**Finance 608**

**Portfolio Theory**

**Fall 2022**

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**Instructor**: Rose Liao

**Phone** (cell): 973 380 7480

**E-mail**: rliao@business.rutgers.edu

**Class Times:** Thursdays 6pm – 9pm

**Class Location:** Zoom Meetings[[1]](#footnote-1)

**Office Hours**: Thursdays 4:00pm – 6:00pm and by appointment.[[2]](#footnote-2)

**Course Web Page**: CANVAS \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**1 The Course**

The course will focus on the fundamental principles of risk and return, diversification, and asset allocation. Students will learn about investment strategies commonly used by mutual funds and hedge funds, as well as how to evaluate a portfolio manager’s performance.

There are two goals for the course. First, to provide students with a framework they can apply to help break down and understand complicated investment strategies that are commonly used by investment managers. Second, to provide students with the technical skills necessary for a career in portfolio management. Both sets of skills will be developed through case studies, homework assignments, lectures, and discussions.

**2 Is the course right for you?**

The course will be intellectually demanding, with an emphasis on applying finance theory to real world situations. You will be introduced to techniques that are commonly used in both industry and academia. The course will deal with complex analytic concepts and quantitative analysis, but will not focus on mathematical derivations or modeling. The workload will be heavy. You will be expected to conduct extensive analysis in Excel. This is not the course for you if you are looking for a “hot topic” course or a fast-track way to make money in the markets.

The prerequisite for the course is 22:390:603 Investment Analysis and Management. I expect that students understand the following concepts:

* Discounted cash flows and net present value
* Calculating returns
* How stock markets work
* Order types and Trading – including short selling
* Basics of the Capital Asset Pricing Model
* Basic statistics (mean, variance, standard deviation, covariance, and correlation)
* Regression analysis
* Differentiation

If you are shaky on these topics then dust off your old notebooks now and get yourself up to speed with this material. You should also be comfortable using Microsoft Excel.

**3 Teaching Method**

To help students learn effectively I use two related teaching techniques, active learning and experiential learning. Active learning consists of two components – out-of-class learning and in-class learning. Out-of-class learning involves watching video lectures online prior to attending each class. The out-of-class lectures work through topics in detail. In-class learning involves the discussion of conceptual questions to get you thinking carefully about the topics you have been studying in the out-of-class lectures (active learning), and applications of the concepts to real world problems (experiential learning).

**Out-of-class learning:**

Students are required to watch pre-recorded lectures before attending each class. The pre-recorded lectures typically last for 15 - 25 minutes each. To incentivize you to watch the lecture prior to coming to class, you will have to complete a short multiple choice quiz on CANVAS **before** the start of each class. You score either zero, one, or two points on each quiz, and these points count towards 15% of your final grade. Quizzes are graded as follows: 0% - 35% = 0; 35% - 70% = 1; 70% - 100% = 2

**In-class learning:**

In-class lectures typically take the following format:

1. A discussion of the latest events in the economy and their impact on financial markets and corporations.
2. Conceptual and numerical questions based on the video lectures for that day.
3. Discussion of a real world example using the concepts covered.
4. Applying concepts to case studies and homework problems.

The classes are meant to be fun and interesting for students. Students are expected to contribute frequently. This format should challenge you to think critically about concepts rather than focusing on memorization.

The class format is the reverse of a typical class. I require you to watch video lectures outside the classroom to grasp the key concepts. In class, we build on these concepts and apply them to real world problems. I will allocate time in class for groups to work on all the homework problems. Occasionally you may be required to work on homework outside the classroom, but the majority of the homework problems will be completed during class time.

**4 Groups**

When you join a company you will have to work in a group or team. Working effectively in groups is an important skill to learn. You will work in groups of three or four students to complete ALL homework assignments. During classes group members will be required to join pre-assigned breakout rooms as classes will involve considerable within-group discussions.

When groups are initially formed on the first day of class, each group will be asked to draw up and sign a one page contract regarding the expectations the group members have about what it takes to be a good, considerate group member. As a group member, you will be expected to abide by the terms of the contract.

In an extreme situation in which a group member has consistently violated the terms of the contract, the remaining group members may fire the group member, but only with the instructor’s permission. If a group member is fired, he/she will have to complete the homework assignments individually.

There will be 4 graded homework assignments to be completed in groups. These assignments will count towards 45% of your final grade. Each group will be asked to submit one set of answers for each assignment on **Microsoft (MS)Teams**.[[3]](#footnote-3) Late assignments will not be accepted except for the most serious of reasons.

