



General Course Information

Instructor: F. Tapon
Email ftapon@uoguelph.ca
Office Location Room 738 MacKinnon
Office Hours Monday 3 – 5.30 pm
Tuesday 2.30 pm – 3.45pm
Wednesday 3 – 5.30 pm
Thursday 2.30 pm – 3.45pm
Department/School Department of Economics and Finance

TA's TBA
Email TBA
Office Location TBA
Office Hours TBA

Class Schedule: Tuesday, Thursday. 1:00-2:30pm

Course Content

“...there is a special paradox in the relationship between mathematics and investment attitudes on common stocks, which is this: Mathematics is ordinarily considered as producing precise and dependable results; but in the stock market the more elaborate and abstruse the mathematics the more uncertain and speculative are the conclusions we draw therefrom. In forty-two years of Wall Street experience and study I have never seen dependable calculations made about common stock values, or related investment policies that went beyond simple arithmetic or the most elementary algebra. Whenever calculus is brought in, or higher algebra, you could take it as a warning signal that the operator was trying to substitute theory for experience, and usually also to give speculation the deceptive guise of investment.”

Benjamin Graham. **The Intelligent Investor**, 4th revised edition, Harper Business, 1973, p.321.

“...Berkshire’s whole record has been achieved without paying one ounce of attention to the efficient market theory in its hard form. And not one ounce of attention to the descendants of that idea, which came out of academic economics and went into corporate finance and morphed into such obscenities as the capital asset pricing model, which we also pay no attention to. I think you’d have to believe in the tooth fairy to believe that you could easily outperform the market by seven-percentage points per annum just by investing in high volatility stocks.”

Charlie Munger, Vice Chairman and long-time partner of Warren Buffett at Berkshire Hathaway in the Herb Kay Undergraduate Lecture at the University of California Santa Barbara’s Economics Department, October 3, 2003. The lecture was entitled **“Academic Economics: Strengths and Faults after Considering Interdisciplinary Needs”**.

“To invest successfully, you need not understand beta, efficient markets, modern portfolio theory, option pricing or emerging markets. You may, in fact, be better off knowing nothing of these.

That, of course, is not the prevailing view at most business schools, whose finance curriculum tends to be dominated by such subjects. In our view, though, investment students need only two well-taught courses- How to Value a Business, and How to Think About Market Prices.

Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily-understandable business whose earnings are virtually certain to be materially higher five, ten and twenty years from now. Over time, you will find only a few companies that meet these standards- so when you see one that qualifies, you should buy a meaningful amount of the stock. If you aren't willing to own a stock for ten years, don't even think about owning for ten minutes. Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio's market value."

Warren Buffett. Berkshire Hathaway
Chairman's Letter- 1996, p.13.

"Most of what is taught about investing in school is theoretical nonsense. There are very few rich professors". Morgan Housel in "50 Unfortunate Truths about Investing", Motley Fool, November 14, 2012.

Course Outline

There is one textbook and one “must have read” book in this seminar. The textbook is *Investment Analysis and Portfolio Management 10th Edition* by Reilly and Brown. Since we are not going to use all the chapters in this book I have arranged with the publisher for you to buy an e-book only for the chapters that we will study (it’s cheaper). Here is the link to purchase our version of this text:

<http://www.nelsonbrain.com/shop/isbn/9780176684747>. The “must have read” book is *The Intelligent Investor* by Benjamin Graham with an introduction and Appendix by Warren Buffett (this is the book that changed Warren Buffett’s life).

Format: The class meets twice a week. Most of our class time will be devoted to discussing the chapters that I have assigned to you. Each class will be led by one of you and I will grade you on this presentation. I will lecture on the various topics as appropriate.

Grades: Presentations	50%
Presentation of company analysis	20%
Paper on company analysis	30%

Note: there are no exams in this course

All work in this course is individual. At the beginning of the semester I will assign to you a company that you will study over the course of the semester with increasing sophistication, as we get deeper in the subject of security analysis. You will also all invest in two ETFs: XIU and SPY, so that your portfolio will consist of one stock and two ETFs. You may track your portfolio’s performance on any site you wish. I use Globeinvestorgold.com and pay for the privilege but Globeinvestor.com is free so this or another site may be appropriate for you. Ask me what I think of your choice.

Week 1:

January 6 Introduction to the course

January 8 To put you in the mood we will discuss “The Superinvestors of Graham-and-Doddsville” by Warren Buffett

<http://www8.gsb.columbia.edu/rfiles/cbs/hermes/Buffett1984.pdf>).

Week 2:

January 13 The Intelligent Investor Chapters 1-2-3-4. This is when the presentations by you begin. I give you one stock, 2 ETFs and \$100,000 virtual dollars (alas). Invest!! This investment will last until March 26 (11 weeks).

January 15 The Intelligent Investor Chapters 5-6-7-8. Chapter 8 is one of the two chapters in this book that Buffett highly recommends.

Week 3:

January 20 The Intelligent Investor Chapters 9-10-11-12.

January 22 The Intelligent Investor Chapters 13-14-15-16.

Week 4:

January 27 The Intelligent Investor Chapters 16-17-18-19.

January 29 The Intelligent Investor Chapter 20. Chapter 20 is the second chapter in this book that Buffett highly recommends.

Week 5:

February 3 Reilly and Brown Chapters 1-2-3-4-5. I will lecture in this class on investment background.

February 5 Reilly and Brown Chapters 1-2-3-4-5.

Week 6:

February 10 Reilly and Brown Chapters 6-7-8-9. I will lecture in this class on market inefficiency, behavioural finance, asset pricing, Markowitz diversification and fundamental indexing.

February 12 Reilly and Brown Chapters 6-7-8-9.

