Using Real Money to Motivate Finance Students

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ABSTRACT

The popularity of student-managed investment portfolios has grown dramatically since their inception over 20 years ago. These programs provide students with many valuable opportunities that are not available in the traditional course setting. First, managing real money provides them with the opportunity to put theory into practice. Second, they learn to conduct research and analysis independently. Third, they are required to hone their presentation skills, since they must present and be accountable for their portfolio recommendations. Fourth, they are required to prepare several professional reports such as annual and quarterly performance reports, and economic forecasts, for use by outside parties. This provides valuable writing and report preparation experience for them. Finally, they are exposed to and tend to seek out opportunities to speak with a wide variety of investment professionals. This assists them in making valuable industry contacts, which is useful for their employment search process, and in pursuing future career endeavors.

This paper elaborates on how to maximize the benefits of such programs for students, and how they may be tied to the existing finance curriculum. We discuss some of the benefits we have observed as co-directors of the Investment Management of Portfolios in Atlantic Canada Training (IMPACT) Program at the Sobey School of Business, which is now in its third year of operation.

INTRODUCTION

The popularity of student-managed investment portfolios has grown dramatically since their inception over 20 years ago. There are a large number of these programs in various forms, but they all share one common trait – they involve having students manage a portfolio of "real money." The size of the actual portfolios managed also varies widely across the programs, ranging from less than $50,000 to more than $3 million.

This paper elaborates on the benefits of such programs for students, and for the school, based on our observations as co-directors of the Investment Management of Portfolios in

Atlantic Canada Training (IMPACT) Program at the Sobey School of Business at Saint Mary's University (SMU), which is now entering its 4th year of operation. In our program, student participants make all investment decisions for the IMPACT Fund (current market value of approximately $185,000), with significant input and advice from both Sobey Faculty and mentors from the investment community. This provides them with the opportunity to serve as "real-world" research analysts and portfolio managers in every sense. The activities of the program are regulated by the IMPACT Charter, as well as by the student-developed Investment Policy Statement. In all duties, students are held to high professional standards of conduct.

THE IMPACT PROGRAM

History

Our program became operational in the fall of 2004; although it was "in the making" for several years. In fact, we had originally approached the SMU Board of Directors in 2000 to allow us to manage some pension and/or endowment funds following a format that is similar to our current program structure. We noted at the time that several schools have allowed student-run programs to manage such monies; and even more do so today. In any event, we were turned down at that time; however, one of the Board members, the spouse of a SMU alumnus, liked the idea. Eventually, he came forward and made a generous donation of common shares from his company, which provided us with a starting portfolio value of approximately $132,000. Our mandate is to establish a scholarship program once the fund reaches a value of $300,000, irrespective of whether this value is achieved by portfolio returns or by future donations to the fund.

Initially we were somewhat disappointed that our seed money was much less than the amount we were looking for from the university, and much smaller than the amount managed by many other programs. However, this has enabled us to operate with a great deal more flexibility than had we been set up as originally proposed, since we are not serving as fiduciaries for another party's funds. In addition, managing funds of our size (or smaller) still provides students and the school with most of the benefits associated with larger funds.

Program Structure

The IMPACT program requires a two-year commitment from students, who are drawn from both the MBA and undergraduate business programs at Saint Mary's University. Applications are submitted and interviews conducted at the beginning of the year, as the program accepts only a small number of elite students, with admittance being restricted to a maximum of 10 new students per year.

In their first year, students are designated Research Associates (RAs), and are responsible for providing assistance to the more senior Fund Managers (FMs). At the end of their first year in the program, the RAs become FMs, and assume all responsibilities for managing the portfolio. The FMs vote on all matters related to investment policies and specific investment decisions. Any buy or sell recommendations need to be approved by a majority of the FMs, and this decision must then be approved by a program mentor (discussed later), or by one of the program co-directors.

We follow a "Top-Down" portfolio management approach, and the students decide on the portfolio asset allocations, within the limits dictated by the following asset allocation guidelines. These guidelines are based upon market values and constitute the acceptable range of exposure to the various asset classes which comprise the IMPACT Fund's portfolio. The approved asset allocations are:

Asset Class	Minimum (%)	Maximum (%)	Mid-Point (Benchmark) (%)
Cash and Short term Securities	**0**	**10**	**5**
Canadian Equity Component	**60**	**80**	**70**
International Equity Component[1]	**5**	**20**	**12.5***
Bond Component	**5**	**20**	**12.5**

Actual asset allocations in the IMPACT Fund may vary through time, within the constraints above. The maximum and minimum asset allocations shall be reviewed annually by the Board of Directors, who shall consider any changes recommended by the Fund Managers.