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| **Assignment** | **Due Date** | **Points** |
| **Homework 1**: Draw up and sign group contracts |  8 Sep 2022 | 2 |
| **Homework 2**: CAPM vs Fama-French three factor model |  15 Sep 2022 | 6 |
| **Term Project 1:** Building Smart Beta Portfolios  |  6 Oct 2022 | 12 |
| **Homework 3:** Harvard Management Company |  27 Oct 2022 | 6 |
| **Homework 4:** International Asset Allocation | 17 Nov 2022 | 7 |
| **Term Project 2:** Building Fixed Income Portfolios for Annaly |  2 Dec 2022 | 12 |

**5 Class Meetings**

I expect that students watch the pre-recorded video lectures, read assigned readings, and complete online quizzes before class. Students will be required to join pre-assigned breakout rooms in class. Students are responsible for all announcements made in class.

Most classes will focus on solving either conceptual or numerical problems. I will be using a polling software called “Turning Point” for most in-class polls. You can download the TurningPoint app from the Google Play or App Store for free, or you can go to ttpoll.com to respond to questions if you do not have a smart phone.

If you do not have an existing subscription with turning point from other classes ($17.99 per semester; 24.99 per year) and/or have not yet linked your subscription to Canvas, please register and link your account before the first day of the class. **Note that all you need is a subscription. You do not need to purchase clickers.[[4]](#footnote-4)**

To join polling sessions during classes, you just need to open the app or go to ttpoll.com and input our session ID “**roseliao**”. You can also watch a 2-minutes video on how to download and use the app here: [TurningPoint app overview](https://nam02.safelinks.protection.outlook.com/?url=https%3A%2F%2Fgo.turningtechnologies.com%2Fe%2F837103%2Fmedias-jtxhq8q6yo%2F2t23%2F6830892%3Fh%3DNqqCmFS__w6mQdb36VtUqmDXR8L5g0DMbl4U4RAU8U4&data=02%7C01%7Cliao%40business.rutgers.edu%7C17d1cfb3ea5c47147a9508d7dfd044c1%7Cb92d2b234d35447093ff69aca6632ffe%7C1%7C0%7C637223958211418153&sdata=UsHgrRDIIG8rRzj403%2BG7kAqTNwJyucnlM2iPRmnCug%3D&reserved=0).

You should have a calculator and a computer that has a camera, a microphone, and MS office software for every class.

**Some students may use Apple Computers. The functionality of Excel differs across Apple and Windows-based computers. I will be teaching using a Windows-based computer. I will not be able to provide additional support for people using Apple computers as I only use Windows-based computers. Note that Chromebook does not work well for a lot of in-class assignments using Excel.**

**All cell phones must be switched off prior to the start of class** unless you are using it to answer polling questions**.**  I consider the use of cell phones during class to be rude and inconsiderate to your fellow students.

As most of the in-class meetings involve polling, group discussions, and group homework, I will not be recording in-class meetings, but will distribute all in-class notes and Excel work on “**MS Teams**” (such as solving questions on traditional whiteboard).[[5]](#footnote-5)

**6 Course resources**

**Powerpoint Slides**: Available from course website

**Online Lectures**: Available from course website

**Additional Readings**: Available from course website

**Class Meeting Notes**: Available from MS Teams

**Harvard Business School Cases:** <https://hbsp.harvard.edu/import/970618>

There are two Harvard Business Cases used in this course. They can be downloaded via the link provided above. Harvard charge $4.25 per case so the cost is approximately $9.

There is no textbook required for this class. Investments textbooks are very expensive, and while there are a number of excellent textbooks available on the topics of investment management and portfolio theory, none cover all of the topics to be discussed in this class. I have multiple copies of these textbooks which you are welcome to borrow from me. If you want to purchase a book I would recommend looking at all the available books first. They differ substantially in their content:

**Bodie, Kane, and Marcus**, Investments, 5th, 6th, 7th or 8th edition (McGraw Hill): A good overview of many topics. Not very technical, and relatively little emphasis is placed on how to implement theories and strategies in reality.

**Elton, Gruber, Brown, and Goetzmann**, Modern Portfolio Theory and Investment Analysis, 6th edition (Wiley): Doesn’t cover as many topics as BKM, but the topics it covers are covered in more detail. The mathematical content is substantially greater than that in BKM.

**Grinold, and Kahn**, Active Portfolio Management, 2nd Edition (McGraw Hill): This book focuses on how to form portfolios that will earn abnormal returns. As such, the authors assume that readers understand many important concepts, such as the CAPM, prior to reading the book. A good book for students with a strong interest in active portfolio management.

