest yield is its yield-to-maturity, followed by its current yield, and lastly the nominal yield.
- For a premium bond, the highest yield is its nominal yield, followed by its current yield, and lastly the yield-to-maturity.
- Bonds that are issued by foreign governments are referred to as sovereign bonds.
- Bonds that are issued by foreign governments and foreign corporations typically pay interest and principal in foreign currency.
- A short straddle is created by writing a call and a put on the same stock, with the same expiration and same strike price. For a short straddle, the investor expects stability.
- If a client expects volatility in a stock, but is unsure of which direction the stock may move, she may buy a straddle. For a long straddle, the investor expects volatility.
- A UIT is not a derivative.

- A swap is a form of derivative whereby two parties agree to exchange fixed for floating interest rate-based cash flows.
- A credit default swap (CDS) is a type of credit derivative which provides a fixed-income investor (usually an institution) with insurance if the issuer defaults. The risk is shifted to an insurance company or other CDS seller in exchange for a fee/premium. If the underlying issuer defaults, the bondholder receives payment from the seller.
- A short stock position can be protected with a long call; a long stock position can be protected by a long put.
- The cash value of a variable life insurance policy is determined by the performance of the subaccounts within the separate account.
- A variable annuitant's payments are based on the AIR and the performance of the separate account.
- An equity-indexed annuity's return may be based on point-to-point, which compares the index value on two particular dates.
- An equity-indexed annuity has a floor of zero (i.e., its return cannot fall below zero).
- A real estate limited partnership passes through both losses and gains to its partners; however, an REIT doesn't pass through losses to its shareholders.
- Blind pools or non-traded REITs don't always invest in real estate.
- Once a client has annuitized her annuity, it may not be rolled over into an IRA.
- A form that's filed with the IRS on behalf of a limited partner is the K-1.
- When a term life policy is extended, its premium will increase.
- Precious metals include gold, silver, platinum, and palladium, but NOT copper.
- Soft commodities are grown, while hard commodities are mined/extracted.
- Conversion price multiplied by the conversion ratio equals par ($1,000).
  - Example: If a bond is convertible at $25, the holder is entitled to 40 shares ($25 x 40 = $1,000).
- Both the buyer and seller of a futures contract have obligations.
- Structured products are debt instruments (e.g., notes or bonds) which offer a rate of return that's linked to an underlying security or basket of securities.

CHAPTER 12 PORTFOLIO MANAGEMENT AND INVESTMENT RISK

- A stop order is a suspended market order, while a stop-limit order becomes a limit order once activated.
- The simplest approach to investing is indexing.
- A Form 8-K is filed with the SEC upon the occurrence of any event that could materially affect a company's share price or financial condition (listed in Sections 1-6 and 9 of the form).
- A Form 8-K is filed with the SEC within four business days upon the occurrence of a material event.
- Highly regulated companies are subject to regulatory risk.
- Fixed assets and long-term debt are not used to determine working capital.
- Current Assets include cash, accounts receivable, and inventories.
- Current Liabilities include accounts payable and short-term debt.
- Debt-to-equity ratio measures the degree of leverage for a company; the necessary data is extracted from the corporate balance sheet.

- To calculate the debt-to-equity ratio, the market value or book value of the debt and shares may be used.
  - If a company's PE ratio recently fell, either the share price declined or EPS increased.
  - If a company's PE ratio recently rose, either the share price increased or EPS declined.
- The Wilshire 5000-to-GDP ratio is used to determine whether U.S. stocks are over- or under-valued.
- In the Modern Portfolio Theory, the basic measure of risk is standard deviation.
- An efficient frontier is represented by a line which graphs optimal portfolios.
- According to CAPM, there are two specific types of risk—diversifiable (non-systematic risk) and non-diversifiable (systematic risk).
- Alpha measures non-systematic risk, while beta measures systematic risk.
- High beta stocks are expected to outperform when the market is rising; however, low beta stocks are expected to outperform when the market is falling.
- Tactical asset allocation may include sector rotation.
- Emerging markets are more susceptible to political risk.
- To determine present value, future value is discounted at a given rate.
- To determine future value, present value is compounded at a given rate.
- According to the dividend discount model, a stock with a market value that's less than the present value of future dividends is a good investment (i.e., the stock should be purchased).
- Net yield (after-tax yield) = taxable yield x (100% - tax bracket %)
- The formula for calculating inflation adjusted return (real return) is: nominal yield – inflation rate.
- A reporting company is required to file a Form 10-Q three times per year, while a Form 10-K is filed annually.
- To calculate the amount needed to assure payments in perpetuity, the annual income desired is divided by the rate of interest needed to produce the future income.
- A measure of profitability is earnings per share (EPS).
- A company's market capitalization is found by multiplying the current market value of its stock by the number of shares outstanding.
- If a company purchases an asset and finances it through debt, this will increase its percentage of debt capital-to-equity capital.
- Given the following numbers, 3, 3, 3, 4, and 7, the Median is the middle value (3), the Mode is the number that appears most often (3), the Mean is the average (4), and the Range is the difference between the highest and lowest number (4).
- Value stocks have low P/Es and low price-to-book ratios, but high dividend payout ratios.
- Growth stocks have high P/Es and high price-to-book ratios, but low dividend payout ratios.
- A technical analyst may examine a stock's 50-day or 200-day moving average.
- The dividend discount model is a stock valuation model that forecasts future dividends and discounts those cash flows to determine the current stock price.
- Loss aversion is covered in behavioral finance.
- The S&P 500 is a capitalization-weighted index, while the Dow Jones Industrial Average (DJIA) is a price-weighted index.

