

# CFA® Exam Tips – LEVEL II

## Study Tips

### Quantitative Methods

#### Model Misspecification – 4 Failures in Regression Functional Form



Failure	1. Omitted variables	2. Inappropriate variable form	3. Inappropriate variable scaling	4. Inappropriate data pooling
Details	Omission of some important independent variable(s)	Ignore economic theory to use linear model for nonlinear relation (e.g. not taking logarithm for proportional change)	Use unscaled data when scaled data are more appropriate (e.g. in common-size financial statements)	Wrongly pool data when sample spans structural breaks (e.g. regime change from low- to high- volatility period)
Possible consequences	heteroskedasticity or serial correlation	heteroskedasticity	heteroskedasticity or multicollinearity	heteroskedasticity or serial correlation



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