

Hong Kong University of Science & Technology

Investment Analysis and Portfolio Management (FINA 221 L1A&B)

Fall 2007

Instructor: Prof. Nengjiu Ju
Office: Room 2379
Phone: 2358-8318
Email: nengjiu@ust.hk
Office hours: Tuesday & Thursday 1:30 – 2:50 or by appointment

Lectures: Tuesday & Thursday
L1A: 9:00 – 10:20, L1B: 10:30 – 11:50, Room 4505

Tutorials: Friday L1A: 12:00 – 12:50, L1B: 13:00 – 13:50, Room 2304
Course Website: <http://webct.ust.hk/>

Demonstrator: Ms. Stella Lien
Office: Room 3392
Phone: 2358-7674
E-mail: fnstella@ust.hk
Office hours: Wed 14:00 – 15:00, Room 3392

COURSE DESCRIPTION

This course is designed to provide a comprehensive introduction to investment theory and practice. This course will help you: 1) become familiar with a wide variety of financial securities found in equity, fixed-income and derivatives markets; 2) understand the theoretical basis for, and practical implementation of, widely-used asset pricing theories; 3) appreciate the fundamentals of portfolio management; and 4) develop important skills needed to succeed as an investment professional.

During the course we will come across some of the most important and influential concepts of finance theory: the Markowitz Portfolio Selection Model, Bill Sharpe's Capital Asset Pricing Model (CAPM), Steve Ross' Arbitrage Pricing Theory (APT), and the famous Black & Scholes option pricing formula.

PREREQUISITES

The prerequisite for this course is FINA 111. Some of the material that we will cover is quite technical. It is therefore advisable to review basic mathematical and statistical concepts such as: probability distribution, mean (average), variance, covariance and basic linear algebra concepts such as: vectors, matrices and their manipulations and basic finance concepts such as: present value, interest calculations, at the beginning of the

course. It is also of extraordinary importance that you familiarize yourself with the spreadsheet program Microsoft EXCEL. If you have never used EXCEL, I strongly recommend that you go through the self-guided EXCEL tutorial from the textbook: Excel Applications for Investments by Troy A. Adair, Jr., McGraw Hill Irwin International. One copy of the text is on reserve at the library.

REQUIRED READING MATERIALS

Textbook: Z. Bodie, A. Kane and A.J. Marcus, Investments (7th edition), McGraw Hill Irwin. The official web site for this textbook contains additional background materials, recent investment news, and on-line practice quizzes.

GRADING

Your final grade will be based on homework assignments and two exams. The relative weightings are as follows.

Homework assignments	20%
Midterm exam	40%
Final exam	40%

Note: the final exam is inclusive, meaning that it includes materials before the midterm. However, the focus will be on the materials after the midterm.

HOMEWORK AND TUTORIALS

All homework assignments should be written in an easily readable fashion. Therefore, I encourage you to type the assignment. If your handwriting is difficult to decipher you may lose 5-10% of homework grade, depending on the severity of the problem.

Homework assignments have to be submitted before class on the due dates to Ms. Lien in order to receive full credit. For each day late you will incur a penalty of 20% of the maximum grade of the assignment.

Homework assignments will be returned during the next tutorial session. During the tutorials you will have the opportunity to ask questions and discuss any problems with Ms. Lien. The tutorial sessions are mandatory.

EXAMS

There are two comprehensive exams, a midterm and a cumulative final, which will mostly consist of numerical problems, NOT multiple choice problems.

Absence from the exams will not be excused except for serious medical illness. A doctor's letter must be provided within one week of the exam.

Cheating will not be tolerated. Any student caught cheating during the exams will receive zero credit and may face further disciplinary action.

MID-TERM MAKEUP

There will be **NO** makeup for midterm, even for legitimate absence. Instead, the final will count for 80%, rather than 50%. I strongly encourage you to take the midterm by any means. If you miss it, you only have one shot (the final exam).

CLASS PARTICIPATION

Active class participation is important for your learning experience and highly encouraged. It helps you to think actively rather than passively. Your class participation also provides me with feedback to gauge whether you understand the material. Often students ask me to write a letter of reference on their behalf. Please keep in mind that if you have never participated in class, I will not be able to write a letter for you.

IMPORTANT DATES

Reuters Demonstration and Trading Lab during class time (Sept 11)

-Venue: Financial Trading Lab (room 4117)

Tutorials

-Tutorial schedule will be posted on WebCT.

-The first tutorial will be on Sept. 7.

