Analyst Guide
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CFA LEVEL 1

Must-Remember CFA Definitions

E-BOOK

SAMPLE

covariance = a measure of **linear association** between two variables

correlation coefficient:

- is easier to interpret than covariance,
- its value ranges from -1 to 1.

When we are dealing with a **perfect positive correlation**, the portfolio risk is equal to the weighted average risk of individual assets in the portfolio and the **diversification** of the portfolio **doesn't** allow us to **reduce the portfolio risk**:

If the correlation coefficient **is lower than +1**, portfolio standard deviation is lower than the weighted average of the standard deviations of individual assets in a portfolio. Therefore the **diversification** of the portfolio allow us to **reduce the portfolio risk**.

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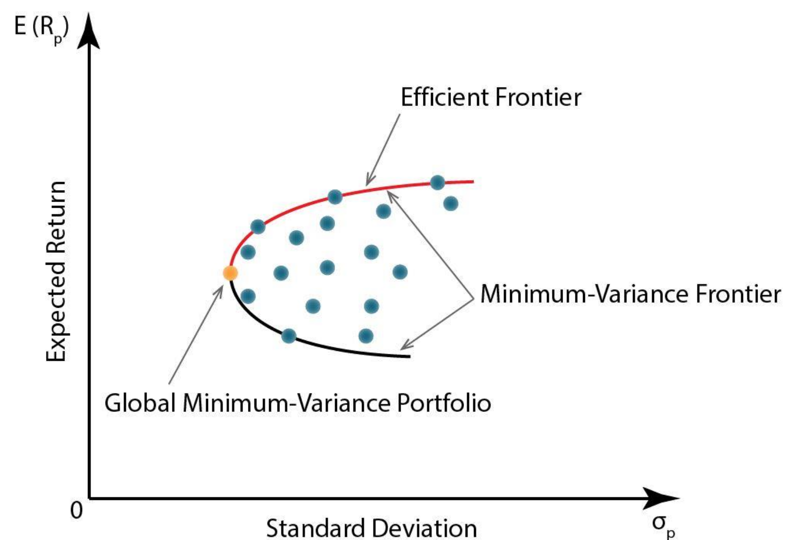
opportunity set = includes all risky portfolios available to an investor

The **efficient frontier** is:

- a set of portfolios that a rational investor will choose,
- a part of the minimum-variance frontier,
- called also Markowitz efficient frontier or efficient set.



The **global minimum-variance portfolio** is:

- the portfolio characterized by the lowest risk of all possible portfolios that the investor can build,
- the beginning of the efficient frontier.

systematic risk = market risk = nondiversifiable risk

Systematic risk:

- is inherent in the market,
- cannot be avoided,
- affects all assets in the market.

nonsystematic risk = unique risk = firm-specific risk = diversifiable risk

Nonsystematic risk:

- is limited to a particular asset or asset classes,
- can be avoid through diversification,
- of the market portfolio equals zero.

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find out more at:

https://analyst.guide/#definitions

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