

# SeeWhy Financial Learning's ~ CSC® #2 Exam Preparation Materials ~

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Here at SeeWhy Financial Learning, we have a knack for making difficult concepts seem easy. After hearing a topic explained properly by one of our trainers, our students often say, “Why doesn’t the textbook just teach it that way?” Frankly, we don’t know why, so we started our own company!

Our CSC® Exam Preparation Success Package provides you with study tools to speed up your learning and ensure that your first exam attempt is a successful one. This package is so effective that it comes with a money back guarantee. In the unlikely event that you do not pass, we will refund your money!

The success package includes:

- Key Concept Flash Cards (online – free sample on our website)
- Realistic Practice Exam Program (online – free sample on our website)
- Textbook Summary Study Guide

The Textbook Summary study guide:

- ✓ Simplifies the CSC® Volume II textbook using everyday language, memory aids and analogies
- ✓ Contains approximately 200 CSC® practice questions
- ✓ Significantly reduces CSC® study time

You can try our exam preparation software for free on our website. The following will give you a feel for how we simplify concepts in our Textbook Summary study guide.

## **Easy To Understand Textbook Summary**

Our study notes read very much like we teach in a class room setting. They are informal, use everyday language, give you insight as to what is most important for the exam, and use memory aids. All of this makes the learning easier. The following are some excerpts from our CSC® #2 Textbook Summary Study Guide.

### ***Excerpt #1: Mutual Funds***

#### **What exactly is a Mutual Fund?**

When studying for your first exam, you would have learned about treasury bills, bonds, preferred shares and common shares. Before we discuss what a mutual fund is, it first makes sense to understand why they exist.

Consider the following scenario:

Amanda has \$3,000 in her bank account to invest. She knows she will not need the money for several years and that she would probably earn a greater return if she invests in the common shares of some good quality companies. What issues could she face?

1. She may not be comfortable selecting which companies to invest in.
2. If she is comfortable selecting the specific companies, she may not have the time to do the required research.
3. She doesn't have sufficient money to buy enough different companies to properly diversify her portfolio (spread out her risk).

Investing in a mutual fund solves the above three problems.

The following bullet points will help you understand how mutual funds work:

- A mutual fund is a big pot of money and investors contribute to the pot.
- Each investor obtains units of the fund based on how much money they contribute.
- The fund manager uses the money in the pot to invest, and is paid a management fee for his professional services.
- Once you have selected an appropriate fund or group of funds, you can sit back and let the fund manager do his or her job.
- Investors profit or lose based on how the fund performs, and how many units they own. For example: If the fund earns \$100,000 in income, and you own 5% of the fund's units, you will receive \$5,000 (5% of \$100,000).

### **Advantages of Mutual Funds:**

**Professional management:**

- A professional money manager invests the assets.

**Cost savings for investors:**

- The fund will pay lower commissions when buying investments since the fund buys in bulk.

**Diversification:**

- A large equity fund may hold shares in 60 to 100 different companies.

**Variety of funds /  
transferability:**

- Each fund family usually has several types of funds. They will also allow you to transfer from one fund to another.

**Liquidity:**

- Most funds allow you to redeem your units at the next valuation point.

**Ease of estate planning:**

- The funds can continue to be invested during the whole probate process right up until the funds are ready to be paid out to the beneficiaries.

**Loan collateral:**

- Mutual funds can be given as collateral for a loan.

**Eligible for margin:**

- Many investment companies will give you a loan based on the value of your funds.

### **Disadvantages of Mutual Funds:**

**Costs:**

- Most mutual funds charge a sales commission and all charge a management fee.

**Unsuitable as a short-term  
investments or emergency  
fund:**

- Due to the nature of the investments that mutual funds invest in, they are not suitable as a short-term investment. The exception is money market funds.

**Professional investment  
management is not infallible:**

- Even a professional money manager can make some poor investment decisions.

