**R02 Flashcards in Q&A format to upload to Github**

**Q: What is volatility?**  
A: Degree of variation in trading price over time.

**Q: What is systemic risk?**  
A: Also known as 'market risk'; it refers to the risk of the whole system or market collapsing and cannot be mitigated through diversification.

**Q: What is non-systemic risk?**  
A: Specific to certain investments or industries; it can be mitigated through diversification.

**Q: What asset classes does inflation risk apply to?**  
A: All, but cash-based investments are more susceptible as they only generate interest.

**Q: Which assets are best for hedging against inflation?**  
A: Real assets like shares and property, which provide capital growth and income.

**Q: What is the relationship between bond prices and yield?**  
A: Price up = Yield down; Price down = Yield up.

**Q: What are the risks associated with cash?**  
A: Default risk (if not covered by FSCS), inflation, and interest rate fluctuation.

**Q: Which areas are not covered by the FSCS?**  
A: Channel Islands and Isle of Man.

**Q: How is interest paid on accounts?**  
A: Paid gross.

**Q: What is the IHT status for ISAs?**  
A: No direct benefit; forms part of the estate. APS can apply for a surviving spouse/partner.

**Q: What is an Additional Permitted Subscription (APS)?**  
A: Increases the survivor’s ISA allowance by the value of the deceased’s ISA holdings.

**Q: What are Flexible ISAs?**  
A: Allow withdrawal and replacement of money within the same tax year without affecting the allowance.

**Q: What are ISA limits for 16 or 17-year-olds?**  
A: £9k into JISA and £20k into an adult cash ISA – £29k total.

**Q: What is the purpose of the Parental Settlement Rule?**  
A: To prevent tax avoidance by shifting income to a child’s ISA.

**Q: When does the Parental Settlement Rule apply?**  
A: When the child is 16-17, unmarried, and the parent supplied the money.

**Q: What is the tax rule under the Parental Settlement Rule?**  
A: If income exceeds £100/year, the whole amount is taxable to the parent.

**Q: What are the age rules for opening a LISA?**  
A: You can open one between ages 18–40 and contribute until age 50.

**Q: What is the purpose of a LISA?**  
A: To purchase a first home or for use from age 60 onwards.

**Q: What are the penalties for early withdrawal from a LISA?**  
A: 25% of the full amount, which is more than the bonus received due to prior bonuses being included.

**Q: Can you have previously owned property and still use a LISA for a house?**  
A: No, owning property in any form, anywhere in the world, disqualifies you.

**Q: What happens if you inherit a property—can you still use a LISA?**  
A: No, even if you sell it immediately, it counts as having owned property.

**Q: What are structured deposits?**  
A: Structured products with returns typically linked to an index like the FTSE 100.

**Q: What are the issues with foreign currency accounts?**  
A: They may have a higher minimum balance and carry currency risk.

**Q: What are the benefits of foreign currency accounts?**  
A: Diversification, hedging, and utility for foreign property or overseas family.

**Q: What are direct money market investments?**  
A: Treasury bills, commercial bills, and certificates of deposit.

**Q: What are indirect money market investments?**  
A: Money-market funds.

**Q: Why don’t most individuals invest directly in the money market?**  
A: High minimum investment amounts; individuals typically use money market funds instead.

**Q: What does WAM (Weighted Average Maturity) measure?**  
A: Interest rate risk; lower WAM is better.

**Q: What does WAL (Weighted Average Life) measure?**  
A: Credit risk; lower WAL is better.

**Q: What is a coupon?**  
A: A fixed interest payment, often paid twice a year.

**Q: What are Permanent Interest Bearing Shares (PIBs)?**  
A: Loans to building societies with no redemption date.

**Q: What are the four main risks with bonds?**  
A: Default, inflation, liquidity, and currency.

**Q: Can bond issuers default?**  
A: Yes, both states and companies can default.

**Q: Are corporate bonds covered by the FSCS?**  
A: Not directly, though possibly if held within a fund.

**Q: Why are bonds susceptible to inflation risk?**  
A: Coupon and nominal value are fixed unless index-linked; longer bonds have higher risk.

