



YALE
UNDERGRADUATE
DIVERSIFIED
INVESTMENTS

Meeting # 3
Investment Philosophies

Announcements

- **Networking Fundraiser**
 - closes Feb 1st at 6pm, raffle takes place afterwards and the winner will be announced the following week...
- **Wall Street Survivor**
 - Starting trading in the competition! If you don't trade, you don't count...
 - Look at current standings
 - Interested in Course Material?

Wall Street Survivor

- What to write on the flash card:
 1. What'd you pay for *all* of the courses (course bundle)
 2. What'd you pay for a *single* course
 3. What you want to get out of the Wall Street Survivor service? Help you learn more about investing? Prepare you for finance interviews, etc...

What we've covered so far...

- Lecture 1:
 - ✓ - Basics to the stock market
 - ✓ - Top Down Approach
- Lecture 2:
 - ✓ Personal Risk Tolerance/Assessment
 - ✓ Asset Allocation
 - ✓ Diversification
 - ✓ Portfolio Management
- Lecture 3:
 - ✓ The beginnings of developing an *investment philosophy*

What is an Investment Philosophy?

- a set of rules, behaviors or procedures, designed to guide an investor's selection of an investment portfolio.
- based on the intractable belief you have in the principles and practices that guide your decision-making.

YOU!