**Tax complications:**

- Any income earned by the fund must be paid out to unit holders each year. The unit holders must pay the applicable tax annually. Unlike owning an individual common share where you can decide if and when you sell it (thereby triggering a capital gain or loss), a mutual fund unit holder has no control when capital gains are triggered.

## Basic types of Mutual Funds

To help you understand how mutual funds work we are first going to talk about our chocolate bar analogy. We know this is a silly analogy but it teaches a very important point.

If you were asked you to tell someone everything you know about a chocolate bar, wouldn't the same hold true of a "package" of six chocolate bars? For example, if a chocolate bar was left on the dashboard of a car in the middle of summer, it would surely melt. Likewise, if you left a six-pack of chocolate bars on the dash, they too would melt.

The same concept holds true of mutual funds. If you were asked you to describe everything you know about a bond, wouldn't the same hold true of a bond fund that is simply a portfolio of many bonds? The answer, of course, is "Yes".

Consider the following:

- If interest rates rise, the market value of a bonds fall. Therefore, if interest rates rise, the value of bond mutual fund units would also fall.
- If interest rates rise, the market value of preferred shares fall. Therefore, the market value of a dividend fund (which invests in preferred shares) would also fall.
- During the expansion phase of the economy, common shares typically perform well. Therefore, in the expansion phase of the economy, equity funds will also perform well.

If you keep the above in mind as you read this chapter, it will be much easier to understand. The only exception to this rule is money market funds, which will be discussed momentarily.

If you are not familiar with bonds, common shares, etc. refer to SeeWhy Financial Learning's CSC® # 1 study notes.

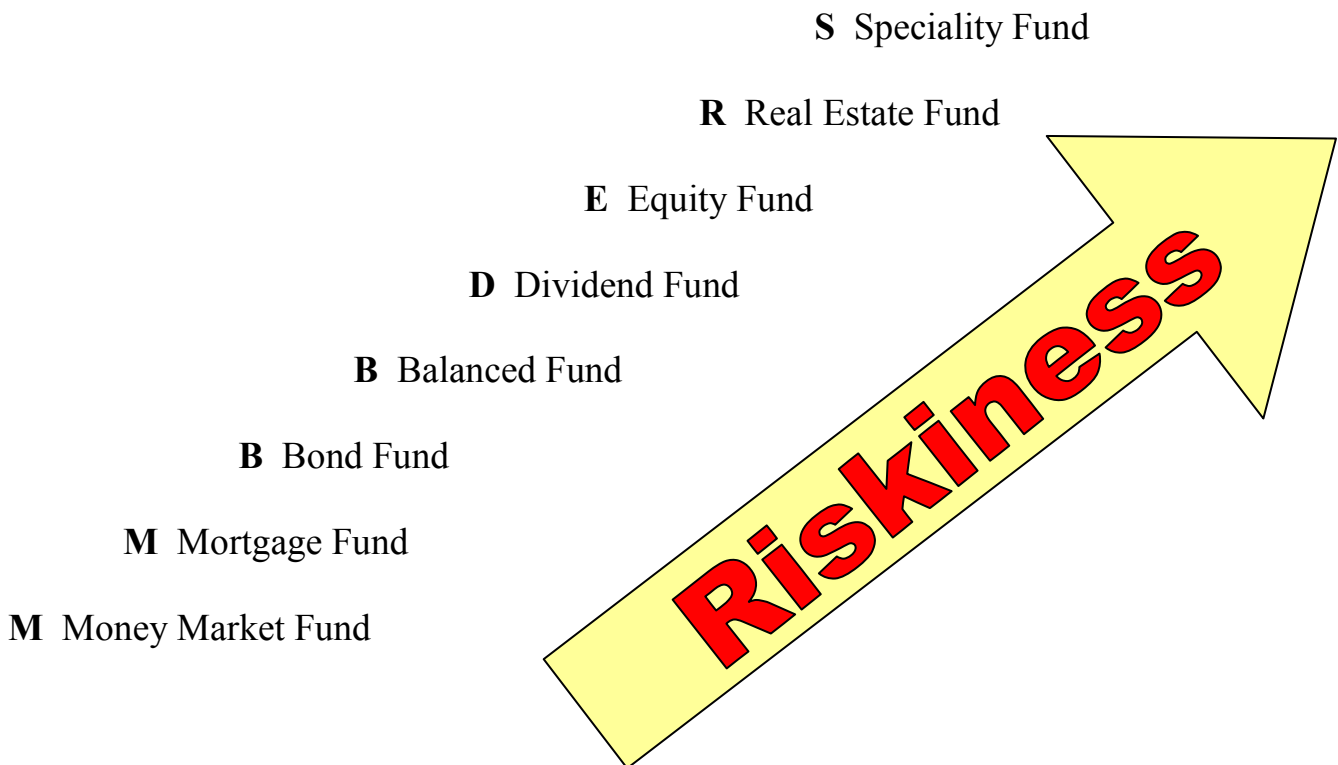
Each fund type is explained here at a very high level, as they will be discussed in much more detail later in the chapter.