For each asset class, as listed above, the specific benchmarks shall be:

- Cash & short term securities – 90-Day Government of Canada Treasury Bills.
- Canadian equity – S&P/TSX Composite Total Return Index.
- Bonds – Scotia McLeod Universe Bond Index.
- International equity - United States portion– S&P 500 Composite Total Return Index.
- International equity - Other portion – MSCI EAFE Total Return Index.

For the portfolio overall, the stylized benchmark against which performance will be measured shall be constructed as a weighted average of the returns of each of the above asset class benchmarks, using the benchmark weights denoted above.

Presently, the Canadian Equity component of the IMPACT portfolio is the only "actively" managed portion of the portfolio, with the other components being invested in the appropriate index exchange traded funds (ETFs), with the exception of the Cash & Short Term Securities component, which is comprised of cash and funds invested in a no-load money market mutual fund. In addition to being involved in asset allocation and sector weighting decisions, each FM (with assistance provided by the associated RA(s)) is responsible for the investment decisions associated with one or more sectors of the Canadian equity market.

The investment decisions made by the FMs are restricted by our Investment Guidelines, most of which are similar to those faced by mutual fund managers. Some of the highlights of these investment guidelines include the following:

- The portfolio will be well diversified, consistent with prudent management of a portfolio for which security of capital is a consideration. Diversification

[1] The International Equity component shall be divided between a U.S. Equity portion and a non-U.S. Equity portion. The benchmark for international equity shall be equally weighted between these two portions.

will be across asset class (including Canadian equity, Canadian bonds, and international equity), across equity sector, and across individual equities.

- All companies in which the Fund invests through the purchase of equity shall have a minimum market capitalization of $300 million.
- No derivative securities such as options, futures, or warrants are permitted as investments of the Fund.
- No short selling of securities is permitted.
- The Fund shall not purchase securities on margin, nor borrow money in any way.
- All trades must be such that the assets of the Fund fall within the stated asset allocation guidelines in effect at the time of the trade.
- The investments of the Fund are limited to:

(a) common shares listed on a Canadian stock exchange whose long-term debt rating (where available) is greater than B according to Dominion Bond Rating Service (DBRS);

(b) preferred shares rated at least Pfd-1 by DBRS and are listed on a Canadian stock exchange;

(c) units of investment trusts listed on a Canadian stock exchange that are rated STA-3 or higher by DBRS ;

(d) exchange traded funds (ETFs) listed on a Canadian stock exchange;

(e) liquid, short term securities rated at least R-1 by Dominion Bond Rating Service such as treasury bills, term deposits, bankers acceptances, commercial paper, money market funds, or cash;

(f) ETFs traded on US stock exchanges which are part of a list approved by the Board of Directors for investment purposes. US traded ETFs shall not be part of the Fund without explicit approval by the Board.

Finally, during the second year of operations, the IMPACT participants devised a selling policy to provide a self-disciplinary mechanism to guide their selling decisions, an often neglected, but critical component in the investment process. The highlights of this policy include that an IMPACT Fund Manager should review the holdings of any security in their designated sector if any one of the following takes place:

(1) The Canadian equity asset class deviates from its target weighting in the portfolio by more than 3%.

(2) If the market value weighting of the sector deviates from its target weight in the Canadian equity portion of the portfolio by more than 3%.

(3) There is some fundamental change in the underlying company's business/sector/marketplace so that past valuation and research no longer accurately reflect our analyst's view of the company's future.

(4) The security's price experiences a gain of 25% or more from the time of purchase. If at that time the decision is made to hold the security, this decision shall be reviewed if the security experiences additional gains of 10% or more from its initial purchase price (i.e. reviews must be conducted for price increases from the original price of 25%, 35%, 45% etc.).

(5) The security's price experiences a loss of 15% or more from the time of purchase. If at that time the decision is made to hold the security, this decision shall be reviewed if the security experiences additional losses of 10% or more from its initial purchase price (i.e. reviews must be conducted for price decreases from the original price of 15%, 25%, 35% etc.).

