

# 2022 CFA<sup>®</sup>

Exam Prep

## Schweser's Secret Sauce<sup>®</sup>

LEVEL III

**KAPLAN**  **SCHWESER**

# Schweser's Secret Sauce®

Level III CFA®

2022

**KAPLAN®** **SCHWESER**

SCHWESER'S SECRET SAUCE®: 2022 LEVEL III CFA®

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Published in 2022 by Kaplan, Inc.

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

ISBN: 978-1-0788-1864-3

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# FOREWORD

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The Secret Sauce is a summary of the high points of the Level III SchweserNotes™, which are based on the 2022 Level III CFA® Curriculum. The Secret Sauce is meant to be used as a review tool after having read the SchweserNotes or thoroughly studying the curriculum in some other manner. The Secret Sauce is a phenomenal way to review the whole curriculum in a relatively short period of time **in the last week or two before the exam**. I recommend that you read the Essential Exam Strategies section near the end of this book first as soon as possible to incorporate these into your final month of studying.

Candidates who study and practice the material have every reason to do well on the exam. But don't fall into the trap of expecting exam questions to be exactly like practice questions. Learn the underlying concepts, apply the concepts in practice questions, and expect surprises on exam day. CFA Institute always finds a way to throw in a few twists.

At Level I, you largely memorized facts and equations and simply applied them to short multiple-choice questions on the exam. At Level II, the topical coverage was more technically difficult with the concepts from within a topic area tested in a stand-alone item set. At Level III, you could be expected to integrate multiple concepts from different parts of the curriculum and apply them to a 4- or 6-part multiple choice item set or constructed response (essay type) question.

Which is the other major challenge at Level III—the constructed response (essay) first section of the exam. You must know the material and directly answer the question asked using an appropriate amount of verbiage. CFA Institute does not award points for a general display of knowledge. Our coaching using the old CFA exam questions and Mock Exams illustrate how to answer constructed response questions in sufficient depth. Answering constructed response questions is a skill acquired through learning the curriculum and a lot of practice writing short answers to open-ended questions.

Level III provides its own unique challenges. Through proper preparation and sufficient practice, you will succeed!

I wish you all the best on exam day.



Kurt Schuldes, MBA, CFA, CAIA

Senior Content Specialist

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# BEHAVIORAL FINANCE

## Study Session 1

Topic Weight on Exam  $\leq 5\%$   
SchweserNotes™ Reference Book 1, Pages 1–56

Expect behavioral finance to make up approximately 5% of the exam. Item set questions and material integrated into IPS constructed response questions are equally probable. Behavioral finance concepts are not complicated but there is a lot of overlapping terminology in other areas such as capital market expectations and asset allocation. Because of the extensive amount of terminology, some candidates have found flashcards to be an effective study tool to help with differentiating between some of the terms.

## THE BEHAVIORAL BIASES OF INDIVIDUALS

Cross-Reference to CFA Institute Assigned Reading #1

**Emotional biases** are caused by individuals' psychological predispositions. Emotional bias is not deliberate; it is more of a spontaneous reaction and it is more difficult to overcome.

**Cognitive errors** are the result of mechanical or physical limitations; they result from the inability to analyze all information or from basing decisions on incomplete information. Cognitive errors are easier to overcome than emotional biases and respond to education.

Cognitive errors stemming from **belief perseverance**:

- **Conservatism bias.** An initial view is rationally formed based on initial information and then maintained.
  - Implications: Investors are too slow to update views and may hold securities too long. To mitigate, seek new information and alternative views.
- **Confirmation bias.** Only information that supports the initial view is sought or considered.
  - Implications: Can lead to under-diversification and over concentration in employer stock. To mitigate, seek out contrary information and alternate methods of analysis.
- **Representativeness bias.** Once a classification is made, the accuracy of the classification is not considered. Base-rate (the assumed probability of the classification) and sample-size (the amount of initial data) neglect are forms of representativeness.
  - Implications: Overemphasizing data covering short time periods and reacting too quickly to new information. To mitigate, understand statistical analysis and develop a suitable long-term strategic asset allocation for the portfolio.