**Q: What is the liquidity like for corporate bonds?**  
A: Often low demand, especially for non–blue chip bonds.

**Q: What happens to bonds when interest rates rise?**  
A: Price falls and yield rises.

**Q: What happens to bonds when interest rates fall?**  
A: Price rises and yield falls.

**Q: What is the relationship between interest rates and bond prices?**  
A: Inverse; rates up = prices down and vice versa.

**Q: How is bond interest taxed?**  
A: As savings income.

**Q: Are qualifying bonds subject to CGT?**  
A: No, qualifying bonds are exempt; non-qualifying ones are liable if sold.

**Q: Are bonds included in IHT calculations?**  
A: Yes, they are part of the estate.

**Q: What are convertible corporate bonds?**  
A: Bonds that can convert into ordinary shares; usually lower coupon and not CGT qualifying.

**Q: Which bonds can be held in an ISA?**  
A: Bonds from companies on recognised stock exchanges.

**Q: Is it always worth putting bonds in an ISA?**  
A: Not necessarily—most people have PSA and qualifying bonds are CGT exempt.

**Q: How can you manufacture a higher return on fixed coupon bonds?**  
A: By buying them at a discount in the secondary market.

**Q: How do you buy a Gilt directly?**  
A: Via a Gilt-edged market maker (GEMM) or approved investor auction application.

**Q: What are retail bonds?**  
A: Non-tradable corporate bonds with minimum £1000 investment.

**Q: What are mini-bonds?**  
A: Non-tradable short-term retail bonds (3–5 years).

**Q: What are Bulldog bonds?**  
A: Loans in sterling to foreign investors to access the UK capital market.

**Q: What are Eurobonds?**  
A: Bonds denominated in a currency different from both the issuer’s and market’s home currency.

**Q: What is the mid-market price?**  
A: The average of the buying (bid) and selling (ask) prices.

**Q: What is a clean price for a bond?**  
A: Price excluding accrued coupon interest.

**Q: What is a dirty price for a bond?**  
A: Price including accrued coupon interest.

**Q: What does 'cum dividend' mean?**  
A: Buyer is entitled to the next coupon payment.

**Q: What does 'ex dividend' mean?**  
A: Seller keeps the coupon; buyer pays lower clean price.

**Q: How is running yield calculated?**  
A: Coupon ÷ Clean Price × 100.

**Q: What does gross redemption yield account for?**  
A: Capital gain/loss at redemption when bought above or below nominal value.

**Q: What does net yield calculate?**  
A: Tax-adjusted return (after applying tax rate to running yield).

**Q: How is net yield calculated using PSA?**  
A: Running yield × (1 − tax rate).

**Q: What makes bonds more volatile?**  
A: Long time to redemption and low coupon.

**Q: What does modified duration measure?**  
A: Bond price sensitivity to interest rate changes; higher MD = more volatile.

**Q: What does a bond with MD of 5 imply if rates rise by 1%?**  
A: The price would fall by 5%.

**Q: What does a normal yield curve indicate?**  
A: Interest rates are expected to rise.

**Q: What does an inverted yield curve indicate?**  
A: Interest rates are expected to fall.

**Q: What do yield curves plot?**  
A: Bonds of similar risk with different maturity dates.

**Q: Why does a normal yield curve offer higher returns?**  
A: Longer-term investments carry more risk like inflation.

**Q: What does a steeper yield curve imply?**  
A: Higher expected changes in interest rates.

**Q: What is a debenture?**  
A: A secured corporate bond with protection in insolvency.

**Q: What’s the difference between a fixed and floating charge in bonds?**  
A: Fixed = specific asset (e.g. building); Floating = general assets of the firm.

**Q: What is the investment horizon for equities?**  
A: Medium to long-term, minimum of 5 years.

**Q: What are the two types of returns from equities?**  
A: Capital growth and income.

**Q: What is the difference between primary and secondary share markets?**  
A: Primary is when shares are first issued; secondary is ongoing trading.

**Q: What is a SPAC?**  
A: Special Purpose Acquisition Company – a ‘blank cheque’ company created to acquire/merge with a private company.

**Q: Why do dividend practices differ geographically?**  
A: UK tends to pay dividends, Asia prefers to reinvest for growth.

**Q: Who pays stockbroker commission on equity trades?**  
A: Both buyers and sellers.

**Q: What is the SD/SDRT rate?**  
A: 0.5% of purchase price.

**Q: What is the difference between SD and SDRT?**  
A: SD is for paper transfers, SDRT is for electronic transfers via CREST.