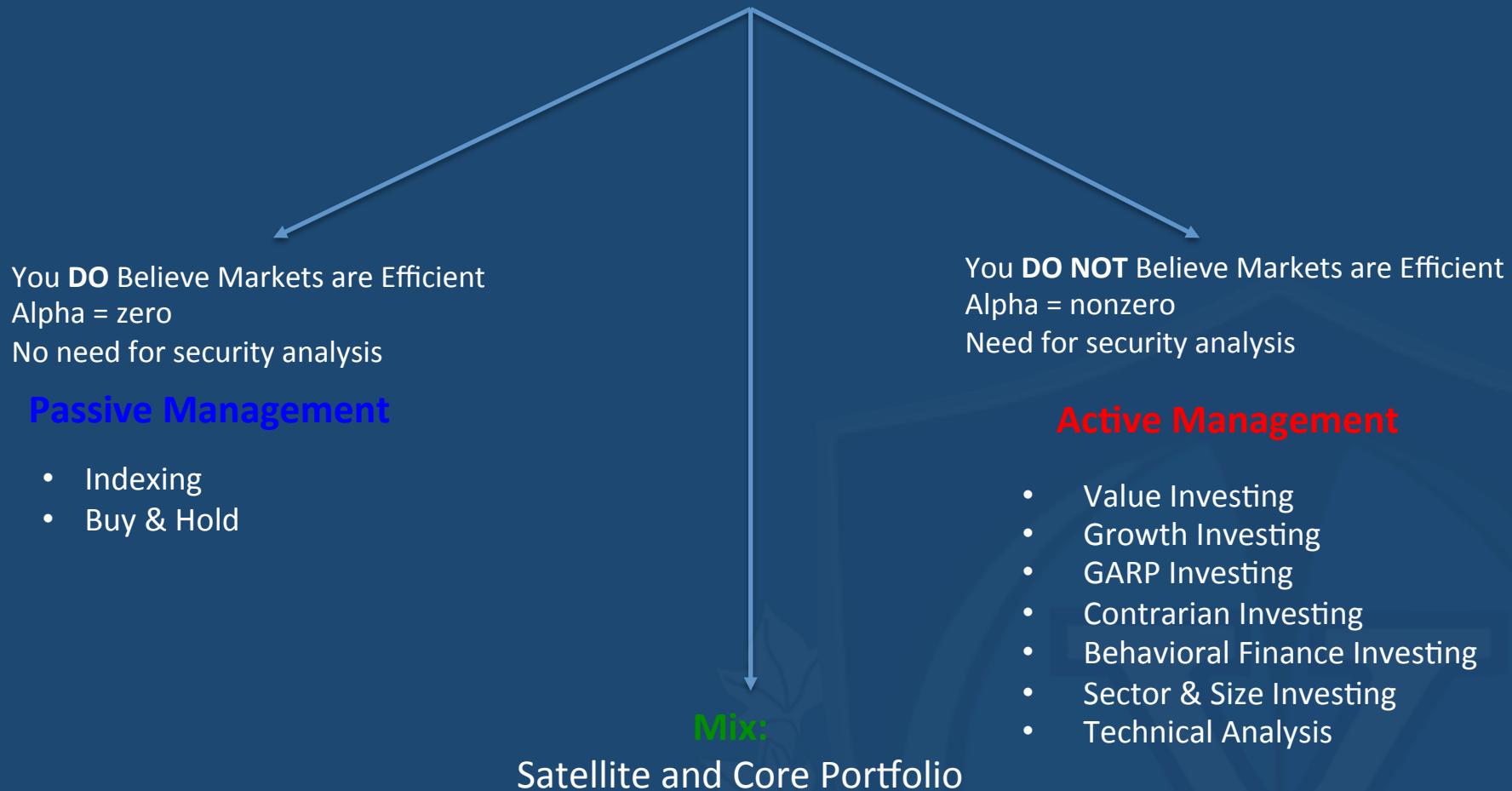


Why is it important to have an investment philosophy?

- You *need* to find an investment philosophy or a combination of such that you believe in.
- Having such a philosophy keeps you disciplined, helps take out some of the emotions in investing, and keeps