(6) The security's price experiences decline in price of 15% from its highest price obtained while the security was held in the portfolio.
(7) The security's price reaches its target value.
(8) Also, by default, each security will be re-evaluated by the end of October, January and March regardless of whether or not one of the above criteria is met.

Finally, each FM and RA serves on one of the following sub-committees:
(1) External Affairs – responsible for preparation of various documents for our website and for external parties including the Economic Outlook and our Annual Report.
(2) Performance Reporting – responsible for tracking portfolio performance, providing performance updates at our weekly meetings, and preparing monthly, quarterly and annual performance reports.
(3) Economics – responsible for providing economic and capital market updates at our weekly meetings, and for providing the majority of input for our annual Economic Forecast, upon which asset allocation decisions will be based.

The typical year begins with a review and update of the portfolio holdings, as well as of the Investment Policy Statement (IPS), which essentially represents the blueprint for operation of the IMPACT Fund. The students then conduct a thorough economic analysis (Canadian, U.S. and Global) upon which to base their asset allocation decisions. Based on extensive analyses of each of the Toronto Stock Exchange (TSX) sectors, the students then establish portfolio weights for each sector within the Canadian equity portion of the portfolio. Finally, the various sector teams make security selection recommendations concerning specific equities to be included in the portfolio. Going through the entire investment process, and doing so within the risk constraints placed on the Fund by its investment guidelines and with due consideration for the Fund's IPS, is an intense and valuable learning experience for the students. They deal with many real-world issues which very often are not seen in the classroom.

Alternative Program Structures

The structure of our program is not especially unique, and is one that we have modeled after those of several other programs. However, various alternative structures are used at other schools, and these have also been very successful. For starters, many schools offer one-year programs. In addition, several schools follow the format of an investment club, which may be less rigid in terms of investment guidelines. On the other hand, many schools manage pension and/or endowment fund money, and face strict investment guidelines in terms of both asset allocation and security selection. The different forms of student managed investment funds are far too numerous to describe here, and in fact there are probably several structures of which we are not aware.

EXPOSURE

Business Professionals

One characteristic that most programs have in common is the involvement of business community professionals. An essential part of these programs is exposing the students to the opinions and practices of actual investment professionals. Many of the most valuable lessons that students take away from the experience can be attributed to the opportunity to work closely with investment professionals. Program success is dependent on the guidance, tutelage and support from the dedicated program mentors and other professionals who generously donate their time to help the students. The mentors to our program provide assistance to the students in their asset allocation, sector weighting and security selection decisions. They also provide the final stamp of approval for any trades. In short, the role they play is invaluable. The students also recognize this fact, and in our second year of operations, they decided to acknowledge one mentor annually as the "Mentor of the Year," as a token of their appreciation.

The students have also gained access to investment professionals through invitations to attend various presentations within the business community. The Atlantic Canada CFA Society (ACFA), in particular, has invited our students to attend various luncheons and seminars throughout the year (at the member rate). The IMPACT Program itself hosts a number of speakers who come to Saint Mary's to talk to our students about various aspects of the capital markets and economics. Two years ago, we began hosting our annual "Kick Off Weekend" in the fall, which has been a resounding success. During this weekend professional portfolio managers, financial analysts and economists from Atlantic Canada and Toronto visit our campus to give talks on various aspects of portfolio management, investment valuation and the financial services industry. Our students universally agree that it is a tremendous learning experience and many of the visiting professionals go out of their way to comment on the impressive quality of our students. Last year, the students of the University of New Brunswick's Student Investment Fund (SIF) also attended the sessions. This year we have expanded it to incorporate a "Valuation Competition," and have invited 10 Atlantic Canada universities to send teams and other observers. We hope to send the winning team to the CFA Institute's Global Valuation Challenge later this year. The response has been very positive so far, and we have managed to secure five high profile speakers, including Dr. Thomas Robinson, CFA, Head, Educational Content, CFA Institute.

External Events

In addition to the events sponsored by ACFA and our annual Kick-Off Weekend, our students are involved in many other external events. Every February, we send a team representing Saint Mary's to Dalhousie University's Annual Credit Risk Case Competition. This unique event pits teams from several universities in a two-day competition of ideas, theory and cutting-edge credit risk decision making. The central concept is to increase awareness of the importance of credit risk, and various methods of mitigating such risk. The competition involves 10 teams of up to four students analyzing a comprehensive realistic credit case. Teams are given the case details at 30-minute intervals. The students then, over the next three hours, prepare a 15-minute presentation, which they deliver to a panel of judges in the afternoon. The event also includes a day of workshops and talks from industry professionals.

