DEPARTMENT OF FINANCE
MCCOMBS SCHOOL OF BUSINESS
UNIVERSITY OF TEXAS AT AUSTIN

Finance 367 : Investment Management

Spring 2005

Monday & Wednesday 2:00-3:30, UTC 4.122, unique #02595
Monday & Wednesday 3:30-5:00, UTC 4.122, unique #02600

Professor: Paul Tetlock
CBA 6.258, 471-1509, tetlock@mail.utexas.edu
Office Hours: Mondays 5:00-6:30 and by appointment

Teaching Assistants:

Shirley Birman
CBA 5.324D, 471-1674
shirley.birman@phd.mccombs.utexas.edu
Office Hours: Fridays 1:30-3:00 and appt.

Jie Cao
CBA 5.324D, 471-1674
jie.cao@phd.mccombs.utexas.edu
Office Hours: Weds. 5:30-7:00 and appt.

Course Description

Finance 367 is an introductory investment course. The course is intended for students who want to become investment professionals, knowledgeable individual investors, or both. The course covers the primary financial securities–bonds, stocks, and derivatives–and methods for combining these underlying assets into a portfolio. Students will have an opportunity to apply the concepts learned in class through a group portfolio project.

First, we will cover the overall layout of U.S. financial markets and the financial instruments available in these markets. After this quick overview (two classes), we will study fixed income securities (bonds). Because bonds pay a fixed amount of interest on a set schedule to investors, the valuation and pricing of bonds is primarily an application of the time value of money concept. This concept should be familiar to students satisfying the central prerequisite to this course (FIN 357). The first test ***(Wednesday, February 16)*** will cover both the general overview material and the bond material, with heavy emphasis on the bond pricing and bond risk measures developed in class and through homework problems and readings.

Following our work on fixed income securities, we will study equity securities (stocks). Because stocks represent an ownership stake in a company, the cash flows to stockholders are generally more variable than the cash flows to bondholders. The course will cover various valuation methods for stocks, focusing on dividend growth models but also discussing other valuation techniques. Next, we will study portfolio theory, which tells us how to measure investment risk and how risk can be mitigated by combining

financial assets into a portfolio. The second test ***(Wednesday, March 30)*** will cover the material on stocks and the material on portfolio theory (everything after the first test).

After the second test, we will discuss derivative securities (options and futures) and investment mechanics. The options material will include both an analysis of the uses of options to construct various payoff schemes and the valuation of options with the Black-Scholes model. Finally, the course will conclude with the topic of investment mechanics. We will learn how the financial securities studied in this course are traded in real markets and how to judge investment performance. The final exam will be cumulative, testing students' knowledge on all of the material covered in the course.

Course Requirements and Grading

Grades will be based on the student's performance on two in-class tests, one final exam, the portfolio project (group project), and class participation. Each graded component will be curved such that roughly 20% of students receive grades below a "B", 40% receive "B"s, and 40% receive "A"s. The exact curve for each component will depend on the level and shape of the score distribution. The weights on each component of the overall course grade are as follows:

First Test	Wednesday, February 16	20%
Second Test	Wednesday, March 30	25%
Final Exam	TBA *(To Be Announced)*	35%
Portfolio Project	ongoing	15%
Class Participation	ongoing	5%

There will be no subjective curves applied to the weighted average of the component grades. In other words, your overall course grade is determined mechanically by the above weightings and the curved component grades.

Make-up exams are generally not possible. There will certainly not be make-up versions of either the first or second test. If you miss either the first test or the second test for a *pre*-approved reason, then the percentage of the missed test will be added to your final. For example, if you miss the first test for a *pre*-approved reason, your final exam will count 55% (35% + 20%). Likewise, if you miss the second test for a *pre*-approved reason, your final exam will count 60% (35% + 25%). Do not miss the final.

What is a valid pre-approved reason for missing a test?
If you develop a schedule conflict with the first test, then I must approve your reason for missing the first test no later than Wednesday, February 9. If you develop a schedule conflict with the second test, then I must approve your reason for missing the second test no later than Wednesday, March 23.

