FINRA SERIES 7 DUMP SHEET

Suitability

Achievable
https://achievable.me

Preservation of capital
- Little to no risk of losing money
- Short-term, high-quality investments
- Typical securities:
  - Money market funds
  - Treasury bills
  - Certificates of deposit (CDs)

Safety of principal
- Willing to take a small amount of risk
- Longer-term, high-quality income investments
- Typical securities:
  - Treasury notes
  - Treasury bonds
  - TIPS

Tax-advantaged income
- Income-based investments with tax benefits
- Typical securities:
  - Municipal bonds
  - Preferred stock

Moderate income
- Taking some risk in return for higher income
- Typical securities:
  - Investment grade corporate bonds
  - Preferred stock
  - Dividend-paying common stock

Moderate growth
- Taking some risk in return for higher growth
- Typical securities:
  - Large and mid-cap growth stocks
  - Defensive stocks

High yield income
- Taking considerable risk in return for high yields
- Typical securities:
  - Speculative (junk) bonds
  - Preferred stock

Aggressive growth
- Taking considerable risk in return for high growth
- Typical securities:
  - Small-cap / start-up common stock
  - Sector funds
  - Emerging market securities

Speculation
- Betting on price movements
- Significant risk involved
- Typical securities:
  - Options
  - Penny stocks
  - Leveraged and inverse ETFs

FINRA suitability standards
- Reasonable basis
  - Is the security suitable for any client?
- Customer-specific
  - Is the security suitable for this client?
- Quantitative
  - How much of the security is suitable for this client?

Financial considerations
- Suitability factors directly relating to money
- Includes:
  - Annual income
  - Net worth
  - Tax status
  - Liquidity needs

Non-financial considerations
- Suitability factors not directly relating to money
- Includes:
  - Stage in life
  - Investment objectives
  - Risk tolerance
  - Investment experience
  - Investment goals

Investor profiles
- 20-30s
  - High risk
  - Long-time growth
- 40-50s
  - Moderate risk
  - Sustained growth
- 60+
  - Low risk
  - Preservation of capital

Best practices
- Diversification
  - Allocating capital among multiple asset classes and securities
  - Reduces non-systematic risks
- Rule of 100
  - Determines appropriate asset allocation based only on age
  - 100 minus age = % in stocks
- 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 - calculations
- Total return
  - Measures overall rate of return on a security or portfolio
- Total return formula
  - Total return=All gains and/or lossesOriginal 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 + (Beta x (MR - RF))

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

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 US
  - Considered the broadest index
  - Cap-weighted index
- EAFE index
  - Tracks stocks in Europe, Australasia and Far East
  - Cap-weighted index