

Syllabus

FIN 377.1 “Portfolio Analysis and Management”

Spring 2013

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Course Information:

location: UTC 1.132
time: TuTh 8:00am - 9:30am (03520), TuTh 9:30am - 11:00am (03525)

TA: Chao Bian
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office hours: M 11:00am - 12:00pm

1 Course Overview

1.1 Objective

This course builds upon FIN367, Investment Theory. FIN377.1, *Portfolio Management and Portfolio Management*, focuses on the investment decision making from the perspective of the portfolio manager. Topics covered include the process of creating, maintaining, and evaluating the performance of professional investment portfolios. The course is designed for upper-level finance majors to provide them with advanced skills in equity and fixed-income

portfolio construction and management, asset allocation, as well as cover advanced topics such as professional asset management, and alternative investments.

The course is taught as a combination of lecture and hands-on-learning. Students take an active role in the class via presentations, discussions, and group projects that simulate the real world decision making of professional portfolio managers and individual investors.

1.2 What I expect from you

- I expect you to be very familiar with the material covered in Investment Theory. FIN377.1. I will review some of the concepts in Investment Theory, in class, but I will assume that you are comfortable with the material.
- I expect you to do the required readings before each class in order to be able to follow the lecture. I include a number of optional readings for those interested in going beyond what is covered in class. I will assign them to specific lectures as we go.
- I will distribute hard copies of lecture notes before class. I will also make available lecture notes after lecture on Blackboard.
- I expect students to abide by the [UT Honor Code](#). Academic dishonesty will not be tolerated and will be immediately referred to the Student Judicial Services (In other words, any academic dishonesty case will be dealt with “[Option A](#)”). For details about UT’s standard of conduct, please follow this [link](#).
- Consistent with the policy of the Department of Finance, the use of computers and other electronic devices in class is generally prohibited.

1.3 What you need

- Blackboard access.
- Textbook: Reilly & Brown, “Investment Analysis & Portfolio Management”, Cengage Learning. Editors tend to ‘update’ their textbooks every year. In my view, this is somewhat unnecessary. Any one of the last few editions should be sufficient. If you use an older version, you will be responsible to compare it to the latest edition and make sure that all material covered is included.
- StockTrak account and copies of cases (I will announce details about these later)

1.4 Students with disabilities

The Provost Office offers the following statement to help inform students of available resources and to fulfill due diligence for Americans With Disabilities Act (ADA):

The University of Texas at Austin provides upon request appropriate academic accommodations for qualified students with disabilities. For more information, contact the [Office of the Dean of Students](#).

1.5 Religious holidays

By UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious day. If you must miss an examination in order to observe a religious holiday, you will be given the opportunity to complete the missed work within a reasonable time after absence.

1.6 Grading

You can collect up to 100 points in this course as follows:

- First Exam (20 points).
- Second Exam (20 points).
- Third Exam (20 points).
- Portfolio Management Project (15 points).
- Financial Advisor Project (10 points).
- Assignments (10 points).
- Attendance (5 points).

1.6.1 Exams

- The three exams given during the semester will carry equal weight toward your final grade. The tests will involve a combination of questions designed to assess your problem-solving, analytical and interpretative (i.e., essay) skills.
- All exams will be closed-book, closed-note, electronic-free (except for calculator). You will need to bring to each exam the following items: writing instruments and financial calculator.

- It is expected that you will be present at the time and date for each of the examinations. No makeup examinations will be given without the prior consent of the instructor. Such consent will only be given for demonstrable conflicts and with the proper documentation.

1.6.2 Projects

- The Mutual Fund Management Project consists in the construction, marketing, and management of an institutional portfolio. This is a group project. We need approximately 10 funds (groups), so the number of students per group will be determined by class enrollment.
- The Financial Advisor Project consists in the design and implementation of an optimal investment strategy for an individual investor advised by you. This is an individual project.
- These two projects are interrelated: funds must sell shares to individual investors. Investors should optimize their investments across the funds offered in the class (excluding their own fund).