If you fail to show up for either test without telling me beforehand, then you must present a doctor's note stating that you were too sick to take the test. Other personal reasons may be considered valid at my discretion. If you miss either test without a valid reason, then you will receive a zero on the missed test. Again, do not miss the final.

Your class participation grade will be determined in large part by your attentiveness in class, your willingness to answer questions when they are directed to you, and your willingness to speak up when questions are directed to the class as a whole. To improve your participation grade, you may wish to read publications such as the *Wall Street Journal* regularly. If you point out to me an *interesting recent article with direct relevance* to the course, then your participation grade will increase.

There is no opportunity in this course to do "extra-credit" work. Your grade will be determined solely by the components listed above.

Problems from the text will be assigned and occasionally discussed in class, but will not be graded. The problems assigned will be particularly useful as study guides for the examinations. A solutions manual accompanying the text, containing solutions to the problems in the text, is available for purchase at the Co-op bookstore. There may be errors in the solutions manual; I will try to alert you to the errors as I find them. If you suspect there is an error in the solutions manual, please bring it to my attention.

Course Materials

Both course textbooks are available at the Co-op. The required text for the course is:

Essentials of Investments, Bodie, Kane, and Marcus, 5th ed., 2004, McGraw-Hill.

A recommended, but not required, book for the course is the solutions manual entitled:

Solutions Manual for Use with Essentials of Investments, Bodie, Kane, Marcus.

Reading assignments will include textbook chapters and a series of short, online articles (see the schedule below). All required readings should be completed prior to the class meeting for which they are assigned. The official course web site, available through the UT Blackboard system, will serve as a mechanism for distributing the assigned online articles and other course materials:

https://courses.utexas.edu/webapps/login

Optional, supplementary materials will be posted on Professor Tetlock's home page:

http://www.mccombs.utexas.edu/faculty/paul.tetlock/

Finally, students will need a financial calculator capable of calculating present values, solving for yields, and performing other basic time value calculations. Time value tables will not be distributed with the tests in this class. Students bear the responsibility for learning to operate their calculators proficiently. Programmable calculators must be cleared before each test; and there is no sharing of calculators during the test.

Portfolio Project

For the portfolio project, student teams of five members will invest a fictitious $100,000 in five stocks and five bonds, with $10,000 invested in each of the 10 financial assets chosen. I will put together the teams with some input from students. The deliverables for the portfolio project are as follows:

1) Wednesday, February 9. Submit team portfolio selections. The portfolio selection memo will contain the team's picks – five stocks and five bonds – and a short explanation (one to two paragraphs) of each of the ten picks justifying why the team expects the stock or bond will perform well over the next two months. The portfolio selection memo will be no longer than ten pages. (5 points for selection memo)

2) Every Other Wednesday, starting on February 23. Submit three-page memo describing:
   - Portfolio performance over the past two weeks (percentage and dollar gain or loss for the two weeks and since inception); *(An Excel spreadsheet for calculating and presenting the results will be available online for copying and adapting to your own portfolio.)*
   - Explanation of the results (what was the cause of the portfolio's performance?);
   - Evaluation of last memo's expectations (performance occurred as expected, or, performance deviated from expectations and why);
   - Expectations for the upcoming two weeks. (5 points total for memos)

3) May 2. Make a presentation to the class explaining portfolio performance over the semester. The presentation will replicate a professional presentation with team members using PowerPoint slides. (5 points for presentation)

4) May 2 (the presentation date). Each student will submit a one-page memo to me grading their fellow team members on a scale of 1 to 5 (5 = excellent team member, exceeded required duties, pleasure to work with, had great ideas, etc.; 1 = provided no help, difficult to work with, contributed no ideas or analysis, didn't show up to meetings, etc.), with a brief explanation of any score of 1 or 2. (0 points for feedback)

General and Miscellaneous Policies

- Although attendance will not be taken, you are responsible for everything covered or assigned in class. The lectures may depart significantly from the material assigned and it is important that you review the assigned readings *prior* to the class session.

- The use of laptop computers is permitted during lectures solely for the purposes of taking notes and obtaining course materials. E-mail and the Internet may not be accessed during lectures except to visit the course web sites listed in the syllabus.

