Subject SP5

CMP Upgrade 2023/24

CMP Upgrade

This CMP Upgrade lists the changes to the Syllabus, Core Reading and the ActEd material since last year that might realistically affect your chance of success in the exam. It is produced so that you can manually amend your 2023 CMP to make it suitable for study for the 2024 exams. It includes replacement pages and additional pages where appropriate.

Alternatively, you can buy a full set of up-to-date Course Notes / CMP at a significantly reduced price if you have previously bought the full-price Course Notes / CMP in this subject. Please see our 2024 *Student Brochure* for more details.

We only accept the current version of assignments for marking, *ie* those published for the sessions leading to the 2024 exams. If you wish to submit your script for marking but only have an old version, then you can order the current assignments free of charge if you have purchased the same assignments in the same subject in a previous year, and have purchased marking for the 2024 session.

This CMP Upgrade contains:

- all significant changes to the Syllabus and Core Reading
- additional changes to the ActEd Course Notes and Assignments that will make them suitable for study for the 2024 exams.

1 Changes to the Syllabus

Syllabus objectives 3.2 and 3.3 have been combined and now read:

3.2 Determine the value of individual investments in different situations, including: (Chapters 12 and 13)

- fixed income analytics and valuation (including interest rate swaps and futures)
- arbitrage pricing and the concept of hedging
- empirical characteristics of asset prices
- fixed income option pricing
- evaluating a securitisation
- evaluating a credit derivative.

Sustainability risk has been added to the list of risk types in syllabus objective 4.1.

Syllabus objectives 8.3.3 and 8.3.5 have been removed.

Syllabus objective topic 9 (Solving Problems) has been moved into the Assessment section of the syllabus document, as it describes how a candidate can demonstrate their learning outcome, rather than describing a learning objective.

Some other, relatively minor changes to the wording of the Syllabus Objectives have also been made.

2 Changes to the Core Reading

This section contains all the ***non-trivial*** changes to the Core Reading.

Chapter 2

Introduction

The following has been added:

An over-the-counter derivatives trade is a bilateral transaction between two counterparties, typically a bank and a client, with each party exposed to credit risk in respect of their counterpart to the trade. This counterparty risk is generally mitigated through collateralisation, *ie* the party who is out of the money is required to provide collateral in respect of their loss-making position with their counterpart. Collateral is typically in the form of cash or high-quality bonds, which may be subject to 'haircuts'.

Chapter 4

Section 1.1

The following has been added:

For examination purposes students are not expected to have knowledge of the technical differences between LIBOR and reference rates such as SONIA. Students may assume that the terms and usage is interchangeable.

Section 3.1, subsection 'Variations'

The definition of a zero coupon swap has been altered to read:

- ***zero coupon swaps* – (where each the payments due under one leg (nearly always the fixed leg) are rolled up and paid as a single lump sum on maturity**

Chapter 5

Section 1.2

The penultimate paragraph of core reading in this section has been altered to read:

The underlying assets are often below investment grade, and the associated loans are typically over-collateralised, both in respect of initial assets and cash flow margins in order to reduce credit risk and make the overall package attractive to investors.

Section 5.2, sub-section 'Asset specific risks'

The penultimate paragraph of core reading in this sub-section has been altered to read:

The asset specific risks will largely depend on the maturity of the asset. For example, in the construction phase, there is considerable risk associated with the construction process (mainly the timetable and cost, but also whether funding remains available through to completion).

Section 6.2, sub-section 'Contract specification'

The final three paragraphs of core reading in this section (referring to commodity indices produced by Goldman Sachs) have been deleted.

Section 6.2, sub-section 'Futures contracts based on commodity indices'

The following has been added:

Futures contracts based on a commodity index also avoid the danger of having to take delivery of the underlying product.

Chapter 7

Section 1.6

The core reading in this section has been amended to read:

People show a tendency to *separate* related events and decisions and find it difficult to *aggregate* events. Thus, rather than netting out all gains and losses people set up a series of 'mental accounts' and view individual decisions as relating to one or another of these accounts. For example, people may remember one profitable trade but 'forget' many negative trades which occurred at the same time and which were greater in size than the profitable trade.

Chapter 11

Section 1.1

The first bullet point in this section has been amended to read:

- **future dividend payments, or other forms of cashflow to shareholders such as share buybacks**

The paragraph in this section referring to economic factors has been extended and now reads:

Changing economic factors affect different companies to different extents and possibly in different ways and so alter their relative share prices. Additionally, the estimates are also driven by the sustainability of the company's business. For example, a business which is considered 'unsustainable' in the longer term (for example, a heavily polluting coal- fired power station) might be penalised with lower future profit estimates compared with a similar, 'cleaner' business.