1.6.3 Assignments

- There are two types of assignments: case-based and questions and problems from the textbook.
- Case-based assignments will be graded and should be handed in on the days they are assigned (see schedule). Deadline is until lectures starts. You may hand them to me at the beginning of lecture or leave them in Chao's mailbox (CBA 6.222). You may work in groups of up to four students, and submit a single group report for each case. There are a total of four cases, and each will count equally towards your "Assignments" 10 points (note that groups for these reports are likely to be different from the groups for the fund project). I will make these four cases available in the Copy Room and announce it in the first couple of weeks.
- I strongly encourage you to work on the assigned problems and questions from the textbook, although they will not be graded (**no need to turn them in**).

1.6.4 Attendance

- I will take attendance in meetings with group presentations (whether your group is presenting or not) and guest speakers (see schedule at the end for exact dates). In order to collect the 5 attendance points, you must attend *all* of these meetings to (i.e., "all or nothing").

1.6.5 Final Grade

The final grade of the course is based on the number of points collected as follows:

+/-	A	B	C	D	F
+	> 99*	87-89.9	77-79.9	67-69.9	
	92-98.9	82-86.9	72-76.9	62-66.9	< 60
-	90-91.9	80-81.9	70-71.9	60-61.9	

* symbolic grade (= A in practice).

2 Financial Advisor Project

This is an individual project that complements the Mutual Fund Management Project (discussed below). In the Financial Advisor Project, you will play the role of a financial advisor that must advise an individual client.

You will be assigned an individual client profile and a limited amount of information about his or her current financial situation and needs. You should help a client in the design of an investment policy statement. In particular, you are responsible for the allocation of your client's savings across the mutual funds managed by your colleagues.

Next, you will analyze the prospectuses and presentations from all groups in the Mutual Fund Management Game. You will use this analysis to prepare a report that contains an investment policy statement and a discussion of your proposed allocation of your client's savings across these funds (except for the fund managed by you in the Mutual Fund Management Project).

The report must contain the following three one-page sections:

1. Investment policy statement with the limited available information you have. The IPS statement must describe the client's background, risk and return objectives (stated by the client or inferred by you), taking into account any constraints the client might have. (1 page)
2. Suggested allocation of funds across each of the funds available in your session. The allocation process is conducted through points. Each client has 100 points to be allocated across funds. (1 page)
3. The report should document the rationale behind the allocation. (1 page)

You should submit your report electronically (send e-mail to Chao: cbian@utexas.edu) by February 22.

3 Mutual Fund Management Project

3.1 Goal

The goal of this game is to give you the opportunity to act as a fund manager and develop your understanding and intuition about all main aspects of portfolio management.

3.2 Overview

Students should form teams¹. Each team represents the management of an active mutual fund. The trading will be based on the Stock Trak platform. Trading accounts will be active

¹Number of students per group will be determined based on the total enrollment in each session and announced in the 1/17 lecture. As a general rule, we need approximately 10 funds to make this an interesting exercise.

on Friday, February 25h and end on Wednesday April 19th (8 weeks total). Each fund must be active as opposed to passive. Each group starts with 200 transactions. In your account you must establish a minimum of 20 trades. Each team should define and document the fund's investment guidelines as described below. Teams should raise funds from "financial advisors" (as described in the Financial Advisor Project"). This game emphasizes not only the portfolio construction, but also the (often underrated) communication and marketing aspects of portfolio management. Students are encouraged to utilize various research resources, such as the Wall Street Journal, Financial Times, Reuters.com, Bloomberg, Morningstar.com, Valueline.com, Thomson Investext Plus database, Mergent Online database, WRDS database, Hoovers Online database, LexisNexis database, Standard and Poors Industry Surveys and Stock Reports (NetAdvantage), etc

3.3 Timeline

See timeline at the end of this syllabus.

3.4 Fund prospectus

The fund prospectus is a 2 page document and should contain the following sections:²

3.4.1 Fund Name

You are free to choose any name for your fund, as long as it is not too generic (e.g., "Mutual Fund").

3.4.2 Investment Objectives and Benchmark

These are the fund's goals and the types of securities chosen to achieve those goals. In this section you should disclose the fund's benchmark (including ticker symbol and/or ISIN). Types of investment objectives include long-term capital growth, stable income, high total return, etc. Mutual funds cannot change these objectives after the prospectus is submitted.

