Course Readings
B40.312
W 6:00-9:00
INVESTMENT PHILOSOPHIES
Kerschner, E.

The class will offer perspectives on: 1) techniques for managing investments for mutual funds, institutional funds and not-for-profits, as well as 2) the current economic and market environment. Each session will have one or more guest speakers. Each class will begin with the speaker making a presentation, during which active class interaction is encouraged. Students will be expected to have read materials provided by speakers in advance as well as other relevant materials obtained on your own. Active class participation is encouraged. Since this is a new class, the format will likely evolve, with suggestions from students encouraged.

Speakers:
(Note: unforeseeable commitments could lead to a change in speakers)

March 31, 2004
Tom Luddy -- JP Morgan Chase

April 7, 2004
Jack Laporte -- T Rowe Price

April 14, 2004
Bill Miller -- Legg Mason

April 21, 2004
Linda Strumpf -- Ford Foundation

April 28, 2004
Kurt Wolfgruber -- Openheimer Funds

May 5, 2004
Richard Hoey -- Dreyfus Funds

In addition to the presentations by the six guest speakers, I will (time permitting) be addressing three “groupings” of subjects over the course of the six sessions.

- The first “grouping” is: Thematic Investing
- The second is: Inflation/Deflation, The Individual Investor and Manias
- The third is: Asset Allocation, Equity Valuation & Forecasting Earnings.

I will do my presentation after the guest speaker is complete. So, I am not sure exactly how much time—if any—I will have.

It is likely that this first grouping will be covered during the first two or three sessions, i.e., March 31, April 7 and maybe April 14.

The second grouping will be covered over the next two or three sessions: April 14 and April 21.

The third grouping will be covered over the remaining sessions.
March 31, April 7, 2004: Thematic Investing

Thematic Investing—Demographic Dynamics

Readings:
“Consumer Comeback” (Kerschner)
“The New Millennium American” (Kerschner)
“The American Age of Affluence” (Kerschner)

Thematic investing seeks to identify multi-year trends that will have significant investment implications. A key force that determines multi-year investment themes: demographics. We discuss why a “Consumer Comeback” got under way in 1995, how the attitudes of the “New Millennium American” have changed, and the factors that led to an “American Age of Affluence.”

Thematic Investing—Technological Trends

Readings:
“Converging Technologies” (Kerschner)
“Net for Naught” (Kerschner)
“The Information Revolution Wars” (Kerschner)

Continuing our discussion of thematic investing, we turn to technology. Technology, by definition, involves tremendous potential for growth. However, the sector is notoriously cyclical and, on top of that, there is always the threat of obsolescence. We discuss the boom and bust in Personal Computing stocks in the early 1980s, the “Information Revolution” of the 1990s.

Thematic Investing—The Death of a Theme

Readings:
“Branded” (Kerschner)
“Brand Breakdown” (Kerschner)
“Euro-Peak” (Kerschner)
“Drug stocks: a healthy opportunity” (Kerschner)
“Medical Megamorphosis” (Kerschner)

Themes that have been successful for several years can suddenly be adversely affected by a change in the economic or investment environment. What are some of the factors to watch for when determining whether a theme that has been successful for some time is at risk? We discuss these issues in the context of three thematics: (i) consumer branded goods (ii) “Euro-industrials”—U.S. industrial companies with a significant exposure to Europe (iii) Healthcare companies
April 14, April 21, April 28, 2004: Inflation/Deflation, The Individual Investor and Manias

Inflations: Inflation and Deflation

Readings:
“Inflated Fears” (Kerschner)
“Benign Deflation?” (Kerschner)

Nothing is more important to formulating a correct investment strategy than understanding whether the underlying economic trend is inflationary or deflationary. We define the terms and examine the underlying political / social / economic forces at work. We examine which asset classes perform best in inflationary and deflationary periods. We discuss why stocks are not an effective hedge against inflation?

The Individual Investor and the Stock and Bond Markets

Readings:
“The Big Shift” (Kerschner)
“The Ozzie and Harriet Market” (Kerschner)

What has motivated flows by the individual investor into the capital markets? We review the “Ozzie and Harriet” market of the 1950s, the avoidance of stocks by public investors in the 1980s, the “Big Shift” of the 1990s, and the behavior of individual investors in the 21st century.

Manias, Panics and Walls of Worry

Readings:
“New Economy: Yes, New Metrics: No” (Kerschner)
“New Metrics: Still Sliding” (Kerschner)
“How Much Is a Tulip Worth?” (Hirschy)
“Climbing the Wall of Worry—Again” (Kerschner)
“Still Climbing the Wall of Worry” (Kerschner)

In the long run capital markets are remarkably efficient. But in the short run, inefficiencies can develop, sometimes fueled by manias (which lead to excessive overvaluation). We review three prior manias: the mania for conglomerates in the 1960s, the LBO mania of the 1980s, and the Internet mania of the 1990s.

Anticipating and responding to financial panics is a necessary element of an investment strategy. We define the term, note and analyze the causes of panics, which include excessive speculation, ineffective regulation of financial markets and institutions, and underlying macroeconomic weaknesses. We discuss how bull markets typically climb a “Wall of Worry.”
April 21, April 28, May 5: Asset Allocation, Equity Valuation & Forecasting Earnings

**Asset Allocation Relationships—Theory and Practice**

Readings:
“Does Asset Allocation Matter Anymore?” (Kerschner)
“Advanced Theory and Methodology of Tactical Asset Allocation” (Lee)

What is asset allocation? Why does it matter? We will discuss the financial theory behind asset allocation, and review the factors that led to the adoption of an asset allocation framework by the investment community. Finally, we will discuss the challenges that face Asset Allocation practitioners today.

**Equity Valuation**

Readings:
“Equity Valuation—Explanation of the Model” (Kerschner);
“Valuation Multiples: A Primer” (UBS Warburg, November 2001)

How much should you pay for those stocks? We review the standard Dividend Discount Model, and how it can be used to calculate a “fair” P/E for the market as a whole. Given this “fair” P/E for the S&P 500, we then extend our analysis to calculate “fair” P/E multiples for individual stocks. What other “multiples” are applicable? How should they be used?

**Profits, the Economy and Stock Prices**

Readings:
“Does Anyone Ever Know What Time It Is?” (Kerschner)
“What is the S&P 500?” (Kerschner)

We now know the “fair” P/E for stocks and the stock market. But what’s the “E”? We discuss various measures of corporate profits and ask “What are S&P 500 EPS?” We analyze the behavior of profits relative to the economy, explaining why profits are more volatile than the economy.