In March, we send a team of four students to represent us at the Rotman International Trading Competition at the University of Toronto. This event brings together over 40 university teams from around the world to compete in various types of simulated trading environments. We leverage this annual trip by taking the chance to tour various financial institutions, meet with industry professionals, and to meet informally with former IMPACT members now working in Toronto.

In late March, we send four students to the Redefining Investment Strategy Education (RISE) Symposium in Dayton, Ohio. This annual event brings together business leaders and students from around the globe. In 2006, there were over 1,500 participants, representing students from 197 colleges and universities from 22 countries. Every year, this event is kicked off with panel discussions involving high profile individuals, with previous speakers including Abbey Cohen, and Ben Bernanke, to name but two. The second day of this conference sees students and advisors attend several highly informative workshops led by some of Wall Street's most respected portfolio managers and analysts. There is also a portfolio performance competition, which is based on the risk-adjusted performance of these student-managed funds over the previous calendar year relative to other funds that are included in the same portfolio category. Our particular fund was chosen the top performer in our category consisting of 41 funds during 2005. In 2006, at RISE, the IMPACT Fund was chosen to be one of only 12 student managed funds given the chance to make a presentation on their investment strategy to a panel of industry experts from Wall Street, designed to provide feedback and advice for the students.

Finally, in April, we attend the Atlantic Canada CFA Society's annual Forecast Dinner, a premier local event with approximately 200 attendees that always features high profile keynote speakers. This is a great networking event for the students and they maximize the opportunity by setting up a display booth at the reception prior to the dinner to increase exposure. The students also enter their capital markets predictions for the upcoming year in the annual University Forecast competition.

Media Exposure

We have had some success in promoting our program through the local media. Other larger and more established programs in prime locations have had great successes at the national and international levels, with schools being featured in Business Week, on Lou Dobbs, and so forth. Of course, every time any school's program is profiled, we benefit from the exposure.

PROGRAM BENEFITS

There are many benefits associated with student managed investment funds for students and for the sponsoring institutions. We discuss some of these below.

Students

These programs provide students with many valuable opportunities that are not available in the traditional course setting. First, managing real money provides them with the opportunity to put theory into practice. Second, they learn to conduct research and analysis independently. Third, they are required to hone their presentation skills, since they must present and be accountable for their portfolio recommendations. As a result, they are well prepared for any job interviews, since they can talk very knowledgeably about the stocks they have chosen (i.e., why they were chosen and how they were valued), their opinion on the outlook for various sectors, and for the economy as a whole. In short, they are miles ahead of most other students entering similar interviews who can merely talk superficially about what they have learned in class. Fourth, they are required to prepare several professional reports such as annual and quarterly performance reports, and economic forecasts, for use by outside parties. This provides valuable writing and report preparation experience for them. Finally, they are exposed to and tend to seek out opportunities to interact with a wide variety of investment professionals. This assists them in making valuable industry contacts, which is useful for their employment search process, and in pursuing future career endeavors.

An additional benefit of exposing the students to finance professionals is that the students immediately become aware of the importance of professional training outside the university environment, especially the Chartered Financial Analyst (CFA) program. We strongly encourage their involvement in the CFA program, and many of our students have enrolled during our first three years.

University

One of the most obvious benefits to the university is that it helps to ensure graduating students will be successful in landing high level positions in the business community, and in the investment industry in particular. This is one of the major objectives for most business schools and it is a self-perpetuating process – once our graduates achieve high level positions and perform well, the businesses are more likely to hire our future graduates, and we end up with more and more contacts in "the right places." In fact, we are seeing a marked increase in the number of companies approaching us looking for program graduates for full time positions, as well as for summer internships. Most of these additional requests can be attributed to "word of mouth" about the quality of our program participants and graduates.

The recruiting benefits for both the undergrad and MBA programs are obvious, since many students will be interested in such a program. At a broader level, it enhances the reputation of the sponsoring institution and shows they are committed to providing students with innovative programs that will enhance their future opportunities. Finally, it provides business schools with another opportunity to strengthen their ties with the business community.