**Q: What is the SD minimum threshold?**  
A: £1000 total purchase price.

**Q: What is the SDRT minimum threshold?**  
A: No minimum.

**Q: How can you diversify your shareholding?**  
A: 15+ shares, across sectors and geographies.

**Q: What affects share liquidity?**  
A: Size of company – blue chips are more liquid; private companies less so.

**Q: How does currency risk apply to shares?**  
A: When investing overseas or in UK companies earning overseas.

**Q: How are dividends paid and taxed?**  
A: Paid gross; tax due at marginal rate above the dividend allowance.

**Q: What is a scrip dividend?**  
A: Receiving shares instead of cash – no SD or commission.

**Q: How is a scrip dividend taxed?**  
A: As if cash dividend had been received.

**Q: What is Bed & Breakfasting?**  
A: Selling and buying back the same asset to realise gains – banned unless 30+ days pass.

**Q: How is IHT treated for unlisted AIM companies?**  
A: 100% Business Relief after 2 years – effectively no IHT.

**Q: Can unlisted shares be held in an ISA?**  
A: No – AIM shares are excluded.

**Q: What is Bed & ISA?**  
A: Sell shares at end of tax year, rebuy in new tax year inside an ISA.

**Q: What are the cons of Bed & ISA?**  
A: Commission, and SD/SDRT on repurchase.

**Q: What are preference shares?**  
A: Fixed dividend, no voting rights, paid before ordinary shareholders.

**Q: What is the order of payment in insolvency?**  
A: Secured bonds (fixed > floating), unsecured bonds, preference shares, then ordinary shares.

**Q: What are cumulative preference shares?**  
A: Missed dividends must be paid in future before ordinary shareholders.

**Q: What do equity ratios tell investors?**  
A: Help decide whether to buy/sell based on trends and peer comparison.

**Q: How is earnings per share calculated?**  
A: Earnings ÷ number of ordinary shares in issue.

**Q: What does EPS tell us?**  
A: Indicates rising or falling profitability.

**Q: How is dividend yield calculated?**  
A: Dividend per share ÷ share price × 100.

**Q: What is the purpose of dividend yield?**  
A: Allows comparison across firms and asset classes.

**Q: What is dividend cover?**  
A: Total earnings ÷ total dividend, or EPS ÷ dividend per share.

**Q: What does dividend cover tell us?**  
A: If >1, dividend is sustainable from current earnings; <1 = reserves used.

**Q: What is the P/E Ratio?**  
A: Price per share ÷ earnings per share.

**Q: What does a high P/E ratio suggest?**  
A: Growth stock or potentially overvalued.

**Q: What if a company has no earnings?**  
A: P/E can’t be calculated; having one at all is a good sign.

**Q: How is NAV calculated?**  
A: Net assets attributable to ordinary shareholders ÷ number of shares.

**Q: What does NAV indicate?**  
A: Capital left after liabilities – how much shareholders would receive if liquidated.

**Q: When is QE used?**  
A: When interest rates are very low and can’t go lower.

**Q: What’s the purpose of QE?**  
A: To boost investment and spending.

**Q: How does QE lower interest rates?**  
A: Government buys bonds; price rises, yield falls.

**Q: What is the impact of higher interest rates on FDI?**  
A: Encourages more FDI.

**Q: What is a financial bubble?**  
A: Asset prices exceed intrinsic value.

**Q: What is M0 (Narrow Money)?**  
A: Notes, coins, and BOE deposits.

**Q: What does narrow money measure?**  
A: Consumer spending.

**Q: What is M4 (Broad Money)?**  
A: M0 + bank accounts and money via lending.

**Q: What does broad money measure?**  
A: Consumer lending.

**Q: Why is government spending preferred over tax cuts?**  
A: It can target growth and domestic products more effectively.