you from acting impulsively when you feel tempted.
- Important note:
 - your ***Investment Philosophy*** should stay the same over time, but your ***Investment Strategy*** will change accordingly with your age and preferences.

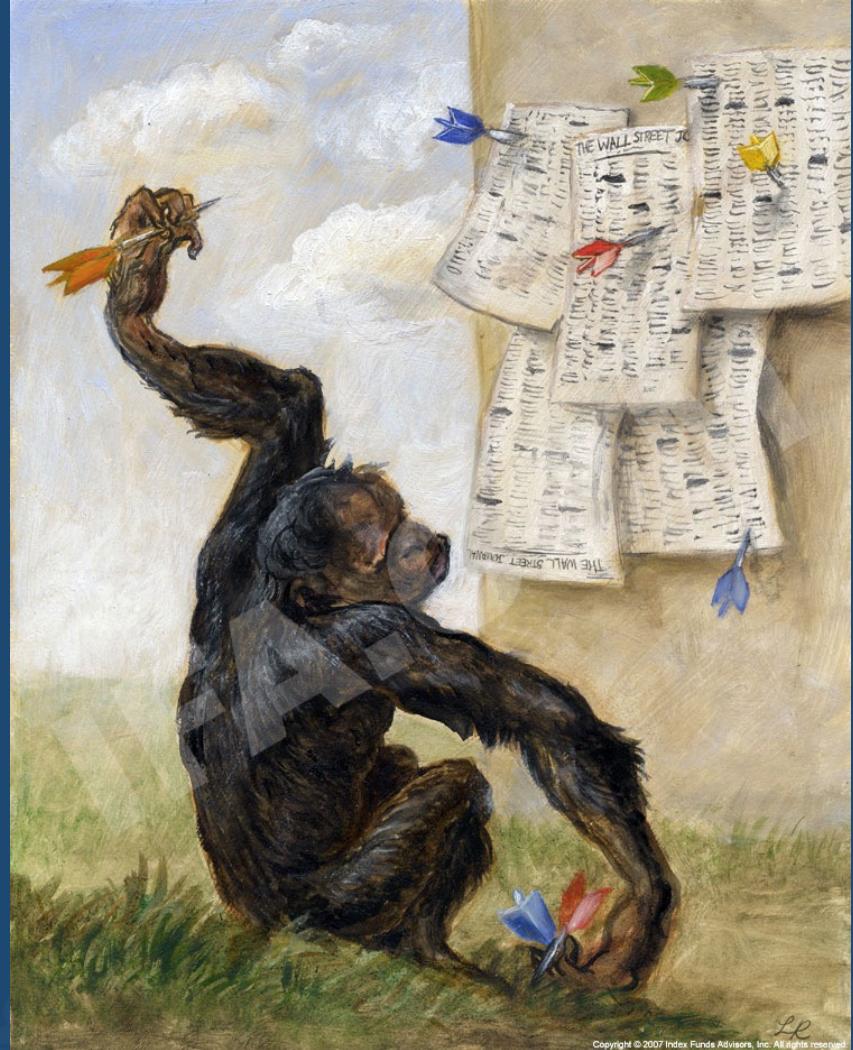
How to choose from the abundance?