- During lectures, you should always be prepared to answer questions. I will address questions to individuals and to the class as a whole at my discretion.

- Academic dishonesty will not be tolerated. Your responsibilities with regard to scholastic dishonesty are described in detail in the Policy Statement on Scholastic Dishonesty for the McCombs School of Business. In particular, it is expected that the work on your examinations will be entirely your own and that you will provide a level and quality of work on your group projects commensurate with your colleagues. Failure in these regards may result in failure on the examination, projects, or course.

- 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 at 471-6259.

Course Schedule

MTG	DAY	DATE	TOPIC	CHAPTER
1	Weds	19-Jan	INTRODUCTION - Schedule, Grading, Portfolio Project, Class Policies	
2	Mon	24-Jan	OVERVIEW - Financial Instruments and Players *Hand out group assignments for portfolio project*	1
3	Weds	26-Jan	OVERVIEW - Financial Markets and Instruments	2
			BONDS	
4	Mon	31-Jan	BONDS - Institutional Details and Definitions	9
5	Weds	2-Feb	BONDS - Yield and Pricing Calculations	9
6	Mon	7-Feb	BONDS - Yield Curve and Credit Spreads	9
7	Weds	9-Feb	BONDS - Interest Rate Risk: Duration and Convexity **Portfolio Selection Memo DUE**	10
8	Mon	14-Feb	BONDS - OC and LTCM Cases Discuss Articles as Time Permits	Online Article(s)
9	Weds	16-Feb	***TEST 1 : BONDS + Overview material***	
			STOCKS	
10	**Mon**	**21-Feb**	STOCKS - Definitions and Valuation Models	12
11	Weds	23-Feb	STOCKS - Valuation Models (DCF) **Portfolio Memo Due**	12
12	Mon	28-Feb	STOCKS - More Valuation Methods	11, 13, 19
			PORTFOLIO THEORY	
13	Weds	2-Mar	RISK AND RETURN - Expected Return and Variance; $E(R_p)$, Asset Allocation	5
14	Mon	7-Mar	DIVERSIFICATION - Portfolio E(R) and Variance Math (Stats)	6
15	Weds	9-Mar	DIVERSFICATION - Optimal Risky Portfolios **Portfolio Memo Due**	6
	Mon	14-Mar	*Spring Break – No Class*	
	Weds	16-Mar	*Spring Break – No Class*	

MTG	DAY	DATE	TOPIC	CHAPTER
16	Mon	21-Mar	CAPM and APT - Theory and Evidence	7
17	Weds	23-Mar	EMH - Efficient Markets Hypothesis: Theory and Evidence **Portfolio Memo Due**	8
18	Mon	28-Mar	EMH - The Possibility of Market Inefficiency: Arbitrage Strategies	Online Article(s)
19	Weds	30-Mar	***TEST 2 : STOCKS and PORTFOLIO THEORY***	
			OPTIONS and FUTURES	
20	Mon	4-Apr	OPTIONS - Instruments, Markets, Definitions, and Payoffs	14
21	Weds	6-Apr	OPTIONS - Valuation: Black-Scholes **Portfolio Memo Due**	15
22	Mon	11-Apr	FUTURES - Markets and Instruments	16
23	Weds	13-Apr	HEDGING - Risk Management and Arbitrage	Online Article(s)
			INVESTMENT MECHANICS	
24	Mon	18-Apr	MECHANICS - Market Microstructure: How Securities Are Traded	3
25	Weds	20-Apr	MECHANICS - Informed Trading: Theory and Evidence **Portfolio Memo Due**	Online Article(s)
26	Mon	25-Apr	PERFORMANCE - Investment Manager Performance Evaluation	20
27	Weds	27-Apr	PERFORMANCE - Investment Manager Performance Evaluation	Online Article(s)
28	Mon	2-May	**Portfolio Project Team Presentations**	
29	Weds	4-May	*Last Day of Class* **Course Wrap-Up & Course Evaluations**	
30	TBA	TBA	**FINAL EXAM : EVERYTHING** **Date, Time, and Room Will Be Announced**	**All of the Above**