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Academy of Professional Finance 专业金融学院

CFA Level II

Economics for Valuation

Introduction

CFA Lecturer: Jiahao Gu

Weight of Economics for Valuation

Topic Area	Level I	Level II	Level III
Ethical and Professional Standards	15	10-15	10-15
Quantitative Methods	12	5-10	0
Economics for Valuation	10	5-10	5-15
Financial Reporting and Analysis	20	15-20	0
Corporate Finance	7	5-15	0
Equity Investments	10	15-25	5-15
Fixed Income	10	10-20	10-20
Derivatives	5	5-15	5-15
Alternative Investments	4	5-10	5-15
Portfolio Management and Wealth Planning	7	5-10	40-55
Total	100	100	100

Data Source: CFAinstitute.org

Overview

Readings	LOS
Currency Exchange Rates: Determination and Forecasting	16
Economic Growth And Investment Decision	12
Economics of Regulation	9

Overview of LOS

Currency Exchange Rates —— Determination And Forecasting	1. Bid-ask spread and factors that affect spread
	2. Identify and calculate triangular arbitrage profit
	3. Calculate forward premium/discount
	4. Calculate mark-to-market value of forward contract
	5. Explain international parity relations and relations
	6. Forecast future spot exchange rates
	7. Assess long-run fair value of exchange rates
	8. Describe carry trade and calculate carry trade profit
	9. Mundell-Fleming Model, monetary asset market approach
	10. Effects of monetary and fiscal policy on exchange rates
	11. Effects of BOP accounts change on exchange rates
	12. Objectives of central bank intervention and capital controls
	13. Warning signs of a currency crisis
	14. Technical analysis in forecasting exchange rates

Overview of LOS

Economic Growth And Investment Decision	1. Growth factors in developed and developing economies
	2. Long-run stock market appreciation and economy growth
	3. Potential GDP growth rate and equity/fixed-income market
	4. Capital deepening investment and technological progress
	5. Forecast potential GDP based on growth accounting relations
	6. Factors affect economic growth
	7. Classical/Neoclassical/endogenous growth theory
	8. Convergence hypothesis
	9. Economic rationale to provide incentives to private investment
	10. Impact of removing trade barriers on capital investment

Overview of LOS

Economics of Regulation	1. Classifications of regulations and regulators.
	2. Use of self-regulation in financial markets.
	3. Describe the economic rationale for regulatory intervention
	4. Describe regulatory interdependencies and their effects
	5. Describe tools of regulatory intervention in markets.
	6. Purposes in regulating commerce and financial markets.
	7. Anticompetitive behaviors and evaluate the antitrust risk
	8. Describe benefits and costs of regulation
	9. Evaluate how a specific regulation affects an industry, company, or security.

Example Question

Use the following information to answer Questions 15 through 20.

Agnetha Poulsen works as an analyst in the foreign exchange overlay strategies department for CFN, a large asset management firm serving institutional clients. She is concerned about the excessive unhedged currency exposure taken on by the overlay strategies department. She makes an appointment with Alvilda Kristensen, director of risk management, to discuss this matter. Prior to the meeting, Poulsen collects information on foreign currency quotes and on interest rates as shown in Exhibits 1 and 2.

Exhibit 1: Current Spot and Forward Exchange Rate Quotes

Quotes	*USD/CHF*	*USD/EUR*
Spot	0.9817/0.9821	1.2235/1.2238
30-day forward	–7.6/–6.9	–7.21/–6.80
60-day forward	–15.3/–13.3	–14.56/–13.76
90-day forward	–24.3/–23.05	–23.84/–22.77

Exhibit 2: Selected Interest Rates

Interest Rates	*USD*	*EUR*	*CHF*
30-day rate	0.20%	0.91%	1.13%
60-day rate	0.21%	0.93%	1.15%
90-day rate	0.26%	1.04%	1.25%

Example Question (cont)

Poulsen also reviews the current open forward contracts. As an example, she reviews two contracts. Contract FX2001 is a 90-day forward contract initiated 60 days ago. The contract calls for purchase of CHF 200 million at an all-in rate of USD 0.9832. Contract FX2051 is a 90-day contract initiated 30 days ago to purchase 100 million EUR at an all-in rate of 1.2242.

During her meeting with Kristensen, Poulsen expresses concern about traders establishing FX carry trades in several emerging market currencies. Kristensen assures Poulsen that CFN has adequate monitoring mechanisms. She continues that these carry trades have been generating significant positive returns for the clients and Poulsen should not worry about it. Kristensen further mentions that the firm's monitoring mechanisms trigger the sale of funding currency whenever volatility levels, implied by options on the investment currency, increase beyond a predetermined threshold.

Poulsen reviews her notes and decides to prepare a report on currency crises. She compiles a list of indicators of an impending currency crisis based on empirical analysis.

Poulsen then turns her attention to the firm's investments in Zambola, an emerging market. She realizes that currently the currency overlay strategy department has no trades involving Zambolan currency (Zu). Poulsen is concerned about significant long exposure of the portfolio in Zu. Zambola is enjoying large capital inflows drawn by

Example Question (cont)

Zambola's attractive yields. Her analysis indicates that Zambola has been running large current account deficits. A trend analysis on Zu indicates a steep upward trend continuing above its PPP value.

15. Based on the information provided in Exhibit 1, the 30-day forward spread on USD/CHF is closest to:
    A. 0.0005.
    B. 0.0007.
    C. 0.7000.

16. The current mark-to-market value of the forward contract FX2001 in USD is *closest* to:
    A. –USD460,000.
    B. –USD451,924.
    C. –USD357,940.

17. The current mark-to-market value of the forward contract FX2051 in USD is *closest* to:
    A. –USD215,900.
    B. –USD107,900.
    C. –USD216,000.

Example Question (cont)

18. Based on Kristensen's description of risk management strategies in FX carry trade, the volatility filter employed is:
    A. appropriate.
    B. inappropriate because it triggers selling of the funding currency.
    C. inappropriate because an increase in volatility is an inappropriate trigger.

19. Which of the following indicators of impending currency crises should Poulsen exclude from her report?
    A. Terms of trade improve.
    B. Increase in money supply relative to bank reserves.
    C. Increase in inflation.

20. If Zambolan government wanted to bring its currency value closer to its long-run fair value, it should:
    A. pursue policies consistent with currency depreciation.
    B. pursue policies consistent with currency appreciation.
    C. increase interest rates while keeping inflation constant.

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Thank You!