**Q: What are the disadvantages of government spending?**  
A: Time lag, inflationary effects, increased borrowing.

**Q: What are the pros of taxation?**  
A: Targets specific behaviour, reduces inequality.

**Q: What are the cons of taxation?**  
A: Complex, time-lagged, may discourage work/investment.

**Q: What is the Public Sector Net Cash Requirement?**  
A: The gap between government spending and tax revenue.

**Q: What is a buoyant bond market?**  
A: High demand for corporate bonds, less for gilts.

**Q: What is disinflation?**  
A: Prices are still rising, but at a slower rate.

**Q: What is stagflation?**  
A: High inflation and low growth simultaneously.

**Q: What does the current account measure?**  
A: Trade in goods and services.

**Q: What does the capital account measure?**  
A: FDI, shares, land, intellectual property, etc.

**Q: What is the focus of Modern Portfolio Theory?**  
A: Risk of the portfolio as a whole, not individual assets.

**Q: What is the goal of Modern Portfolio Theory?**  
A: Maximise return for a given level of risk.

**Q: Are all investors risk-averse under MPT?**  
A: Yes – will only take more risk for higher returns.

**Q: What is more important: quantity or quality of diversification?**  
A: Quality – assets should be negatively correlated.

**Q: What does standard deviation (SD) measure?**  
A: Spread of asset prices from the mean – indicates volatility.

**Q: What does a low SD indicate?**  
A: Low volatility.

**Q: What does a high SD indicate?**  
A: High volatility.

**Q: What does an SD of 2 mean?**  
A: Prices expected to move ±4% (2% per SD).

**Q: What does a correlation coefficient of 1 mean?**  
A: Assets move in perfect sync.

**Q: What assets offer the best diversification?**  
A: Negatively correlated ones.

**Q: What does the Efficient Frontier graph show?**  
A: Max return for a given risk or lowest risk for a given return.

**Q: What if a portfolio is not on the frontier?**  
A: It's not efficient – avoid it.

**Q: What does beta measure?**  
A: An asset’s volatility relative to the market.

**Q: What does a beta of 1 mean?**  
A: Moves in line with the market.

**Q: What does CAPM calculate?**  
A: Expected return based on beta.

**Q: What is the CAPM formula?**  
A: Expected Return = (Market Premium × Beta) + Risk-Free Rate.

**Q: What is the market premium?**  
A: Return on market − Risk-free rate.

**Q: What does CAPM tell investors?**  
A: Expected return for a given risk (beta).

**Q: What is the Efficient Market Hypothesis?**  
A: All known information is already reflected in prices.

**Q: What is the implication of EMH?**  
A: Can’t consistently outperform the market – use low-fee trackers.

**Q: Where is EMH most valid?**  
A: Developed, regulated markets like US, EU, Japan.

**Q: How to achieve higher returns in an efficient market?**  
A: Take more risk.

**Q: What is a narrative fallacy?**  
A: Oversimplifying events into a story – e.g., attributing success to a CEO.

**Q: What are the benefits of collective investments?**  
A: Diversified, professionally managed, low-cost, accessible.

**Q: What are the three types of collective investments?**  
A: Investment funds, investment trusts, investment bonds.

**Q: Which are open-ended?**  
A: Investment funds and investment bonds.

**Q: Which are closed-ended?**  
A: Investment trusts.

**Q: How do open-ended investments work?**  
A: Provider creates/cancels units; price = NAV.

**Q: How do closed-ended investments work?**  
A: Fixed number of shares traded on exchange; price = supply/demand.

**Q: What is a risk of open-ended funds?**  
A: May suspend trading if mass redemptions occur.

**Q: What are examples of onshore investment funds?**  
A: Unit Trusts, OEICs.

**Q: What are offshore fund types?**  
A: Reporting funds and non-reporting funds.

**Q: Who oversees Unit Trusts?**  
A: Trustees.

**Q: Who oversees OEICs?**  
A: Depositary.

**Q: What are Qualified Investor Schemes?**  
A: More flexible rules – for professionals/institutional investors.

**Q: How many assets do actively managed funds typically hold?**  
A: 50–80.

**Q: What are UCITs rules on holdings in one asset?**  
A: Max 20%; up to 35% in exceptional cases.

**Q: What gearing is allowed in retail UCITs?**  
A: Up to 10% of fund value.

**Q: What is a UCIS?**  
A: Unregulated Collective Investment Scheme – higher risk, broader holdings.

**Q: How is income taxed from funds with >60% interest-bearing assets?**  
A: As savings income.

**Q: And if <60% interest-bearing?**  
A: As dividend income.