3.4.3 Investment Strategies

This part of the prospectus explains the way in which a fund plans to allocate and manage its resources to achieve its investment objectives. Aspects considered when designing such a strategy include setting goals for net asset value, determining asset allocation, investment restrictions (such as only investing or avoiding certain industries) and deciding whether leverage, short selling, and derivatives may be used. When leverage, short selling, and or derivatives will be employed in the fund, then explicit limits should be in place. An example

²You are free to choose the format and font size. But you must state the name of the fund at the top of the first page and use the order of the all sections given below:

of such limit could be a maximum of 50% of leveraging in the fund (in other words, a ratio of assets under management over net worth below 1.5).

3.4.4 Risks of Investing in the Fund

Because investors have varying degrees of risk tolerance, the risk section of a prospectus is very important. It details the risks associated with a particular fund, such as credit risk, interest rate risk, market risk, etc.

3.4.5 Fees and Expenses

Here you should inform your investors about how your group will be compensated. In reality, there are dozens of different types of fees charged by funds. For simplicity we will consider the three most common ones: management, performance, and front-load fees. To keep prospectuses as comparable as possible with each other, you should make sure to express the fees in the following units:

1. Management fees: these should be expressed in % of fund NAV **for the entire eight week period**.
2. Performance fees: these should be expressed in % of excess fund returns over the benchmark (defined in the first section of the prospectus). Performance fees will be accounted at the end of the eight week period.
3. Front-Load fees: these should be expressed in % of initial NAV of the fund.

3.4.6 Fund Management

A short description of the fund's managers. This should include information about the manager's relative expertise and different roles in the fund management.

3.5 Regulation

1. Students are not allowed to invest in their own funds, as discussed in the "Financial Advisor Project" rules.
2. Students are not allowed to switch teams after the beginning of the game.
3. Funds are only allowed to undertake the following activities when explicitly stated in the fund prospectus (see item Investment Strategies above):
 - Lever up investments (or borrow against the value of its assets);
 - Short selling; and
 - Use derivatives such as options, futures, forward contracts;

3.6 Evaluation

There are two components to the final project grade:

1. Total fees collected by the fund at the end of eight weeks: 60%. The procedure is the following: funds will be ranked based on the amount of collected fees. The top third of the groups earns 100 points. The second third earns 85 points. The bottom third earns 80 points.
2. Second presentation: 40%. To earn the full 100 points, groups should practice a few times before hand, present relevant and insightful information, and be well prepared to answer questions from investors (and me).

Note that the prospectus and first presentation are not evaluated directly. They are in fact evaluated indirectly through the amount of funds raised by your group.

Suggested Readings

- [1] Elements of an investment policy statement for individual investors. *CFA Institute*.
- [2] Elements of an investment policy statement for institutional investors. *CFA Institute*.
- [3] Barras, L., O. Scaillet, and R. Wermers (2010, February). False discoveries in mutual fund performance: Measuring luck in estimated alphas. *The Journal of Finance* 55(4), 179–216.
- [4] Byrnes, N. (2010, dec). Are you a stock or a bond? *Reuters Money*.
- [5] Cassidy, J. (2007, July). Hedge clipping. *The New Yorker*.
- [6] Dybvig, P. H. (1988). Inefficient dynamic portfolio strategies or how to throw away a million dollars in the stock market. *The Review of Financial Studies* 1(1), 67–88.
- [7] Estrada, J. (2008). Black swans and market timing: how not to generate alpha. *Journal of Investing* 17(3).
- [8] Fuller, R. J. (1998). Behavioral finance and the sources of alpha. *Journal of Pension Plan Investing* 2(3), 291–293.
- [9] Ibbotson, R. G. (2010). The importance of asset allocation. *Journal of Financial Analysts* 66(2), 18–20.
- [10] Ibbotson, R. G. and P. D. Kaplan (2000). Does asset allocation policy explain 40, 90, or 100 percent of performance? *Financial Analysts Journal* 56(1), 26–33.
- [11] Jorion, P. (2003). The Long-Term risks of global stock markets. *Financial Management* 32(4), 5–26.
- [12] Khandani, A. and A. W. Lo (2007, November). What happened to the quants in august 2007? *SSRN eLibrary*.
- [13] Lee, C. M. C. and B. Swaminathan (1999, October). Valuing the dow: A Bottom-Up approach. *Financial Analysts Journal*, 4–23.
- [14] Leinwebber, D. (2007, February). Algo vs. algo. *Institutional Investor's Alpha*, 45–51.
- [15] Leland, H. E. (1996, December). Options and expectations. *Journal of Portfolio Management*.
- [16] Litterman, R. (1996, December). Hot spots and hedges. *Journal of Portfolio Management*, 52–75.
- [17] Lo, A. W. and P. N. Patel (2008). 130/30: The new Long-Only. *The Journal of Portfolio Management* (Winter), 186–211.