KEY FORMULAS

Chapter 10 – Investment Advisory Clients

- Personal Net Worth = Assets – Liabilities
- Discretionary (Net) Income = Income – Expenses

Chapter 11 – Investment Vehicles

- Conversion Ratio = $\dfrac{\text{Par Value}}{\text{Conversion Price}}$
- Breakeven on Long Stock plus Long Put = Cost of Stock + Put Premium
- Total Profit on Futures Trade = (Sale Price – Purchase Price) x Contract Size

Chapter 12 – Portfolio Management and Investment Risk

- Working Capital = Current Assets – Current Liabilities
- Current Ratio = $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$
- Quick Ratio = $\dfrac{\text{(Current Assets – Inventory)}}{\text{Current Liabilities}}$
- Debt-to-Equity Ratio = $\dfrac{\text{Debt}}{\text{Equity}}$
- Earnings Per Share (EPS) = $\dfrac{\text{(Net Income – Preferred Dividend)}}{\text{Common Shares Outstanding}}$
- Price-to-Earnings (P/E) Ratio = $\dfrac{\text{Price of Common Stock}}{\text{Earnings Per Share (EPS)}}$
- Dividend Discount Model = $\dfrac{\text{Annual Dividend}}{\text{Discount Rate}}$
- Expected Return (MPT) = Bullish Return x Probability of Bull Market
  + Neutral Return x Probability of Neutral Market
  + Bearish Return x Probability of Bearish Market

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- Expected Return (CAPM): $Ri = Rf + \beta(Rm - Rf)$
- Risk Premium (Excess Market Return) = Rm – Rf
- Alpha = Actual Return – Expected Return
- Risk Adjusted Return = Rate of Return – Risk-Free Return
- Sharpe Ratio = $\frac{\text{(Portfolio Return – Risk-Free Rate)}}{\text{Portfolio's Standard Deviation}}$
- Present Value (P_0)= $\frac{P_n}{(1 + r)^n}$
- Future Value (P_n) = $P_0 \times (1 + r)^n$
- Present Value Perpetuity = $\frac{\text{Payment in Perpetuity}}{\text{Discount Rate}}$
- Rule of 72 (Number of Years for Money to Double) = $\frac{72}{\text{Rate of Return}}$
- Rule of 72 (Rate of Return Required for Money to Double) = $\frac{72}{\text{Number of Years to Double}}$
- Net Present Value = Value of Discounted Cash Flows – Market Value of Investment
- Current Yield (Stock) = $\frac{\text{Annual Dividend}}{\text{Current Market Price}}$
- Current Yield (Bond) = $\frac{\text{Annual Interest}}{\text{Current Market Price}}$
- Dividend Payout Ratio = $\frac{\text{Annual Dividend}}{\text{Earnings Per Shares (EPS)}}$
- Total Return = $\frac{\text{(Ending Market Value – Starting Market Value) + Dividends + Interest}}{\text{Starting Market Value}}$
- Real (Inflation-Adjusted) Return = Rate of Return – Inflation
- Taxable Equivalent Yield = $\frac{\text{Municipal Yield}}{\text{(100\% - Tax Bracket \%)}}$
- Net (After-Tax) Yield = Taxable Yield x (100% – Tax Bracket %)