Homework Assignments

-First Homework Assignment Due (Tuesday before class, Sept 25)

-Second Homework Assignment Due (Thursday before class, Oct. 25)

-Third Homework Assignment Due (Tuesday before class, Nov. 20)

-Fourth Homework Assignment Due (Tuesday before class, Nov. 27)

-Fifth Homework Assignment Due (Monday before 2:00pm, Dec. 10)

Exams

-Midterm: Oct. 30, in classroom

-Final: time and room to be announced

COURSE OUTLINE AND READING ASSIGNMENTS

Topic 1: Financial Markets and Instruments (Sept. 4, 6)

- Real and financial assets
- Overview of financial markets
- Financial instruments
- Market participants and their objectives
- Financial markets in Hong Kong

Readings: Chapters 1 and 2

Note: Reuters Demonstration and Trading Lab is on Sept. 11 during class time, BUT not in classroom.

Topic 2: Securities Trading (Sept. 13, 18)

- Arbitrage and equilibrium
- Securities markets (centralized exchanges, OTC markets)
- Financial market indices
- Market makers
- Trading costs
- Types of orders
- Margin trading and short sale
- Mutual fund
- Securities trading and investing in Hong Kong

Readings: Chapter 3, 4

Problem Solving of Chapters 1-4 (Sept. 20)

First Homework Assignment Due (Tuesday before class, Sept 25)

Topics 3: Risk and Returns (Sept. 25, 27)

- Arithmetic and geometric mean returns
- Expected return and variance
- Risk and returns from historical perspectives
- Risk premium
- Expected utility and risk aversion
- Mean-variance approach

Readings: Chapters 5, 6

Topic 4: Asset Allocation and Diversification (Oct. 2, 4)

- Portfolio mathematics
- Asset allocation between a risky and a risk-free assets
- Asset allocation between two risky portfolios
- Optimal risky portfolio of many risky assets
- Markowitz portfolio selection model in the real world
- Efficient frontier
- Separation property
- Mutual fund theorems

Readings: Chapters 7, 8

Topic 5: Capital Asset Pricing Model (Oct. 9, 11)

- Underlying assumptions of CAPM
- Implications of CAPM
- Security market line

- Applications of CAPM

Readings: Chapter 9

Topic 6: Factor Models and Arbitrage Pricing Theory (Oct. 16, 18)

- Single index models
- Multifactor models

Readings: Chapters 10, 11

Problem Solving of Chapters 5-11 (Oct. 23)

Left-over materials, reviews, examples, Q&A before Midterm (Oct 25)

Second Homework Assignment Due (Thursday before class, Oct. 25)

Midterm Exam: Oct. 30, in classroom

Note that: (1) You HAVE to take the midterm for your registered session. (2) You will NOT be allowed to take the exam if you arrive late.

Topic 7: Fixed Income Securities and Term Structure of Interest Rates (Nov. 1, Nov 6)

- Bond characteristics
- Government and corporate bonds
- Default risk
- Bond pricing
- Bond yields
- Yield curve
- Forward rates
- Expectation hypothesis
- Liquidity preference
- Interpretation of the term structure of interest rates

Readings: Chapters 14, 15

Topic 8: Bond Portfolio Management (Nov. 8)

- Interest rate sensitivities of bond prices
- Interest rate risk
- Bond duration
- Immunization techniques

Readings: Chapters 16

Problem Solving of Chapters 14-16 (Nov. 13)

Third Homework Assignment Due (Tuesday before class, Nov. 20)

Topic 9: Securities Analysis (Nov. 15)

- Macroeconomic and industry analysis
- Dividend discount models
- Price-earnings ratio
- Inflation and stock valuation
- Financial statement analysis

Readings: Chapters 17, 18

Problem Solving of Chapters 17-18 (Nov. 20)

Fourth Homework Assignment Due (Tuesday before class, Nov. 27)

Topic 10: Efficient Market Hypothesis (Nov. 22)

- Random walk
- Different forms of EMH
- Implications of EMH
- Small firm effect, January effect, and other market anomalies

Readings: Chapter 12

Topic 11: Portfolio Performance Evaluation (Nov. 27)

- Risk adjusted returns
- Performance measures

Readings: Chapter 12

Topic 12: Futures and Options (Nov. 29, Dec. 4, 6)

- Futures market
- Futures trading strategies
- Determination of futures price
- The importance of options
- Option trading strategies
- Put-call parity
- Black and Scholes option pricing formula

Readings: Chapters 20, 21, 22

Fifth Homework Assignment Due (Monday before 2:00pm, Dec. 10)

Final Exam (time and room to be announced)