- [18] Maginn, J. L., D. L. Tuttle, D. W. McLeavey, and J. E. Pinto (Eds.) (2007, March). *Managing Investment Portfolios: A Dynamic Process* (3 ed.). Wiley.
- [19] Malkiel, B. G. (2011, January). *A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing*. W. W. Norton & Company.
- [20] Sharpe, W. (1994). The sharpe ratio. *Journal of Portfolio Management*, 49–58.
- [21] Sharpe, W. F. (1992). Asset allocation. *The Journal of Portfolio Management* 18(2).
- [22] Siegel, J. J. (2007, November). *Stocks for the Long Run: The Definitive Guide to Financial Market Returns & Long Term Investment Strategies, 4th Edition* (4 ed.). McGraw-Hill.
- [23] Stewart, S., C. Piros, and J. Heisler (2010, January). *Running Money: Professional Portfolio Management* (1 ed.). McGraw-Hill/Irwin.
- [24] Wermers, R. (2000). Mutual fund performance: An empirical decomposition into stock-picking talent, style, transactions costs, and expenses. *The Journal of Finance* 55(4).

Semester Schedule for FIN 377.1, Spring 2013
(subject to adjustments)

Meeting Date	Topic	Readings*	Assignments*
Part 1: Portfolio Construction			
1	Jan 15	Overview	
2	Jan 17	Asset Allocation and Investment Policy	Ch.2 (pp.33-55), [10], [9], [4]
3	Jan 22	Review of Risk and Return Risk and Diversification	Ch.1 (pp.3-26), App.1A Ch.7 (pp.181-197)
			Q2.1, Q2.6, Q2.9, P2.5
			Q1.11, P1.5
			Q7.3, Q7.6, P7.5 P7.6, P7.7
4	Jan 24	Mean Variance Optimization	Ch.7 (pp.198-201) [16]
			Q7.11, Q7.12, Q7.13, Q7.14 P7.6, P7.7
5	Jan 29	Security Valuation part A	Ch.11 (pp.327-347)
			Q11.4, Q11.5, P11.1
6	Jan 31	Security Valuation part B	Ch.11 (pp.347-360)
			Q11.13, P11.9, P11.14, P11.15
7	Feb 5	Review of Asset Pricing Models	Ch.8 (pp. 207-225, 232-234) Ch.9 (pp. 241-245, 250-261)
			Q8.2, P8.5, P8.7, P8.8, Q9.5, P9.2, P9.6, P9.7
8	Feb 7	Case Discussion	
			Harbor Capital Case**
9	Feb 12	Review of Fixed-Income Theory part A	Ch.18 (pp.623-632, 633-650)
			Q18.1, Q18.5, Q18.6, P18.2, P18.10
10	Feb 14	Review of Fixed-Income Theory part B	Ch.18 (pp.623-632, 633-650)
			Q18.1, Q18.5, Q18.6, P18.2, P18.10
11	Feb 19	Group Presentations	
12	Feb 21	Group Presentations	
13	Feb 26	First Exam	

*Chapters are from Reilly & Brown, 10th edition, unless otherwise stated. Numerical reference indicates article in "Suggested Readings" list.