**Benninga**, Financial Modeling, 2nd or 3rd Edition (MIT Press): The focus of this book is on how to apply financial theory in reality. Rather than carefully describing financial theory, Benninga focuses on how you operationalize the theory in Microsoft Excel. The book covers the vast majority of empirical applications covered in this class, but the writing style is terse. A great book if you want to learn more about Excel and how to program in Visual Basic.

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**7 Course Evaluation**

Your final grade will be based on points earned in exams, group assignments, online quizzes, and class participation. These items will be weighted according to the following schedule:

Individual Classroom Contribution 15%

Online Quizzes 15%

Group Assignments 45%

Exam 25%

I expect the grade distribution in the course to follow the distribution below, but I reserve the right to alter the distribution as I deem necessary:

A 35%

B 60%

C 5%

D or F 0%

**Individual Classroom Contribution:**

Class participation is an important part of the course. I consider such things as asking thoughtful questions, attendance, respecting your fellow classmates’ views on particular issues, contributing to a positive atmosphere in the class, and preparation for the scheduled lecture topic as class participation.

**Exams:**

Absence from the exam will not be excused except for the most serious reasons. Such serious circumstances must be validated in writing by an appropriately accredited professional (i.e. medical doctor).[[6]](#footnote-6) The exam will cover material from lectures, assigned readings, and assigned problems. The goal is to test the level of comprehension and not merely the memorization skills of the student. There will be no formula sheet.

**8 Other policies**

**Fairness:**

I strive to treat students with dignity and fairness and to be particularly sensitive to the diversity that exists within the student body. No discriminatory remarks should be made with regard to gender, race, age, ethnicity, sexual orientation, or disability. If you have a disability that may require some modification of seating, testing, or any other class requirement, please let me know as soon as possible so that appropriate arrangements can be made. Additional assistance is available from the [Office of Disability Services for Students](http://disabilityservices.rutgers.edu/).

**Absences and Late Assignments:**

As a matter of courtesy, I would appreciate an email or phone message if you unable to attend class.

Late assignments will not be accepted for credit, except for the most serious of reasons. Absence from the exam will not be excused, except for the most serious reasons. Such serious circumstances must be validated in writing by an appropriately accredited professional (e.g. medical doctor). Any unexcused absences will result in a grade of zero.

**Contacting the Instructor:**

Emails should ONLY be used for matters related to COURSE ADMINISTRATION. I will NOT answer technical questions via email. I am happy to discuss issues of concern to you on an individual basis during office hours. If you are unable to attend regular office hours an individual appointment can be set up. I ask that you let me know the subject matter so that I can be prepared. Typically I schedule 20 minute appointments, but if you need more time, we can arrange it.

**Appeals:**

Grading errors should be corrected. Appeals must be in writing and include a description of the question that needs to be re-examined as well as an explanation of why the original grade was incorrect. In general, the entire document will be checked for grading errors, and correcting any errors could either raise or lower the overall score.

**Academic Misconduct:**

It is my sincere hope that no student in this class submits work that is not his or her own. If I determine that any assignment was not written solely by the student whose name appears on the assignment, the student will be reported to the Academic Integrity Review Committee which recommends appropriate sanctions to the Office of Student Conduct. There will be no exception to this rule. Please visit the following website for more information on the University's Code of Academic Integrity and possible sanctions: <http://academicintegrity.rutgers.edu/integrity.shtml>.

**Grievance Policy:**

Student concerns regarding this course should first be discussed with me, the faculty member teaching this course. If we can't resolve the complaint, you may contact the Chair of the Finance and Economics Department, Professor Ivan Brick, 973-353-5155, ibrick@andromeda.rutgers.edu.

**9 Tentative Course schedule[[7]](#footnote-7)**

**09/08/2022 Week 1** **Introduction** **and Market Efficiency**

 Watch the following online video lecture prior to class:

1. Market efficiency

**Required Reading**: “Efficiency and Beyond”

“Time to bin the efficient market hypothesis”

 “Turn on a paradigm”

**Complete online quiz prior to class.**

**Homework 1 due by the end of class.**

**09/15/2022 Week 2**  **Capital Asset Pricing Model (CAPM), Multifactor Models, and Testing**

Watch the following online lectures prior to class:

1. The CAPM
2. Reality and the CAPM
3. Multifactor Models

**Complete online quizzes prior to class.**

In-class lecture involves use of Excel. An extra screen would be useful.

**Homework 2 due by the end of class.**

**09/22/2022 Week 3:** Performance Evaluation

Watch the following online lectures prior to class:

1. Performance Evaluation
2. Performance Evaluation in Excel

**Required Reading: “**[**Why Investors should be weaned off tight tracking to market indices**](https://www.ft.com/content/82af7b86-dfe4-11e7-8f9f-de1c2175f5ce)**”**

**Complete online quiz prior to class.**

In-class lecture involves use of Excel. An extra screen would be useful.

