

Solutions

1. Which of the following is an investment philosophy (as opposed to an investment strategy)?
 - a. Invest in low PE stocks
 - b. Invest in under valued companies
 - c. Invest in companies that pay high dividends
 - d. Invest on the belief that investors over react to big news and announcements and that markets correct themselves over time.**
 - e. All of the above

Explanation: The remaining choices all represent strategies. There is no core belief about human behavior that drives them (or at least none is stated) and if the strategy stops working, there is no basis for coming up with other strategies.

2. Assume that your investment philosophy is based upon the belief that investors learn slowly. Which of the following strategies would fit into that philosophy?
 - a. Buy after big positive earnings surprises (actual earnings are greater than expected)**
 - b. Buy after big negative earnings surprises (actual earnings are less than expected)
 - c. Buy before earnings are announced, if investors are expecting high earnings growth
 - d. Sell before earnings are announced, if investors are expecting high earnings growth
 - e. Buy before earnings are announced, if investors are expecting low earnings growth
 - f. Sell before earnings are announced, if investors are expecting low earnings growth

Explanation: If investors learn slowly, you want to buy after very positive news since prices will continue to go up after the news story (as a result of the slow learning).

3. Which of the following will play a role in determining your investment philosophy?
 - a. Your risk aversion
 - b. Your time horizon
 - c. Your tax status
 - d. Your wealth
 - e. All of the above**

Explanation: All of these factors are relevant in determining the right investment philosophy for you.

4. Can you have different investment philosophies for different parts of your portfolio (your savings versus your pension fund, for instance)?
 - a. Yes**
 - b. No

Explanation: While your core beliefs about markets should remain the same, differences in tax treatment and time horizon across different parts of your portfolio may lead you to adopt different investment philosophies for each of them.