

HKUST
FINA 527: Fundamentals of Investment I
Spring 2004

GENERAL INFORMATION

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Class Hours: Saturdays, February 7 – March 27, 9:00 AM-12:20 PM, Room 4333

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COURSE DESCRIPTION

This is the first half of an investments course where we will build an analytic framework for making investment decisions, with an emphasis on equities. The second half of the investments course (FINA 528) will emphasize fixed income securities.

We will cover some aspects of equity valuation, such as Dividend Discount and Cash Flow models. We will also discuss portfolio optimization and the Capital Asset Pricing Model (CAPM), which are used in allocating investment capital. The last part of the course will deal with derivative securities, with an application to equity derivatives.

A portion of the course will be devoted to practical issues in equity and portfolio analysis, relying on interactive cases and class discussion.

This course is *not* intended as a CFA review course. However, the FINA 527 and 528 sequence will cover substantially the same material as that covered in the CFA Level I Asset Valuation study sessions 12 through 18. The material will be covered in a different order, and with different degree of emphasis and depth. After having successfully completed the FINA 527 and FINA 528 sequence, students should be able to prepare for the Asset Valuation portion of the CFA exam with a small amount of independent review.

PREREQUISITES

The prerequisites for this course are elementary economics, statistics and FINA 511 or equivalent. We will not spend a lot of time on a review of elementary statistics, which are fundamental to fully benefiting from the material in this course.

READING MATERIAL

Textbook: The main textbook will be *Frank Reilly and Keith Brown, Investment Analysis and Portfolio Management (Seventh Edition), Dryden*. We will also rely on *Robert W. Kolb, Futures, Options, and Swaps (Third Edition), Blackwell*.

Supplementary readings: We will be assigning additional supplementary readings for some lectures. These will be available a few days before each lecture so students can prepare.

Cases: This course will have three case sessions. In these case sessions, students will read and prepare a case that will be presented and discussed in class. Class preparation for the case sessions is discussed below. The cases will be available a few days prior to the case session for the students to prepare.

Beta Management Co.

A manager of a small investment company has been successfully using index funds for limited market timing. Growth has allowed her to move into picking stocks. She is considering two small and highly variable listed stocks, but is concerned about the risk that these investments might add to her "portfolio." Provides a lead-in to the CAPM. Students learn about total risk, non-diversifiable or portfolio risk, and (CAPM) beta, and calculate variability of the stocks separately, and portfolio variance with and without the stocks, to see how an extremely risky (but low-beta) stock actually reduces risk and calculate stock betas.

Netscape's Initial Public Offering

In August 1995, Netscape's board of directors was confronted with a decision about what price to offer the company's shares in its initial public offering (IPO). Preliminary demand for shares was high, but the company had not generated any positive earnings at the time of the offering.

Keller Fund's Option Investment Strategies

A closed-end mutual fund's decision to study option trading provides an opportunity to study the profit profile and pricing of multiple option investment strategies (e.g., buy a call, buy a put, write a call, buy stock-write call, etc.). This case is designed to provide students with an introduction to option pricing.

ASSESSMENT

The grading breakdown will consist of approximately the following:

Case Writeups: 30%

Case Presentations: 15%

Class Attendance: 5%

Class Participation: 10%

Final Exam: 40%

Homeworks: I will occasionally assign homework from the textbook. These are not graded, and are completely optional. They are exclusively for you to review and solidify the topics covered in class. I will provide you with a solution booklet for the assigned questions.

Case Writeups

Each case provides factual details and organizational circumstances surrounding a particular managerial situation. The essence of case analysis is to examine the facts by applying the concepts discussed in the class in arriving at your recommendations. A significant portion of case analysis grade depends on the justification of your recommendations. The following steps can be very helpful in dealing with case studies in general:

1. Read the case through rather quickly for familiarity of facts and other details.
2. Read the case a second time to select salient facts, issues etc.
3. Study all the exhibits carefully—in Finance cases the real story most often is in numbers.
4. Determine the major and minor issues.
5. Analyze the issues using concepts and techniques discussed in your readings and in class.
6. Resolve conflicts regarding validity of data and assumptions.
7. Make and justify your recommendations

There will be two case analyses, for two of the cases listed above. In general, the following guidelines will apply to all case studies:

1. You may work individually or in groups of up to **5** people. If you choose to work in groups (which is recommended), you are responsible for selecting your team-mates. If necessary we may hold a “market” to allow people ease in joining a team. You may switch teams for each
2. For each case your group should submit a written report not to exceed **five double-spaced** typed pages using standard format. This limit excludes spreadsheets, tables, charts and graphs. All your analysis and discussion (included copies of spreadsheets and charts) should be included in your hardcopy submission.