<b>Money market:</b>	Invests in safe investments such as government issued treasury bills, short-term commercial paper, banker acceptance paper and Government of Canada bonds with terms of three years or less.
<b>Mortgage:</b>	Invests in conventional mortgages or mortgages which are secured by Canada Mortgage Housing Corporation.
<b>Bond:</b>	Invests in corporate or government bonds.
<b>Balanced:</b>	<p>Invests in all three asset classes namely money market, fixed income, and equities. The manager will adjust the asset mix according to what he feels the outlook is for each asset class. If he feels equities will do well he will shift the portfolio closer to equities. If he feels bonds will do well he will shift the portfolio towards bonds. However, the manager has ranges that they must stay within. For example, the prospectus may say he needs to have between 20% and 50% of the fund's assets invested in bonds.</p> <p><b>Note:</b> A similar type of fund exists where the manager does not have to stay within certain ranges. This is known as an asset <b>allocation fund</b>.</p>
<b>Dividend:</b>	Invests in preferred shares and the common shares of blue chip companies that historically pay a stable dividend.
<b>Equity:</b>	Invests in common shares.
<b>Real Estate:</b>	Invests in real estate (usually commercial real estate).
<b>Specialty:</b>	Very specialized funds that invest in things like precious metals, oil and resources, etc.

There are many different types of mutual funds, ranging from ones that are very safe (such as money market funds) to very risky funds (such as specialty funds).

To remember the risk level of the various funds, use the following memory aid:

**“My Mortgage Broker Brought Down Every Rate Substantially”.**



**Excerpt #2: Segregated Funds**

In the previous excerpt, you learned how mutual funds can play a key role in your portfolio. A segregated fund is basically the same thing as a mutual fund, but there are some key differences.

**Segregated funds Vs. Mutual Funds**

All of these things will be discussed in greater detail throughout the chapter. However, a quick overview of the differences between Segregated Funds and Mutual Funds will surely help.

Features	Mutual Funds	Segregated Funds
<b>Legal status</b>	Security	Insurance contract
<b>Who owns assets of the fund?</b>	Unit holders	Insurance contract – although kept separate from their other assets
<b>Main disclosure document</b>	Prospectus: Must be mailed out within 2 business days of sale	Information folder: Must be given before the sale.
<b>Maturity guarantee</b>	Sometimes (Protected funds)	Yes
<b>Death benefits</b>	No	Yes
<b>Creditor proof</b>	No	Yes, under certain conditions
<b>Ability to bypass probate</b>	No	Yes
<b>Effect distribution has on NAVPS</b>	NAVPS falls by the amount of distribution	Allocation does not affect NAVPS

When a student first reads about segregated funds, they learn that they are sold by insurance companies. They then read about death benefits and annuitants (the life on which the contract is based). Naturally, they start to think that segregated funds are life insurance, but that's not true. Segregated funds are not life insurance! We begin with a brief discussion on what segregated funds are not.

