

Chartered Wealth Manager Qualification

Portfolio Construction Theory

Edition 8, January 2021

This workbook relates to syllabus
version 7 and will cover the exams from
4 June 2021 to 3 December 2021



APPROVED WORKBOOK

Welcome to the Chartered Institute for Securities & Investment's Portfolio Construction Theory study material.

This workbook has been written to prepare you for the Chartered Institute for Securities & Investment's Portfolio Construction Theory examination.

Candidates sitting the Chartered Wealth Manager titles will be provided with an Information Pack along with the question paper for the exam. This contains taxation rates and allowances for the relevant tax year and tables of gilt market prices.

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Candidates should be aware that the laws mentioned in this workbook may not always apply to Scotland.

A learning map, which contains the full syllabus, appears at the end of this workbook. The syllabus can also be viewed on cisi.org and is also available by contacting the Customer Support Centre on +44 20 7645 0777. Please note that the examination is based upon the syllabus. Candidates are reminded to check the Candidate Update area details (cisi.org/candidateupdate) on a regular basis for updates as a result of industry change(s) that could affect their examination.

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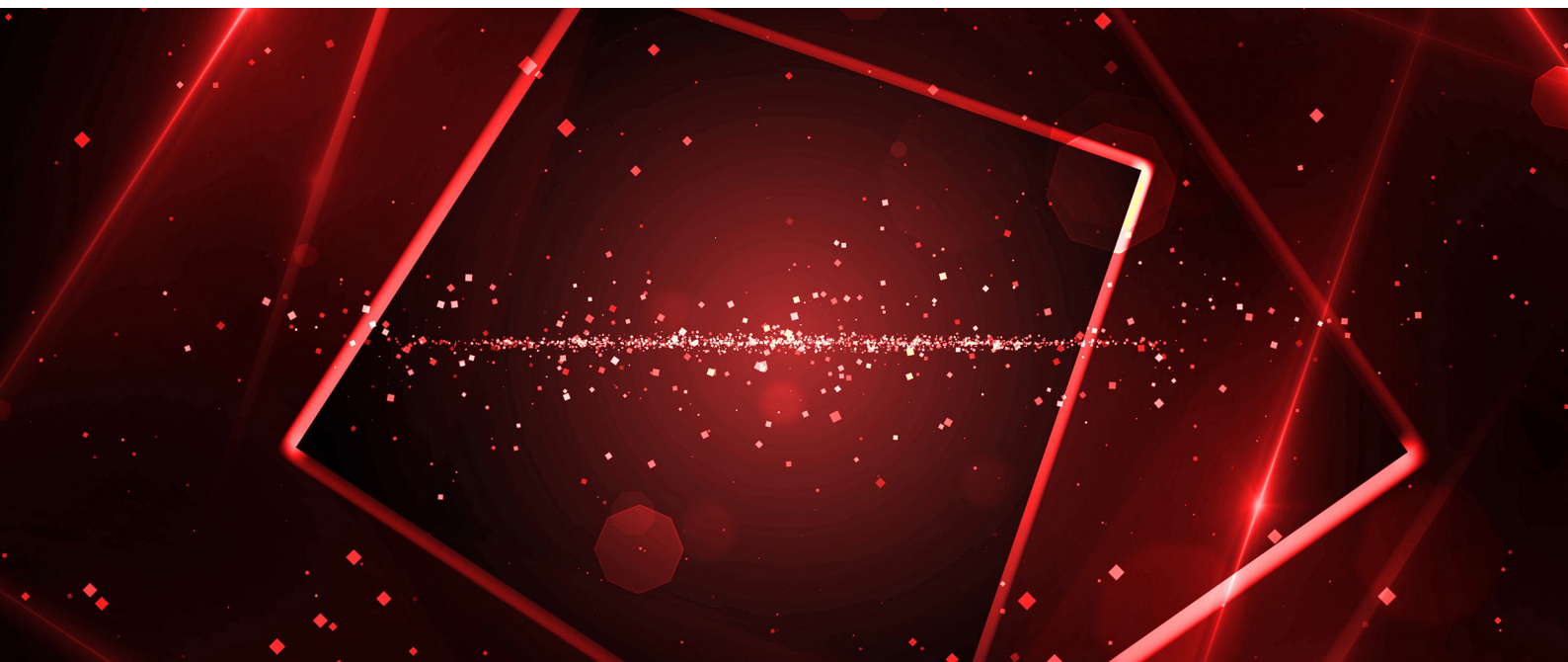
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It is estimated that candidates will require approximately 200 hours of study time, including study of this workbook, any formal tuition and wider reading in order to be successful in the examination.

Chapter One

Fundamentals of Investment Theory

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Learning Outcome 01

Be able to determine client risk characteristics and establish investment objectives and strategy

1. Introduction to Wealth Management

In this book, we shall be examining the fundamentals of **investment theory** and looking at the insights provided from a number of sources on best practice for investment managers to construct a portfolio of investments to achieve desired objectives. Our focus is on **wealth management** practices, where the professional relationship between the wealth manager and their client is of even greater importance than for a money manager working in a traditional investment management firm. This relationship continues to evolve, and has been subject to some significant changes over the years, including:

- the **Treating Customers Fairly (TCF)** initiative (launched in July 2006)
- the **Retail Distribution Review (RDR)** that came into effect in 2012, and
- when the **Financial Conduct Authority (FCA)** took over supervision of consumer protection from the Financial Services Authority (FSA), its 2013 Risk Outlook outlined the new conduct risk regime, which looks at the **risks** of banks' controls and operations failing. The FCA has referred to conduct risk in terms of '*consumer detriment arising from the wrong products ending up in the wrong hands, and the detriment to society of people not being able to get access to the right products*'.

This increased regulatory focus on adviser conduct continues today, with further consultations and advice reviews planned. In wealth management there is a personal aspect to the transactions, because portfolios are customised to the precise needs of individual clients.

In this chapter, we shall be examining the process involved in developing, implementing and reviewing portfolios. The chapter will also lay down the theoretical foundations to understanding the risk and return aspects of modern investment theory. The approach taken in this book is focused on the application of techniques, with a level of mathematics used consistent with the material being covered.

In addition to conventional skills, managers operating in wealth management need to have highly developed client relationship skills, requiring a commitment to the long-term goals of their clients. Representative clients are often **high net worth individuals (HNWIs)**, entrepreneurs and their families, and wealthy retail clients. They seek bespoke solutions to their investment and financial planning problems. The entry bar for investment is usually set high, although some firms do provide financial planning and wealth management advisory services to individuals with a net worth in the range from £100,000 to £1 million. It is fair to say that a sizeable proportion of this group will not be educated in areas of finance, unlike institutional investors who invest in **collective investment** schemes, among a range of other investments. As a result, investing clients will be heavily reliant on the guidance, education and advisory capacities of the wealth manager and their team. The process of meeting client goals starts with an extensive **data-gathering** exercise that is specifically designed to understand the needs of the individual. This intelligence will serve as valuable input for developing well-defined investment solutions matched to client objectives. Knowledge and experience of the market's behaviour and characteristics then creates opportunities to select the appropriate securities and to construct a bespoke portfolio that can meet the client's future income and wealth needs. Wealth management firms provide the financial planning that is required to meet long-term goals in a tax-efficient wrapper.