**Q: Are UCIS regulated by FCA or covered by FSCS/FOS?**  
A: No – unless mis-selling can be proven.

**Q: How are investment trusts structured?**  
A: As public limited companies (PLCs).

**Q: What’s the key risk of closed-ended investment structures?**  
A: Market price may not reflect the actual NAV.

**Q: How do you find value in investment trusts?**  
A: Look for discounts where share price < NAV.

**Q: Can investment trusts borrow money (gearing)?**  
A: Yes, like any PLC – adds risk.

**Q: What does it mean if a trust trades at a premium?**  
A: Share price > NAV.

**Q: What if it trades at a discount?**  
A: Share price < NAV.

**Q: Why is there a difference between share price and NAV in trusts?**  
A: Due to market sentiment, sector, and management quality.

**Q: What is a warrant?**  
A: Right to buy shares at a fixed price within a set period.

**Q: Do warrants attract SD/SDRT?**  
A: No – it’s a right, not a transaction.

**Q: Is there income tax on warrants?**  
A: No – they don’t produce income.

**Q: Is there CGT on warrants?**  
A: Yes – if sold at a profit.

**Q: What are the two types of shares in split capital trusts?**  
A: Zero Dividend Preference Shares (Zeros) and Ordinary Shares.

**Q: What are Zero Dividend Preference Shares (Zeros)?**  
A: Provide fixed capital growth, no income, and rank ahead of ordinary shares.

**Q: What are Ordinary Shares in split trusts?**  
A: Receive all income and any capital after Zeros – higher risk.

**Q: What is a hurdle rate?**  
A: Required growth for Zeros to meet targets and return for Ordinary shares.

**Q: What is a negative hurdle rate?**  
A: A good sign – indicates enough assets to meet obligations.

**Q: How is investment trust income taxed?**  
A: As dividend income; capital gains taxed under CGT.

**Q: What are REIT income sources?**  
A: Rental income and property management fees.

**Q: Are REIT profits subject to corporation tax?**  
A: No – exempt.

**Q: Why are REITs more liquid than property funds?**  
A: They’re listed and traded on stock markets.

**Q: What are REIT criteria?**  
A: 75% of profits and assets from property letting; 90% of rental income must be distributed.

**Q: How is REIT rental income taxed?**  
A: As Property Income Distribution (PID) – non-savings income, taxed at source.

**Q: How is secondary REIT income (e.g., mgmt fees) taxed?**  
A: As normal dividend income – paid gross.

**Q: Are REIT capital gains taxed like property?**  
A: No – normal CGT applies; property surcharges don’t apply.

**Q: How is a PAIF different from a REIT?**  
A: Legally structured as an OEIC but nearly identical in function.

**Q: What is the income/asset test for PAIFs?**  
A: At least 60% from property investment.

**Q: What are investment bonds?**  
A: Single premium life assurance policies.

**Q: Who can hold investment bonds?**  
A: Individuals or jointly, with multiple owners possible.

**Q: How are open-ended bonds returned?**  
A: Returned to the provider.

**Q: How is the value of an investment bond determined?**  
A: By its Net Asset Value (NAV).

**Q: What is a qualifying life policy?**  
A: One that meets strict criteria and avoids income tax.

**Q: Are investment bonds subject to corporation tax?**  
A: Yes – tax is paid within the fund (unlike unit trusts).

**Q: Can investors reclaim this corporation tax?**  
A: No – even non-taxpayers can’t reclaim it.

**Q: What are the main chargeable events?**  
A: DAMPS – Death, Assignment, Maturity, Partial Surrender, Surrender.

**Q: Is tax due after death?**  
A: Yes – depends on income in year of death; estate pays.

**Q: What is taxed upon full surrender?**  
A: The gain – not the income.

**Q: What is an assignment?**  
A: Transfer of policy ownership.

**Q: Is assignment a chargeable event?**  
A: Only if exchanged for money or value – not gifts.

**Q: What’s the 5% withdrawal rule?**  
A: Withdraw up to 5% of original premium annually for 20 years, tax deferred.

**Q: What happens if more than 5% is withdrawn?**  
A: The excess becomes immediately taxable.

**Q: Is the 5% allowance tax-free?**  
A: No – it’s tax-deferred.

**Q: How is gain on surrender calculated?**  
A: Value + Untaxed Withdrawals − Original Investment.

**Q: How is tax handled within onshore bonds?**  
A: Corporation tax is paid within the fund.

**Q: Do offshore bonds pay corporation tax within the fund?**  
A: No – but withholding tax may apply.

**Q: How is income taxed on onshore bonds?**  
A: Basic rate tax is deemed paid; higher/additional rate taxpayers owe 20%/25% more.