SOME OBSTACLES AND SUGGESTIONS

Obstacles

One obvious problem that we alluded to previously is that of getting seed money to establish the fund itself. It is also important to ensure sufficient operating funds are available annually to support the program – the amount required varies depending on the nature of the program and the types of activities pursued, but we suggest that you could probably get by (barely) on $5,000 to $10,000 per year, but to do things first class you would probably want to think in amounts closer to $20,000 per year. Despite the track record of many of these funds and the fact that more schools are establishing them every year, the initial reaction of many people is to shutter at the thought of students managing money. Certainly, on many occasions we have had to reassure such people that the students are not merely "playing a game" or "day trading." Having ready documentation (e.g., such as the track record of student-managed funds in general or for a particular fund, or having a set of investment guidelines) is one obvious and effective way to deal with such concerns.

On the positive side, most people we approach think it's a great idea and are happy to become involved in various capacities – as mentors, speakers, etc. In fact, we have found it surprisingly easy to attract professionals to donate their time, and the most common comment we get is "I wish they had something like this when I went through school." Most of them also go out of their way to comment on the impressive quality of our students. The other good news is that this is a self-perpetuating process, as word spreads, and also as our IMPACT alumni base grows. For example, one of our speakers at last year's Kick-Off Weekend was one of our graduates who works as a financial analyst in Toronto, and he was a big hit. Another graduate showed our students around his "shop" when we made our trip to Toronto last year. Other programs that have been running longer have an extensive alumni network at their disposal. The career placement process is also self-perpetuating – once an organization hires one of our graduates and recognizes what they bring to the table, they want to hire more.

Believe it or not, given all the benefits to students discussed above, one of the greatest challenges we face every year is getting good students to apply and commit to the program. Our program gives them credit for only one half year course for each year they are in the program and many students are not willing to make the required commitment of time (which is substantial, requiring an "average" of 10-15 hours of work per week for each student) for the "payback" in terms of course credits. Other students are concerned their grade point average will suffer as a result of the extra commitment. Of course these students are missing the big picture, which is that the experience itself is invaluable, not to mention that they are setting themselves up for future career success. Some programs offer more course credits for program participants, which helps alleviate some of the students' reservations. On the other hand, some programs offer no course credits, and seem to operate without a hitch. Our structure is a compromise between the two extremes. We provide some course relief to compensate students for the added time commitment, but the compensation is not sufficient to entice them to enter the program unless they are truly committed.

There are numerous challenges that arise in running a program such as ours, and we will not deal with all of them here, but will note two more. One obvious issue is how to deal with managing the fund during the summer months, since many students are simply not available. We have talked with several other program directors who also struggle with this issue. Our charter allows us (the co-directors) to initiate trades to ensure the fund satisfies the appropriate asset allocation and investment guidelines as necessary as a fail safe measure. However, much to our surprise, we have found it unnecessary for us to do so over the last two summers because the students have been so keen that they have followed the portfolio performance and initiated trades on their own as necessary, even during the summer months.

Another operational challenge is tracking portfolio performance and reporting on that performance. We can assure you that it is much harder to do in practice than it would seem, and we highly suggest that if you have funds available to purchase some form of performance tracking system, it would be money well spent.

A Few Suggestions

If you are involved in running, or are considering initiating, a student-managed investment portfolio, we strongly suggest that you talk to others who have such a program. We found that most program directors have been more than happy to provide us with advice. Attending the RISE conference is a good place to meet them and there are also special sessions there designed to educate. "Surfing the net" for websites for such programs is also very useful.

As mentioned, there are various forms of programs, and many ways to do things. Perform some due diligence and determine which approach will work best for your school's situation.

Have a solid set of investment guidelines in place, and have the students develop a selling policy. This will make it easier to access funding, and it will also simplify the operation of the fund itself.

One of the best ways to address many of the concerns above and to help the program grow in stature is to have graduates successfully land good jobs. Help them prepare for their job search – read over their resumes and cover letters (our graduates have also found our Annual Reports to be effective "self-marketing" documents), use contacts to help them with their networking, establish a summer internship program so that students are better prepared for the job market. Establishing summer internships will also help to attract more students to apply.

CONCLUDING REMARKS

We have discussed the benefits and challenges associated with student-managed investment portfolios in general, using our IMPACT program as an example. As a parting comment, we would note that coordinating such a program requires a significant time commitment, but that the rewards are substantial. We cannot say enough about what such programs offer students, and also the benefits they provide for the sponsoring schools.