Week 7:

Midwinter break

Week 8:

February 24 Reilly and Brown Chapter 10. You will lecture on Chapter 10 in this class using the firm I have assigned to you.

February 26 Reilly and Brown Chapter 11. You will lecture on Chapter 11 in this class using the firm I have assigned to you.

Week 9:

March 3 Reilly and Brown Chapter 13. You will lecture on Chapter 13 in this class using the firm I have assigned to you.

March 5 Reilly and Brown Chapter 14. You will lecture on Chapter 14 in this class using the firm I have assigned to you.

Week 10:

March 10 Reilly and Brown Chapter 16. I will lecture on Chapter 16 using my company's (www.inpode.com) portfolios.

March 12 Reilly and Brown Chapter 16. I will lecture on Chapter 16 using my company's (www.inpode.com) portfolios.

Week 11:

March 17 Reilly and Brown Chapter 24. You will lecture on Chapter 24.

March 19 Reilly and Brown Chapter 24. You will lecture on Chapter 24.

Week 12:

March 24 Reilly and Brown Chapter 25. You will evaluate your portfolio's (one stock and two ETFs) performance. Liquidate your portfolio on March 24.

March 26 Reilly and Brown Chapter 25. You will evaluate your portfolio's

(one stock and two ETFs) performance.

Week 13:

March 31 Student's presentations of their report.

April 2 Student's presentations of their report.

FORMAT FOR YOUR PORTFOLIO MANAGEMENT REPORTS

1. Business Model (what does this firm do?)
2. Value Proposition (what makes this firm different from its competitors?)
3. Competitive Analysis (use Porter's 5 Forces model; no SWOT!!!). How deep are the "moats" around its businesses? How secure and long lasting are they?
4. Quality of Management:
 - 4.1 The Board's composition and independence
 - 4.2 Do managers act with integrity and intelligently?
 - 4.3 Is management candid with its shareholders?
 - 4.4 Does management allocate capital rationally?
 - 4.5 Does management have "skin in the game"?
5. The numbers: Length of time dividends have been paid, Dividend per share in dollars and cents, Dividend Payout ratio, Dividend yield, Growth in dividends, Price/Book, Price/Earnings; ROE, Margins, Leverage (Debt/Equity); Return on Capital Employed (ROCE). Compare these numbers with the competition. Present all these numbers in a table. Use IBES (available on Datastream in the library) to find out how many analysts follow the stock.
6. Intrinsic Value using dividends paid. Is there a margin of safety? How cheap is the stock? Remember this pearl of wisdom from Warren Buffett: "It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price." Show this information in a table. To calculate intrinsic value and the **margin of safety** (Margin of Safety = $\frac{\text{Market Price} - \text{Intrinsic Value}}{\text{Market Price}}$) **run 3 scenarios: low interest rate (1.75%); normal interest rate (2.75%); high interest rate (3.10%)**. Yes you are using the long term Canada 10 year bond rate, not the WACC and the CAPM!!! Buffett doesn't either. Use a two-stage Dividend Discount Model (referred to as a DDM in the trade).

7. Portfolio Performance compared to the benchmark; since we are Canadians investors **the benchmark is the TSX-S&P Composite index** over that period. Use the Sharpe ratio. The risk-free rate is the rate for Canada 10-year bonds. This is a yearly rate so you will need to adjust it for the 9 weeks out of 52 weeks that you invested for this exercise.

8. Conclusions / Pearls of Wisdom / Lessons Learnt.

Course Policies

Grading Policies

<https://www.uoguelph.ca/registrar/calendars/graduate/2014-2015/>

University Policies

Academic Consideration

When you find yourself unable to meet an in-course requirement because of illness or compassionate reasons, please advise the course instructor in writing, with your name, id#, and e-mail contact. See the academic calendar for information on regulations and procedures for

Academic Consideration: <https://www.uoguelph.ca/registrar/calendars/graduate/2014-2015/>

Academic Misconduct

The University of Guelph is committed to upholding the highest standards of academic integrity and it is the responsibility of all members of the University community, faculty, staff, and students to be aware of what constitutes academic misconduct and to do as much as possible to prevent academic offences from occurring.

University of Guelph students have the responsibility of abiding by the University's policy on academic misconduct regardless of their location of study; faculty, staff and students have the responsibility of supporting an environment that discourages misconduct. Students need to remain aware that instructors have access to and the right to use electronic and other means of detection. Please note: Whether or not a student intended to commit academic misconduct is not relevant for a finding of guilt. Hurried or careless submission of assignments does not excuse students from responsibility for verifying the academic integrity of their work before submitting it. Students who are in any doubt as to whether an action on their part could be construed as an academic offence should consult with a faculty member or faculty advisor.

The Academic Misconduct Policy is detailed in the Undergraduate Calendar:

<https://www.uoguelph.ca/registrar/calendars/graduate/2014-2015/>

Accessibility

The University of Guelph is committed to creating a barrier-free environment. Providing services for students is a shared responsibility among students, faculty and administrators. This relationship is based on respect of individual rights, the dignity of the individual and the University community's shared commitment to an open and supportive learning environment. Students requiring service or accommodation, whether due to an identified, ongoing disability or a short-term disability should contact Student Accessibility Services as soon as possible.

For more information, contact SAS at 519-824-4120 ext. 56208 or email csd@uoguelph.ca or see the website: <http://www.csd.uoguelph.ca/csd/>

Course Evaluation Information

Please refer to <https://www.uoguelph.ca/economics/course-evaluation>

Drop date

The last date to drop one-semester courses, without academic penalty, is March 6th, 2015. For regulations and procedures for Dropping Courses, see the Academic Calendar:

<https://www.uoguelph.ca/registrar/calendars/graduate/2014-2015/>