Section 1.1, sub-section 'Factors affecting the relative market price of a share'

The second bulleted list in this section has been extended and now reads:

In order to form a view on these factors, a fundamental analyst will investigate:

- **the financial accounts and accounting ratios**
- **current and future environmental changes and potential regulatory responses to these**
- **the sustainability of the business and risks from environmental, social or governance factors**
- **dividend and earnings cover**
- **profit variability and growth (by looking at all sources of revenue and expenditure)** –
- **the level of borrowing**
- **the level of liquidity**
- **growth in asset values**
- **comparative figures for other similar companies.**

Section 1.3

The first paragraph now reads:

It will be necessary to use as many sources of information as possible. A competitive advantage may be obtained by finding information which the rest of the market does not have or may have misinterpreted. The primary source is likely to be the company's published accounts but there are many other sources of information which include:

The bulleted list is unchanged.

Section 2.1

The final bullet in the list has been replaced by:

- **research and development of new products or services.**

Section 2.6

The penultimate paragraph has been extended and now reads:

Historically, many bond investors have tended to place significant reliance on issuer and bond credit ratings, rather than carry out their own credit analysis independently. For smaller investors, this may be appropriate on the grounds of lower costs relative to buying independent research or building an internal team of credit experts. However, for larger investors these factors are less compelling, and it is generally considered desirable to obtain or carry out independent research in addition to monitoring ratings. This is particularly true of investors seeking to outperform the market; the information provided by the rating agencies will be known to everyone and on its own will not provide any unique analysis or information.

Section 3

References to ‘trade cycle’ have been replaced by references to ‘business cycle’.

At the end of this section the following has been added:

An important variable will be policymakers’ response to the business cycle. For example, a central bank’s interest rate policy may be closely tied to its understanding and forecast of the economy’s point in the cycle.

Chapter 14

Section 2

The descriptions of some of the sectors have been altered. They now read as follows:

Consumer services

The companies in this group include food, drug and general retailers, media companies and companies in the travel and leisure industries, such as passenger airlines, casinos, hotels, bars and restaurants. The group therefore includes both defensive companies (like food retailers) as well as companies closely linked to discretionary spending (like travel companies). Once again, the impact of the economic cycle will be greater on the cyclical industries.

Telecommunications

This group covers the providers of fixed line and mobile telephone services, but can also include social media companies and in some regions e-commerce platforms if there is not a ‘Technology’ group in that market.

Chapter 15

Section 1.3

The descriptions of unweighted and price weighted indices have been split out and expanded to read as follows:

Unweighted arithmetic indices

An unweighted arithmetic index changes from one period to the next by the arithmetic average of the relative price changes of the constituents. It treats large companies equally importantly to small companies, which may be appropriate in some situations (for example, when studying the behaviour of shares exhibiting certain characteristics but where the researcher wishes to eliminate the greater influence that a large company may have in that cohort). In general, it is unsuitable as a benchmark for dynamic institutional portfolios.

Price weighted arithmetic indices

A price weighted arithmetic index is typically determined by taking the price of each stock in the index and dividing by the total number of companies to determine the index's value. It gives greater weight to companies whose stock prices are high over those with small prices. Having a large or small stock price is usually more to do with corporate finance decisions (new issue prices, stock splits and so on) than a reflection of a company's economic or market importance. It is unsuitable as a benchmark for dynamic institutional portfolios.

Section 3.1

The core reading relating to the following indices has been removed:

- FTSE 250 index
- FTSE 350 Supersectors indices
- FTSE SmallCap index
- FTSE Fledgling index
- FTSE AIM index series.

Section 3.2

The following has been added:

The Russell index series which include a small cap index and indices covering various investment styles, such as 'growth' and 'value'.

Section 3.7

The core reading paragraph introducing the VIX index has been amended to read as follows:

The most well-known volatility index is the Chicago Board Options Exchange Volatility Index, commonly known as the VIX. This is essentially a weighted average of implied volatilities for a range of 30-day expiry put and call options on the S&P 500 index (discussed earlier in this chapter).

Section 4.2

The following has been added:

The MSCI indices cover a very wide range of regions and countries. The MSCI World Index is arguably the most widely-used index of global equity markets.

Section 6.1, sub-section 'Alternatives to property indices'

This section (consisting of two paragraphs of core reading) has been removed.

Chapter 17

Section 2.1

The final paragraph of core reading in this section and associated the self-assessment question and answer, which refer to 'value' and 'growth' investors, have been removed.

Chapter 18

Section 1

A sixth risk has been added, namely:

6. *Sustainability risk* – the risk that an environmental, social or governance event or condition could cause a material negative impact on the value of investments.

New Section 1.6

This new section of core reading reads as follows:

Sustainability refers to encouraging businesses to frame decisions in terms of financial, environmental (including climate, biodiversity), social and human effects when making commercial or investment decisions, ensuring resilience and long-term value creation.

