RO2 LEARNING OUTCOME 3

Chapter 4
Investment Theory
(Learning outcome 3)

PSYCHOLOGICAL FACTORS OR BEHAVIOURAL BIASES

- ✓ Prospect theory/loss aversion
- ✓ Regret
- ✓ Overconfidence and over and underreaction

REDUCTION OF RISK

1. Hedging out risk
2. Diversifying portfolio holdings

THREE FORMS OF EFFICIENT MARKET HYPOTHESIS (EMH)

1. Week-form efficiency
2. Semi-strong efficiency
3. Strong-form efficiency

CORRELATION

- ✓ Positive correlation
- ✓ Negative correlation
- ✓ No correlation

MULTI-FACTOR MODELS

- ✓ Fama and French model
- ✓ Arbitrage pricing theory (APT)

CAPITAL ASSET PRICING MODEL (CAPM) EQUATION

E (Ri) = Rf + Bi (Rm-Rf)

DIVERSIFICATION

- ✓ Holding different asset classes within a portfolio
- ✓ Choosing companies from different sectors
- ✓ Including overseas companies

MPT VARIANCE

- ✓ Systematic or market risk
- ✓ Non-systematic or investment-specific risk