**Hand-in assignment

Semester Schedule for FIN 377.1, Spring 2013 (cont'd.)
(subject to adjustments)

Meeting Date	Topic	Readings*	Assignments*	
Part 2: Portfolio Management				
14	Feb 28	Alphas or Betas?	Ch.6 (pp.147-177) [8]	Q6.20, Q6.24, P6.1, P6.2, P6.3
15	Mar 5	Traditional Asset Management	Ch.24 (pp.911-929, 946-950)	Q24.1, Q24.2, Q24.3
16	Mar 7	Equity Portfolio Mgmt Strategies part A	Ch.16 (pp.549-572) [17] [7]	Q16.1, Q16.2, Q16.5, Q16.8, P16.4
17	Mar 19	Equity Portfolio Mgmt Strategies part B	Ch.16 (pp.573-583)	Q16.9, Q16.10, Q16.11, P16.7, P16.8
		Case Discussion		Maverick Capital Case**
18	Mar 21	Fixed-Income Portfolio Mgmt Strategies part A	Ch.19 (pp. 691-697, 713-724), App.19	Q19.1, Q19.8, P19.7
19	Mar 26	Fixed-Income Portfolio Mgmt Strategies part B	Ch.19 (pp. 697-729)	P19.1, P19.2, P19.3, P19.4, P19.5
		Case Discussion		Greydanus Case**
20	Mar 28	Guest Speaker (tentative date)		
21	Apr 2	Second Exam		

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**Hand-in assignment

Semester Schedule for FIN 377.1, Spring 2013 (cont'd.)
(subject to adjustments)

Meeting Date	Topic	Readings*	Assignments*	
Part 3: Advanced Topics				
22	Apr 4	Use of Derivatives in Portfolio Mgmt part A	Ch.20 (pp.767-773), Ch.22 (pp.850-861) [15]	P20.1, P20.2, P20.3, P20.7a, P22.10, P22.11
23	Apr 9	Use of Derivatives in Portfolio Mgmt part B	Ch.23 (pp. 868-875, 885-890, 892-894) [6] [16]	Q23.7, Q23.9, P23.6, P23.9
24	Apr 11	Performance Measurement part A	Ch.25 (pp.959-978) [3]	Q25.3, P25.1, P25.2, P25.3
25	Apr 16	Performance Measurement part B	Ch.25 (pp.980-993)[24]	Q25.4, Q25.5, Q25.7, Q25.8, P25.4, P25.6, P25.7, P25.8
26	Apr 18	Alternative Investments	Ch.24 (pp. 929-945)	Q24.8, P24.4, P24.6
27	Apr 23	Case Discussion		Yale Case**
28	Apr 25	Group Presentations		
29	Apr 30	Group Presentations		
30	May 2	Third Exam		

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**Hand-in assignment

Financial Advisor Project Timeline
(subject to adjustments)

Date	Event
Jan 22	Clients are assigned to financial advisors (the assignment will be posed on Blackboard)
Jan 22 – Feb 15	Financial advisors should prepare an investment policy statement (IPS) for client
Feb 19	Attend and evaluate mutual fund presentations
Feb 21	Attend and evaluate mutual fund presentations
Feb 22	Financial advisors submit Financial Advisor Report (e-mail to Chao: cbian@utexas.edu)

Mutual Fund Management Project Timeline
(subject to adjustments)

Date	Event
Jan 17	Number of students per group announced in lecture
Jan 22	Send group names to Chao: cbian@utexas.edu
Jan 22 – Feb 15	Groups should define fund name, prepare a fund prospectus, and presentation slides Details about creation of Stock Trak accounts announced.
Feb 15	All groups submit electronically their first presentation slides and fund prospectus. (e-mail to Chao: cbian@utexas.edu)
Feb 19	First half of the groups (randomly selected before presentation) present their material
Feb 21	Second half of the groups present
Feb 25	Amount of points raised from “financial advisors” is announced (posed on Blackboard).
Feb 25 – Apr 19	Groups manage their funds with the Stock Trak platform.
Apr 23	All groups submit electronically their second presentation slides. (e-mail to Chao: cbian@utexas.edu)
Apr 24	First half of groups (randomly selected again–new draw) presents results to their clients and discuss strategies and lessons learned.
Apr 26	Remainder of groups presents results.