### **Segregated Funds are not Life Insurance**

It is extremely important to understand that a segregated fund is not life insurance. The only way to understand this is to first discuss life insurance.

*Consider the following Example*

Michael and Sarah are newly married and have a six-month-old daughter. Michael earns \$90,000 per year as a computer programmer and Sarah works part-time, earning \$15,000 annually. They recently purchased their first home with a huge mortgage and they have very little savings. Michael worries that if something were to happen to him, Sarah would have difficulty earning enough to take care of their child and provide for herself. Life insurance is the solution! Michael bought a \$1,000,000 life insurance policy that has a monthly premium of \$250. In the event that he dies, the policy would pay Sarah \$1,000,000. This would provide her with sufficient funds to payout the mortgage and enough to support herself and their child for several years.

Imagine that instead of selling Michael a life insurance policy, his advisor sold him a mutual fund into which Michael was going to invest \$250 per month. Would a mutual fund have addressed Michael's concerns? What if Michael died after just one monthly contribution? Sarah would have a grand total of \$250 to support herself and her daughter. Clearly, this would not be sufficient. Because segregated funds are really just fancier versions of mutual funds, they would not have addressed his concerns either.

As you read this chapter, it is very important that you keep in mind the following bullet points. Reread these bullet points often to ensure that you don't get sidetracked.

- Segregated funds are not life insurance!
- Segregated fund's are the insurance industry's version of a "mutual fund" and therefore have many similarities to mutual funds.
- Segregated funds offer some unique advantages over mutual funds.
- A segregated fund is technically a "contract" with the insurer; therefore, you will often see them referred to as "the contract".

## **Segregated Funds are Similar to Mutual Funds, but also offer some Key Advantages**

Segregated funds offer the following unique features:

- Guarantee a portion of your principal at death or upon a 10-year maturity date.
- Offer the ability to bypass probate at death.
- Offer the opportunity for creditor proofing.

### **Guarantees at Death and at Maturity**

Some investors are uncomfortable with risk. Segregated funds are required to guarantee a minimum of 75% of the original investment when the annuitant dies or upon the 10-year maturity mark. While the equity markets fluctuate, historically the market has always had a positive return over a prolonged period (10 years or more). For this reason, many segregated funds offer a 100% guarantee.

#### Guarantees at Death:

Segregated funds offer a minimum guarantee of 75% at death. Consider the following example:

Walter has \$250,000 in his investment portfolio and is 58 years old. He wants to invest his portfolio somewhat aggressively, but wants to know that in the event he dies, he will have a minimum of \$250,000 to leave to his loved ones. Walter bought a segregated fund that guarantees 100% at death. Walter hopes he lives a long and healthy life, and that he will grow his portfolio to much more than \$250,000, but he is relieved to know that no matter what happens, his children will inherit a minimum of \$250,000.

*Excerpt #3: Technical Analysis*

## Technical Analysis

Before we discuss some tools that a technical analyst can use, let's re-visit what technical analysis is.

Technical analysis is the study of historical stock prices and stock market behaviour in an attempt to identify recurring patterns in the data. In a nutshell, a technical analyst studies numbers; this includes things like price movements, trading volumes, data on the number of stocks that rise in price versus the number of stocks that fall in price, etc.

For example, Bob has been studying DEF common shares. He notices that historically, when the price of DEF common share falls to \$10, it then turns around and starts to increase. With this recurring trend identified, the next time DEF falls to \$10, Bob will buy the shares.

Many of the technical analysis techniques, charts and theories discussed in the upcoming section are difficult to understand. In many cases, they are discussed briefly in the actual textbook but you are not given enough information to truly understand them. The trick is learning (or memorizing) what you need to know for the exam.