**Start Term Project 1**

**09/29/2022** **Week 4:** Building quant portfolios with **CapitalIQ** Guest Speaker

Watch the following video prior to class:

1. [Dynamic Multi-factor Investing by Chris Brightman](https://www.researchaffiliates.com/en_us/publications/video/598-chris-brightman-on-dynamic-multi-factor-investing.html)
2. [What Matters in Multi-Factor Investing?](https://www.researchaffiliates.com/en_us/publications/video/part-1-what-matters-in-multi-factor-investing.html) (optional)

In-class lecture involves use of Excel. An extra screen would be useful.

**Term Project 1: Part 1 due by the end of class.**

**10/06/2022** **Week 5:** Risk Aversion, Utility Functions, and Portfolio Theory

Watch the following online lectures prior to class:

* 1. Returns, Risk, and Risk Aversion
	2. Correlation and Risk Reduction
	3. Portfolio Theory

**Complete online quizzes prior to class.**

In-class lecture involves calculations. Bring a calculator.

**Term Project 1: due by the end of class.**

**10/13/2022** **Week 6: Guest Speaker and Student Presentation**

**10/20/2022** **Week 7: No Live Class**

Watch the following online lectures:

1. Portfolios and Matrices: Matrix Review
2. Portfolios and Matrices: Portfolios
3. Portfolios and Matrices: Excel

**Required Reading: “**HBS Case: Harvard Management Company”

**Start Homework 3.**

**10/27/2022** **Week 8:** The Mechanics of Portfolio Theory

Watch the following online lectures prior to class:

1. Portfolio Allocation: The Mechanics
2. Portfolio Allocation: Excel (Optional – covered in class)
3. Portfolio Allocation, no short sales, and Solver (Optional – covered in class)

In-class lecture involves use of Excel. An extra screen would be useful.

**Complete Homework 3.**

**11/03/2022 Week 9:** Building fixed income portfolios with Guest Speakers from **Annaly:**

 **Andreas Strzodka (Macro Strategist)**

Class Discussion: Portfolio Allocation at Annaly

**Start Term Project 2**

**11/10/2022 Week 10:** Black-Litterman Asset Allocation

Watch the following online lectures prior to class:

1. Problems with Expected Returns
2. The Black-Litterman Model
3. The Black-Litterman Model: Excel (Optional – covered in class)

**Complete online quiz prior to class.**

In-class lecture involves use of Excel. An extra screen would be useful.

**11/17/2022** **Week 11:** Applying the Black-Litterman Model

**Required Reading: “**HBS Case: Innocents Abroad: Currencies and International Stock Returns”

Class Discussion: International Asset Allocation

**Homework 4: due by the end of class.**

**11/22/2022** **Week 12 (Tuesday):** Solving Portfolio Allocation Problem for Annaly’s Fixed Income Portfolio

**12/1/2022** **Week 13:** Presentations: MBA Students’ Allocation Performance vs Annaly’s

**Term Project 2: due by the end of class.**

**12/8/2022 Week 14: EXAM** (in class)

Covers material from Sep 08, 2022 to Dec 01, 2022

Exam lasts 180 minutes.

1. **I will be sending a Zoom link before class. Password: roseliao.** [↑](#footnote-ref-1)
2. Zoom Personal Room Meeting ID: 462 160 2834; Password: roseliao

or use link: <https://rutgers.zoom.us/j/4621602834?pwd=d3U2UDU1QndqZ1FFZlRDeHZwL1JaQT09>

You can also find me on Skype: rosefinancerutgers [↑](#footnote-ref-2)
3. You can find the information on Canvas under “How-to” Folder: *How to use MS Teams in Zoom class meetings: Part II* [↑](#footnote-ref-3)
4. See *How to Add/Purchase a Subscription from Turning Point polling* posted on Canvas under “How-to” Folder. [↑](#footnote-ref-4)
5. You can find information on Canvas under “How-to” Folder: *How to use MS Teams in Zoom class meetings: Part I* [↑](#footnote-ref-5)
6. Students are allowed to make up examinations which have been missed due to illness, mandatory religious obligations, University activities, or other unavoidable circumstances. [↑](#footnote-ref-6)
7. The exam dates are fixed. The outline of topics to be covered, however, is subject to change depending upon the speed at which we progress through the material. Students will be notified of any changes in the schedule at least one class in advance. [↑](#footnote-ref-7)