**Q: Can non-taxpayers reclaim tax on onshore bonds?**  
A: No.

**Q: Which type of bond is unsuitable for non-taxpayers?**  
A: Onshore bonds – tax can't be reclaimed.

**Q: How is income taxed on offshore bonds?**  
A: No tax deemed paid; NT owe nothing, BR 20%, HR/AR 40/45%.

**Q: What is top-slicing?**  
A: Divides gain over number of years to prevent jumping tax brackets.

**Q: When is top-slicing beneficial?**  
A: When gain pushes you into a higher bracket or over £100k threshold.

**Q: Who are investment bonds suitable for?**  
A: Those currently higher-rate taxpayers who expect to pay less tax later.

**Q: What is segmentation in investment bonds?**  
A: Splitting into mini-bonds for flexibility and tax planning.

**Q: What is a 'with-profits' bond?**  
A: Includes regular bonuses and possibly a terminal bonus – smoother returns.

**Q: What is a unitised ‘with-profits’ bond?**  
A: Bonuses increase unit value or number of units.

**Q: What is a unit-linked bond?**  
A: Invests in units that reflect NAV – fluctuate daily.

**Q: What are the pros of investment bonds?**  
A: Flexible tax timing, tax-free gifting, no CGT when switching, trust-friendly.

**Q: What is a major con of onshore investment bonds?**  
A: Tax drag from corporation tax within the fund.

**Q: What are ETFs?**  
A: Funds traded on stock exchanges – usually passive and diversified.

**Q: Is stamp duty payable on ETFs?**  
A: No.

**Q: What is the structure of ETFs?**  
A: Open-ended.

**Q: Are ETFs UCITS-regulated?**  
A: Generally follow UCITS rules, though not strictly bound.

**Q: How are ETFs priced?**  
A: Real-time – updated constantly.

**Q: What are physical ETFs?**  
A: Buy actual underlying assets (e.g., FTSE 100 shares).

**Q: What are synthetic ETFs?**  
A: Use derivatives to replicate returns.

**Q: What are Exchange-Traded Notes (ETNs)?**  
A: Unsecured bank bonds – no coupon, often track currency indices.

**Q: Do EIS/SEIS/VCTs invest directly or pooled?**  
A: Direct investment into qualifying companies.

**Q: What is a Venture Capital Trust (VCT)?**  
A: Close-ended investment trust investing in qualifying companies.

**Q: What is the tax relief on EIS/SEIS/VCTs?**  
A: Investment × tax relief % = reduction in tax bill (e.g., £100k × 30%).

**Q: What happens if you sell before the holding period?**  
A: Tax relief may be clawed back – unless transferred to spouse or death.

**Q: Do EIS/SEIS/VCTs produce income?**  
A: Unlikely – companies are young/growth-focused.

**Q: EIS/SEIS/VCTs: Which pays tax-free dividends?**  
A: VCTs only.

**Q: EIS/SEIS/VCTs - CGT status?**  
A: VCTs always exempt; EIS/SEIS exempt after 3 years.

**Q: Can previous year ISA balances be transferred?**  
A: Yes – full or partial; does not affect current year allowance.

**Q: Can current year ISAs be transferred?**  
A: Yes – but must be transferred in full.

**Q: What is the transfer time limit?**  
A: 15 days for cash ISAs; 30 days for stocks & shares ISAs.

**Q: How are VCTs compared to ISAs?**  
A: Viewed as ISAs on ‘steroids’ – higher contribution (£200k) + 30% tax relief.

**Q: What is FSCS protection for pensions?**  
A: Personal Pensions: 100% of fund; SIPP: £85k per firm.

**Q: What’s the difference between Pension Annuity and Purchased Life Annuity (PLA)?**  
A: Pension annuity is from pension fund; PLA from any source (e.g., lottery win).

**Q: What is a derivative?**  
A: A contract based on an underlying asset’s price movements.

**Q: What are structured products?**  
A: Composite financial products for a specific outcome (e.g., guaranteed income).

**Q: What is a discretionary agreement?**  
A: Adviser can transact within limits – for time-poor or less confident clients.