For example, consider the **Elliot Wave Theory**. We are paraphrasing here, but this is basically what the actual textbook says about the Elliott Wave Theory.

### **Elliot Wave Theory:**

- A complicated theory that says the market moves in huge waves and cycles.
- Superimposed on those waves are smaller waves.
- Superimposed on the smaller waves are even smaller waves.
- The market moves up in a series of five waves and down in a series of three waves.

Our bet is you can read these four bullet points over and over, and you will never truly understand what the Elliot Wave Theory is. Our advice is simple: Don't bother trying! We discuss the technical analysis tools below, and memorize what you can.

Don't worry, as our interactive software will prepare you for the types of questions you will likely encounter on the exam.

## Chart Analysis

Chart analysis is the use of graphic representations of data. They often provide a visual sense of where the market has been, which helps an analyst predict where the market may be headed. The most common type of chart shows hourly, weekly, monthly or even yearly high, low and closing prices for a given stock.

Charting can also help identify support and resistance price levels for a given stock.

**Support levels:** A price level where investors start sensing value and are therefore willing to buy.

For example, on ABC stock, when the price falls to \$10, demand exceeds supply (there are more buyers than sellers), which prevents the price from falling any lower.

**Resistance levels:** The opposite of a support level is a resistance level. At this point, supply exceeds demand for the stock, preventing the stock price from heading any higher.

For example, on ABC stock, when the price reaches \$30, supply exceeds demand (more people want to sell than want to buy) preventing the stock price from going any higher.

Think of the bouncing a "super-ball" straight down on the floor. The floor would be the support level because once the ball hits the floor, it isn't going to go down any further. It then bounces off the floor and hits the ceiling. The ceiling would be the resistance level because it prevents the ball from bouncing any higher.

## Reversal Patterns

Reversal patterns are formations that can appear on a chart that precede a sizeable advance or decline in stock prices. Know the following for the exam:

**Bottom head and shoulders formation:** Buy signal.

**Head and shoulders formation:** Sell signal

How can you keep them straight?

Bottom head and shoulders starts with a “B”, so remember B for Buy.

## Quantitative Analysis

### Moving Average

Moving averages can be calculated on a 5-day basis, 10-day basis, 5-week basis, etc. To calculate a 5-week moving average, the last 5 weekly prices are determined, and are plotted on a graph. The dots can then be connected to form the moving average line. The following are questions that can be asked on an exam:

### Sample exam question #1

Calculate the 5-week moving average for DAN Shares:

Price on:

Week 1	\$15	
Week 2	\$12	
Week 3	\$16	} Most recent 5-week period
Week 4	\$20	
Week 5	\$25	
Week 6	\$23	
Week 7	\$28	

To calculate the 5-week moving average, add up the prices for the last 5 weeks (week 3 to week 7) and divide by 5. In this example, the answer is \$22.

### Sample exam question #2

If the stock price breaks through the moving average line on from below on heavy volume, would it be a buy or a sell signal?

If you visualize this, the only way something can break through something else from below is if it is going up, so it is considered a **buy signal**.

### Sample exam question #3

If the stock price breaks through the moving average line on from above on heavy volume, would it be a buy or a sell signal?

If you visualize this, the only way something can break through something else from above is if it is going down, so it is considered a **sell signal**.

### Moving Average Convergence-Divergence (MACD)

Although it is difficult to understand, the MACD has historically been tested. Simply *memorize* (don't try to understand) the following points:

- The MACD starts with two moving averages (such as the 12-day and 26-day).
- It then subtracts the 26-day moving average from the 12-day moving average.
- That difference is then "smoothed" by a 9-day moving average and this is called the signal line.

Know these for the exam:

- If a stock is moving higher but the MACD is trending lower, this could be a warning signal that the market is losing upward momentum.
- Likewise, a series of higher MACD highs when the market for that stock is moving down may indicate that a bottom is near.