Failure to allow for sustainability risk could result in the value of the investment declining sharply if regulations or public opinion move against the company.

Chapter 20

Section 1.1

The final paragraph of core reading in this section has been amended to read as follows:

However, these examples relate only to specific characteristics of the liabilities, whereas liability hedging aims to select assets which perform as closely as possible to the liabilities in all states.

New Section 2.3 – Liquidity risks

This new section of core reading reads as follows:

The investor will also need to be clear about the method of implementing the LDI strategy, in particular whether to adopt a leveraged approach (by investing into a leveraged LDI fund for example) or taking an unleveraged approach where the investor owns a portfolio of bonds outright. The leveraged approach introduces additional liquidity risks if interest rates move unfavourably and collateral needs to be found to meet margin calls.

Chapter 21

Section 2.1, sub-section 'Relative merits of the two approaches'

The following new core reading paragraph has been appended to this section:

Stock pickers could also argue that the top-down approach gives relatively few opportunities to make independent bets over a given time period, whereas selecting stock gives many more which should result in better risk-adjusted performance for the same level of underlying skill.

Chapter 23

Section 2

This whole section has been removed.

3 Changes to the ActEd material

This section contains all the ***non-trivial*** changes to the ActEd text.

Chapter 6

The following paragraph has been inserted in section 1.4:

More recently, as a response to higher inflation, the scale of QE has been reduced, a process which is referred to as tapering, or more actively reversed through Quantitative Tightening (QT). Under QT, the portfolio of financial assets built up through QE is reduced by selling some prior to maturity and/or not replacing those which mature.

Chapter 13

References to ‘SONIA’ have been replaced by ‘forward-looking reference rate’.

Chapter 18

New section 1.6

After the new core reading (described earlier in this document), the following ActEd text has been included:

For example, before the manager of a property portfolio makes an investment in an infrastructure development, they should consider whether appropriate account has been taken of potential ESG factors (such as flood risk, density of population, clean air targets *etc*) when designing / locating those developments.

Chapter 20

New section 2.3

After the new core reading (described earlier in this document), the following ActEd text has been included:

Particular liquidity risks arise from the collateralisation of swaps, repos and geared LDI products. A notable example of this occurred in the UK in September 2022, when gilt prices fell too fast for market participants to digest. The UK mini-budget that was announced at that time increased investors’ fear of higher government borrowing, and generated a wave of negative sentiment about gilt prices. As gilt prices fell, collateral on swaps, repos and geared LDI products rocketed upwards, and gave institutional investors (*eg* pension funds) real problems raising the cash quickly enough to avoid technical default. A cycle arose where institutions sold bonds to raise collateral cash, but by selling the bonds they pushed prices down further, which raised the amount of collateral cash required. The only way out of the cycle was for the central bank to step in with printed money and become a bond buyer.

Chapter 23

References to ‘SONIA’ have been replaced by ‘forward-looking reference rate’.

Changes to the X Assignments

We have made a few changes to the assignments for 2024, but the 2023 versions of the SP5 X Assignments remain fit-for-purpose.

However, we only accept the current version of assignments for marking, *ie* those published for the sessions leading to the 2024 exams. If you wish to submit a script for marking but have only an old version of the assignments, then you can order the current version free of charge if you have purchased the same assignments in the same subject in a previous year and have purchased marking for the 2024 session.

4 Other tuition services

In addition to the CMP you might find the following services helpful with your study.

4.1 Study material

We also offer the following study material in Subject SP5:

- Flashcards
- Revision Notes
- ASET (ActEd Solutions with Exam Technique) and Mini-ASET
- Mock Exam and AMP (Additional Mock Pack).

For further details on ActEd's study materials, please refer to the 2023 *Student Brochure*, which is available from the ActEd website at **ActEd.co.uk**.

4.2 Tutorials

We offer the following (face-to-face and/or online) tutorials in Subject SP5:

- a set of Regular Tutorials (lasting a total of three days)
- a Block (or Split Block) Tutorial (lasting three full days)
- an Online Classroom.

For further details on ActEd's tutorials, please refer to our latest *Tuition Bulletin*, which is available from the ActEd website at **ActEd.co.uk**.

4.3 Marking

You can have your attempts at any of our assignments or mock exams marked by ActEd. When marking your scripts, we aim to provide specific advice to improve your chances of success in the exam and to return your scripts as quickly as possible.

For further details on ActEd's marking services, please refer to the 2023 *Student Brochure*, which is available from the ActEd website at **ActEd.co.uk**.

4.4 Feedback on the study material

ActEd is always pleased to receive feedback from students about any aspect of our study programmes. Please let us know if you have any specific comments (*eg* about certain sections of the notes or particular questions) or general suggestions about how we can improve the study material. We will incorporate as many of your suggestions as we can when we update the course material each year.

If you have any comments on this course, please send them by email to **SP5@bpp.com**.