**Q: Which has higher costs: advice or discretionary?**  
A: Discretionary.

**Q: What must an ongoing fee include?**  
A: An ongoing service (e.g., reviews, reports).

**Q: What is attitude to risk?**  
A: Subjective view – may change over time.

**Q: What is tolerance to risk?**  
A: Psychological ability to cope with loss.

**Q: What is capacity for loss?**  
A: Objective ability to suffer a loss without serious impact.

**Q: What is a total return strategy?**  
A: Balanced growth and income – often uses accumulation units.

**Q: What is pound-cost averaging?**  
A: Regular investing to smooth market entry risk.

**Q: When does pound-cost averaging NOT work?**  
A: In rising markets or with non-volatile assets like cash.

**Q: What is sequencing risk?**  
A: Withdrawing in a market dip – needing to sell more units.

**Q: What’s a 'lifestyle' fund?**  
A: Gradually de-risks as retirement nears.

**Q: What is theoretical asset allocation?**  
A: Based on MPT – uses frontier curves and correlations.

**Q: What is pragmatic asset allocation?**  
A: Based on historical returns data.

**Q: What is strategic asset allocation?**  
A: Fixed percentages maintained long-term.

**Q: When should strategic allocation change?**  
A: Significant client goal shifts or exceptional markets.

**Q: What is tactical asset allocation?**  
A: Active short-term changes within ranges.

**Q: What is top-down management?**  
A: Starts with macro view → asset class → sectors → stocks.

**Q: What is bottom-up management?**  
A: Starts with company fundamentals → builds portfolio.

**Q: What are active funds?**  
A: Try to outperform the market (‘alpha’).

**Q: What are passive fund types?**  
A: Full replicators (buy all) or partial (sample).

**Q: What is tracking error?**  
A: Difference between fund performance and index.

**Q: What is core/satellite management?**  
A: Core = passive; satellite = specialist active strategies.

**Q: What are discrete returns?**  
A: Over set periods – e.g., yearly or quarterly.

**Q: What are cumulative returns?**  
A: Total return over the investment period.

**Q: What does Ongoing Charges Figure (OCF) include?**  
A: AMC + other ongoing costs.

**Q: What does Total Cost of Ownership (TCO) include?**  
A: OCF + transaction + performance + external costs.

**Q: What is excess return?**  
A: Return above the benchmark threshold.

**Q: How often must portfolios be reported?**  
A: At least quarterly.

**Q: What is rebalancing?**  
A: Adjusting portfolio weights – usually annually.

**Q: What tax applies during rebalancing?**  
A: Possible CGT liability if assets sold.

**📈 Rates of Return & Ratios**

**Q: What is Money Weighted Rate of Return (MWRR)?**  
A: Measures total return including cash inflows/outflows.

**Q: What is MWRR good for?**  
A: Showing a client their overall portfolio return.

**Q: What is MWRR bad for?**  
A: Comparing portfolios or fund manager consistency.

**Q: What is Time Weighted Rate of Return (TWRR)?**  
A: Measures performance excluding cash flow effects.

**Q: What is the Sharpe Ratio?**  
A: Risk-adjusted return = (Return − RFR) ÷ Standard Deviation.

**Q: What does a negative Sharpe Ratio mean?**  
A: Return is lower than risk-free rate – avoid.

**Q: What is the Information Ratio?**  
A: Risk-adjusted return relative to a benchmark.

**Q: What is Alpha?**  
A: Actual return − CAPM expected return (manager skill).

**Q: What is required for benchmarking?**  
A: Must compare to an approved benchmark (e.g., FTSE 100).

**📊 Compounding & Inflation**

**Q: What is compounding?**  
A: Earning interest on interest – builds future value.

**Q: What is discounting?**  
A: Finding today's value of a future amount.

**Q: What is the compounding formula?**  
A: Present Value × (1 + return)^years.

**Q: How do you decimalise a return rate?**  
A: Divide % by 100 and add 1 (e.g., 4.5% → 1.045).

**Q: What does Annual Effective Rate show?**  
A: True yearly interest rate with compounding.

**Q: What is the real return formula?**  
A: Nominal return − inflation.