Finance 781: Topics in Institutional Investment

Course OutlineSemester 2 2014

Teaching Staff

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Location and Time

Thursday 1.00-3.00pm

OGGB

Course Description

This course offers an introduction to the issues facing institutional investors, and the market structures and practices that have been established to handle them. The biggest players in the institutional investment market are superannuation funds, insurance companies and charitable trusts, affecting virtually every citizen. Institutional investors form a huge part of financial markets, and their actions have a major impact on how these markets operate.

We will study a number of the components of the investment process typically adopted by institutional investors to govern their affairs, formulate their investment objectives, design investment structures to meet their objectives, appoint agents to manage those structures, and to monitor and review their performance and decisions. (A short outline of the investment process is attached.) We will investigate the linkage between investment theory and practice in these areas.

Goals of the Course

The main goal is for students to appreciate the responsibilities of institutional investors and the ways they seek to meet these responsibilities within the market environment. The issues facing institutional investors are both theoretical and practical, ranging from investment theory to market realities to the legal, social and political constraints on how they can be dealt with. We will concentrate on a subset of issues, and contrast New Zealand and global practices for institutional investors. We will attempt to reconcile commercial practice with investment theory.

Investment funds

We will illustrate the course material using three hypothetical investment funds, based loosely on major New Zealand funds. The issues facing these funds are typical of those encountered in practice. Each student will be assigned one of these funds for detailed analysis..

Asset-liability study

Asset-liability models are computer simulation models used to investigate the cash flow requirements of investment funds and to analyse the risk effects of possible portfolio choices. Each student will be required to conduct an asset-liability study on his/her investment fund to understand the nature of the investment choices faced by the managers of the fund. Detailed instructions will be given on how to go about this exercise. The studies will necessarily be simpler than actual studies carried out in practice, but the elements of the method and the nature of the results will be realistic.

Class presentations

The course is based on seminars in which groups of students present topics using papers in the reading list. Students will be assigned to presentation groups at the start of the term. The presenters are expected to look beyond the assigned papers, not just summarise them. Some of the questions that might be addressed are:

- What is the importance of the paper to institutional investors?
- What parts of the investment process is it concerned with?
- Is it consistent with the theoretical and empirical finance literature?
- Are there shortcomings in the argument?
- What further questions need to be addressed?
- What are the practical implications?

There could be two or three papers for a particular subtopic assigned to a presenter. Most of the readings are drawn from the "practitioner" literature. They are often short and not written at a high technical level, but they address issues that are very important for institutional investors, issues that must be dealt with on a day by day basis. For this course, the emphasis is on understanding why these issues are important, and what progress has made in using financial theory to solve the associated problems.

Participation

Student participation in seminars is central to this course. The topics are broad and open-ended, and solid preparation followed by seminar discussions is an ideal way to learn and understand the issues. In particular, students will be called upon to describe how their investment fund would be affected by the ideas being presented.

The participation grade will be based on combination of evidence of preparation, and quality of participation.

Summaries

Students who do not have presentation responsibility for the week are required to provide a one-page summary and critique with at least three questions for the topic presented. The questions might be drawn from those suggested above for presenters, but may also look further afield.

Final presentation

Over the course of the term students will formulate investment strategies for their investment funds based on the course material. On the final day of class (23 October) the students assigned to each of the three funds will make group presentations on the strategies they have formulated for their funds. An external expert will comment on the presentations.

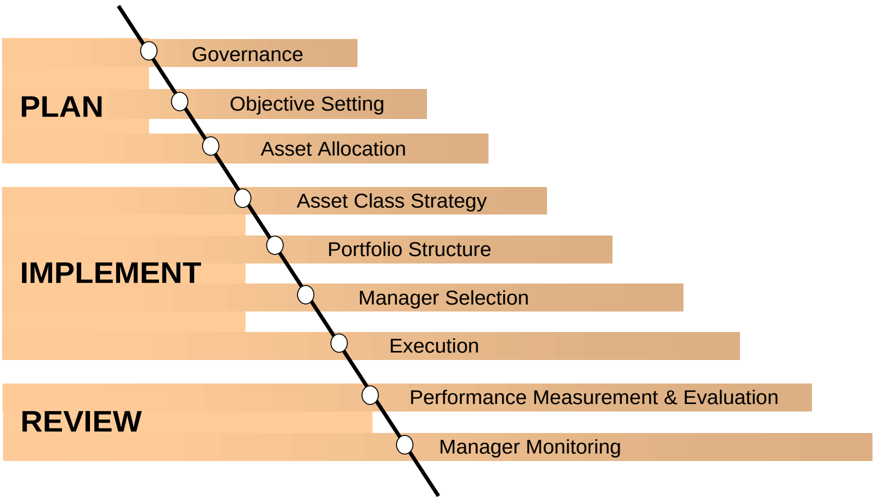
Final Exam

The final exam will be three hours, open book/open notes.

Grading

Asset liability study	15%
Topic presentations	15%
Seminar participation	10%
Weekly summaries	5%
Final strategy presentation	15%
Final exam	40%

The Investment Process



Governance is about ensuring that a portfolio is managed properly. Its focus is to ensure that decisions and tasks are assigned to the most appropriate person or group, and to operate compliance systems.

Objective Setting elucidates the investment result that the institution aims to achieve. They must be realistic, and reconcile competing sub-goals.

Asset Allocation determines what proportion of total assets will be allocated to each broadly defined class of assets – e.g., equities, fixed income, or property. The asset allocation decision depends on the objectives defined in the previous decision step, and forecasts of asset class returns.

Asset Class Strategy defines in detail how the allocation to individual asset classes will be invested across sectors within the class — active or passive, combinations of styles — and sets up performance benchmarks and targets.

Portfolio Structure matches specific investment managers to the chosen asset class strategy. This step is critical in reviewing and changing asset class and manager structure.

Manager Selection involves research to identify the best managers for the asset allocation and portfolio structure that has been chosen.

Execution covers the steps necessary to implement the investment programme efficiently — transition, manager guidelines, custody, fee and contract negotiations.

Performance Measurement and Evaluation involves analysis of total fund, asset class and manager performance vs. benchmarks and peer groups. Results are compared with objectives and changes that may be necessary are highlighted.

Manager Monitoring is ongoing research of investment managers to ensure that they continue to be suited to their respective roles in the portfolio structure, that there are no organisational or personnel changes that would endanger the fund's performance, and that they are complying with their guidelines.