### Sentiment Indicators

Sentiment indicators focus on investor expectations. **Contrarian** investors use these indicators to determine what the majority investors will do, and then do the opposite. This is easy to remember if you keep in mind the meaning of the word "contrary".

*Excerpt #4: The Dividend Discount Model (DDM) and the Equity Cycle*

**The Dividend Discount Model (DDM) and the Equity Cycle**

How the DDM and the equity cycle are related is a very difficult concept to understand...just look how complicated this section of the textbook is. There are also parts that are very confusing and could actually cause you to lose marks in other areas if you dwell on this section too much. According to the DDM, equity prices fall during the expansion phase of the equity cycle. This probably contradicts everything you have learned up until this point (you would think that stock prices should rise in the expansion phase of the equity cycle).

We could explain this whole relationship by first discussing the difference between the “equity cycle” and “business cycle”, and then delving into the mechanics of the DDM formula as it relates to the different variables, but that probably isn't why you purchased this study guide. Therefore, we have covered this section with one thing in mind:

- ☑ Get you the marks on your exam in the quickest and easiest way possible.

This section is often heavily tested (it could be as many as 3 - 4 marks) but memorizing the following table will get you **all** of those marks on the exam! We suggest writing it on the back page of your exam booklet as soon as they tell you that you can begin. This way, when you get a question that tests you on the material, you can just refer to this chart.

$P = \frac{Div_1}{r - g}$	<i>Expansion</i>	<i>Peak</i>	<i>Contraction</i>	<i>Trough</i>
<i>P</i>	↓	↑	↓	↑
<i>r</i>	↑	↑	↑	↓
<i>g</i>	↑	↑	↓	↓

To remember the order of the Equity cycle phases across the top, use the following memory aid:

*On an exam, Every Person Concentrates Thoroughly*  
*Expansion Peak Contraction Trough*

To remember the order of the DDM variables down the left hand side, use the following memory aid:

*On an exam, People rarely guess*  
*P r g*



### **Dividend Discount Model (DDM) and the Equity Cycle**

1. What will happen to stock prices during the expansion phase of the equity cycle?
  - a) Rise
  - b) Fall
  - c) No effect
  - d) Not enough information
  
2. During which phase of the equity cycle is the discount rate falling?
  - a) Expansion
  - b) Peak
  - c) Contraction
  - d) Trough
  
3. What will happen to stock prices during the trough phase of the equity cycle?
  - a) Rise
  - b) Fall
  - c) No effect
  - d) Not enough information

**DDM and the Equity Cycle Practice Question Answers:**

1. B Using the simplified DDM/equity cycle chart to answer this question, we see that during the expansion phase, "P" (stock prices) is falling, as odd as this may seem.

$P = \frac{Div_1}{r - g}$	Expansion	Peak	Contraction	Trough
<i>P</i>	↓	↑	↓	↑
<i>r</i>	↑	↑	↑	↓
<i>g</i>	↑	↑	↓	↓

2. B The discount rate is represented by "r". By simply memorizing the DDM/equity cycle chart, you would have got this mark on your exam.

$P = \frac{Div_1}{r - g}$	Expansion	Peak	Contraction	Trough
<i>P</i>	↓	↑	↓	↑
<i>r</i>	↑	↑	↑	↓
<i>g</i>	↑	↑	↓	↓

3. A Using the simplified DDM/equity cycle chart to answer this question, we see that during the trough phase, "P" (stock prices) is rising, as odd as this may seem.

$P = \frac{Div_1}{r - g}$	Expansion	Peak	Contraction	Trough
<i>P</i>	↓	↑	↓	↑
<i>r</i>	↑	↑	↑	↓
<i>g</i>	↑	↑	↓	↓



**Thank you for your interest in SeeWhy Financial Learning. We sincerely hope that you will allow us to be a part of your upcoming exam success!**

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