



FINRA SERIES 7 DUMP SHEET

Suitability

Best practice

- ✓ **Diversification**
 - Allocating capital among multiple asset classes and securities
 - Reduces non-systematic risk
- ✓ **Rule of 100**
 - Determines appropriate asset allocation based only on age
 - 100 minus age = % in stock
- ✓ **Strategic asset allocation**
 - Long-term asset allocation goal
 - Rebalance portfolio periodically
- ✓ **Tactical asset allocation**
 - Deviating away from long-term goal for short-term opportunity
- ✓ **Passive management**
 - Investing in a pre-determined large portfolio ("the market")
 - Lower expenses than active management
- ✓ **Active management**
 - Investing in chosen securities within a large portfolio
 - Higher expenses than passive management

Portfolio analysis — calculation

- ✓ **Total return**
 - Measures overall rate of return on a security or portfolio
- ✓ **Total return formula**
 - $\text{Total return} = \frac{\text{All gains and/or losses}}{\text{Original cost}}$
- ✓ **After-tax return**
 - Total return with taxes factored out
- ✓ **Capital asset pricing model (CAPM)**
 - Financial model for determining the expected return
 - Only considers systematic risk
- ✓ **Expected return calculation**
 - $ER = RF + (\text{Beta} \times (\text{MR} - \text{RF}))$

Portfolio analysis — markets

- ✓ **S&P 500 index**
 - Tracks 500 large-cap stocks
 - Cap-weighted index
- ✓ **S&P 100**
 - Tracks 100 large-cap stocks (a subset of the S&P 500)
 - Cap-weighted index
- ✓ **S&P 400**
 - Tracks 400 mid-cap stocks
 - Cap-weighted index
- ✓ **Dow Jones Composite**
 - Tracks 65 prominent stocks
 - Composite of DJIA, DJTA, and DJUA (see below)
 - Price-weighted index
- ✓ **Dow Jones Industrial Average (DJIA)**
 - Tracks 30 prominent stocks (various industries)
 - Price-weighted index
- ✓ **Dow Jones Transportation Average (DJTA)**
 - Tracks 20 prominent transportation stocks
 - Price-weighted index
- ✓ **Dow Jones Utilities Average (DJUA)**
 - Tracks 15 prominent utilities stocks
 - Price-weighted index
- ✓ **Russell 2000**
 - Tracks 2,000 small-cap stocks
 - Cap-weighted index
- ✓ **NASDAQ Composite**
 - Tracks all stocks on the NASDAQ exchange
 - Cap-weighted index
- ✓ **NASDAQ 100**
 - Tracks 100 largest stocks on the NASDAQ exchange
 - Cap-weighted index
- ✓ **Wilshire 5000**
 - Tracks all actively traded stocks in the U.S.
 - Considered the broadest index
 - Cap-weighted index
- ✓ **EAFE index**
 - Tracks stocks in Europe, Australasia, and Far East
 - Cap-weighted index

Portfolio analysis — Modern portfolio theory

- ✓ **Modern protocols and best practices related to investing**
- ✓ **Goal: to attain the highest return potential with the smallest risk exposure**
- ✓ **Overall risk/return profile of the portfolio is the most important**
- ✓ **Risk/return profile of individual securities not significant**
- ✓ **Diversification necessary to reduce risk**
- ✓ **Add negatively correlated securities to the portfolio to diversify**