3. It is helpful if you think of your team as a consulting firm and the case company as your client. The suggested questions (to be provided) are to get you started. However, like any consulting assignment, your report should be organized and structured as if you were actually presenting it to your client. Merely answering the questions is not adequate and, therefore, unacceptable.
4. Written case reports will be graded on 30% on presentation, organization, readability, grammar, and relevance; 30% on logic and justification underlying recommendations, and 40% on the numerical analysis.
5. Each member of the group will receive the grade earned for the report. While groups provide opportunity for team based learning, they also create significant potential for “free rider” problem. Therefore, it is important that you be careful in selecting your group members. You should share the workload equally among all team members. If you experience any free-rider problems in your team you should inform me as soon as possible. I will handle any complaints confidentially.
6. Since we discuss the case solutions in class, late reports cannot be accepted.

Case Presentations

As part of your case grade, each team will be asked to make a brief, timed presentation to the rest of the class on the case subject. Evaluation criteria will be timeliness (keeping within the allotted time), relevance, creativity, and quality of the delivered presentation. Each criterion will carry a 25% weight. In order to maximize your presentation grade, feel free to have the most skilled presenters make the presentation. All team members, whether they presented or not, will be evaluated with the same grade.

Class Attendance

You have to attend at least 75% of the classes (cannot miss more than 2 classes). To minimize the disruption to the rest of the class, you are expected to come on time. Your final grade could be adjusted downward for frequent late arrival (more than 15 minutes).

Class Participation

Class participation consists of your comments and questions during lectures and case discussions, as well as case presentations. Remember that the quality of your participation counts more than the quantity. Your participation will be evaluated after each class, and I reserve the right to call upon students without prior warning. The best way to prepare for class is to carry out the assignments and to come ready with your questions and knowledge and to interact with your classmates and myself in a discussion. Furthermore, you are expected to participate and contribute to the discussion in the class.

To make sure you receive credit for your class participation, you should display your name card at all times during class. At the beginning of each class, please collect the card with your name and put it in front of you. At the end of the class, please return it to me so that I can keep track of your attendance. There will be no seat assignments. However, after a couple of weeks, I hope that you will try to occupy the same seat every time. Late arrivals are very disruptive to the quality of the learning environment in the classroom. I discourage these strongly. Consistent late arrivals will affect your

participation grade negatively. Please also disable your mobile phone/pager during class time. I reserve the right to answer ringing phones in class. The person at the other end of the line will likely never talk to you again after I'm done, so let's turn phones off.

Feedback

At the end of every class, I will hand out a form asking you for direct feedback on the class that day. I would like to hear about the speed of the course, the clarity of the explanations, and how the class can be better. Please take a minute at the end of each class to fill out this form. It is totally optional and can be done anonymously.

Final Exam

There is only one exam, which is scheduled on the last day of class. A typical exam format would include a mixture of quantitative and qualitative problems and questions based on readings, lectures and assignments. Please do not ask to be excused from exams as students are rarely given the chance to make up missed exams. Exams will be marked on both the approach taken and the correctness of the response, so to obtain full credit, you need to show your work so that I can follow your reasoning. Absence from the exam will not be excused except for serious and extraordinary circumstances.

PRELIMINARY COURSE OUTLINE

Date	Topics	Readings	Cases	Remarks
Class 1	<ul style="list-style-type: none"> • Introduction and course outline • Introduction to equity valuation 	<ul style="list-style-type: none"> • Reilly & Brown (Ch. 11,13) 		Be prepared to come to class after having read the Reilly & Brown material.
Class 2	<ul style="list-style-type: none"> • Dividend Discount Models, Cash Flow Models 	<ul style="list-style-type: none"> • Reilly & Brown (Ch. 14, 15) 		
Class 3	<ul style="list-style-type: none"> • Equity valuation applications 	<ul style="list-style-type: none"> • Review Reilly & Brown (Ch. 11,13,14,15) 	<ul style="list-style-type: none"> • Netscape's Initial Public Offering 	Case questions will be assigned one week before. Be prepared to make a presentation and to turn in your case write-up-at the end of class.
Class 4	<ul style="list-style-type: none"> • Market efficiency • Portfolio optimization • The CAPM 	<ul style="list-style-type: none"> • Reilly & Brown (Ch. 4,5,6) 		
Class 5	<ul style="list-style-type: none"> • Simple practical implementation of the CAPM • Review of regression techniques 	<ul style="list-style-type: none"> • Reilly & Brown (Ch. 7,8) 	<ul style="list-style-type: none"> • Beta Management 	Case questions will be assigned one week before.
Class 6	<ul style="list-style-type: none"> • Introduction to futures, forwards, and options 	<ul style="list-style-type: none"> • Kolb (Ch. 1,2, 10) 		
Class 7	<ul style="list-style-type: none"> • Option strategies and applications • Review and Q&A (1 hour) 	<ul style="list-style-type: none"> • Kolb (Ch. 11) 	<ul style="list-style-type: none"> • Keller Fund's Option Investment Strategies 	Case questions will be assigned one week before. Be prepared to make a presentation and to turn in your case write-up-at the end of class.
Class 8	<ul style="list-style-type: none"> • Final Exam 			Exam will be closed book. Calculators will be allowed. I will provide formula sheet.