Start with your opinion on the Efficient Market Hypothesis (EMH)



We are going to test the Efficient Market Hypothesis...

Pick *random* stocks
and put them into
their own WSS
portfolio...

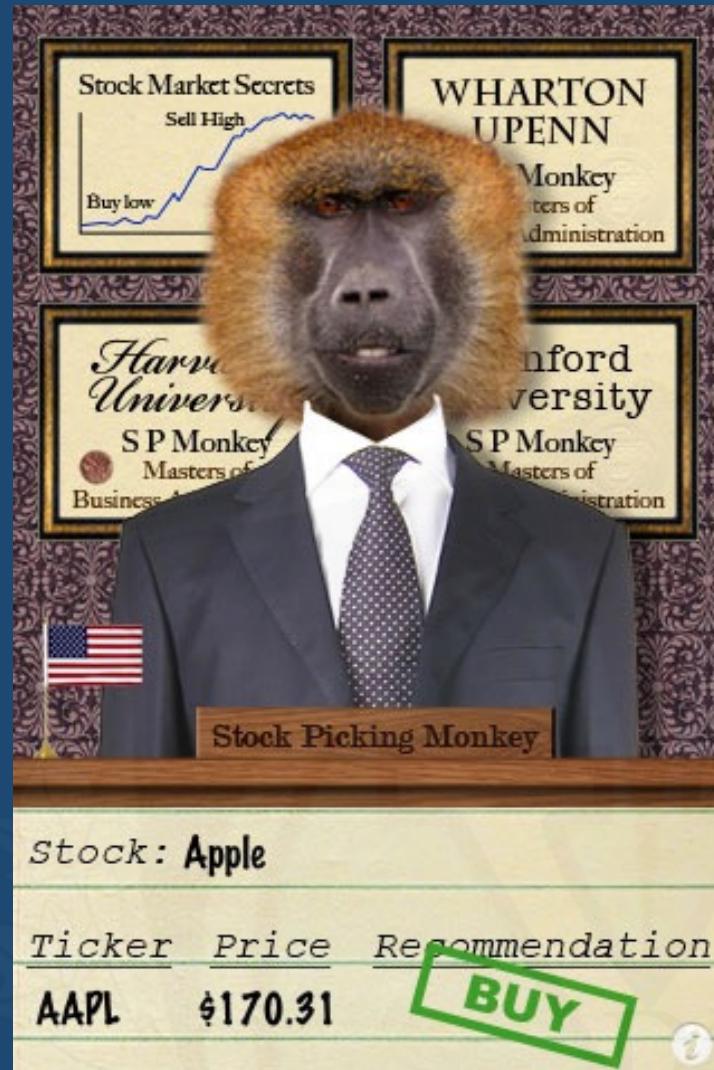


<http://finance.yahoo.com/news/random-stock-picking-beat-p-074932565.html>

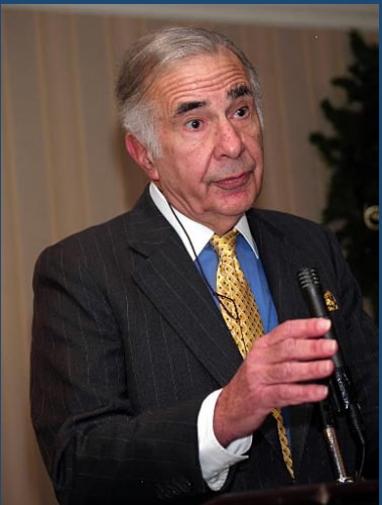
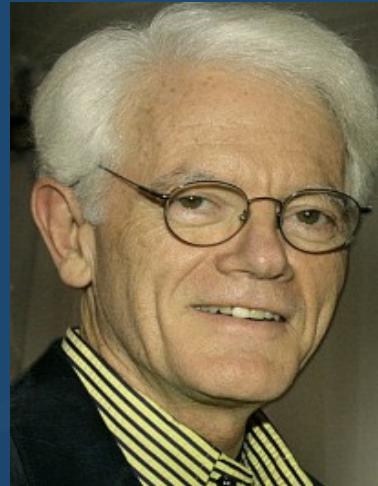
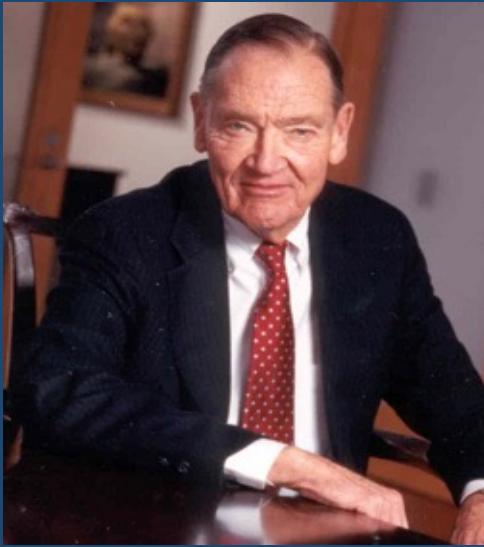
Random Stocks Generated...

<http://randomstocks.buckmaster.ca/>

1.	MDM	1. IPAR
2.	IMUC	2. DPLO
3.	KEG	3. x
4.	TSEM	4. PBF
5.	PNI	5. FAN
6.	UBN	6. NLR
7.	CRTN	7. CVCY
8.	AXS-D	8. FNHC
9.	MVC	9. UIHC
10.	MDGN	10.XLF
11.	BNSO	11.HQY
12.	OSTK	12.ABMD
13.	SZMK	13.EXEL
14.	GPE-A	14.ARDX
15.	SSYS	15.BA
16.	AOSL	16.TXT
17.	PHI	17.ADT
18.	TUP	18.CIX
19.	RTH	19.FSL
20.	IPD	20.EA
21.	ANFI	21.PSEM
22.	FHCO	22.CMCSA
		23.BIOA
		24.PLG
		25.HNH
		26.BCOM
		27.IRDM
		28.KEN
		29.PCYO
		30.WEC
		31.ED



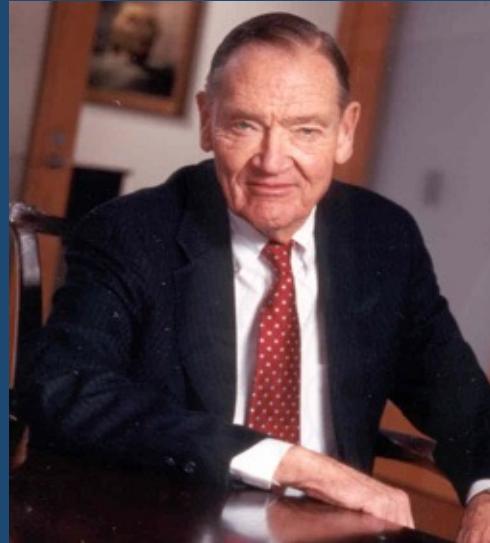
Famous Investors and their Philosophies



So...let's dive into the nature of these investing philosophies...

1) Passive Investing

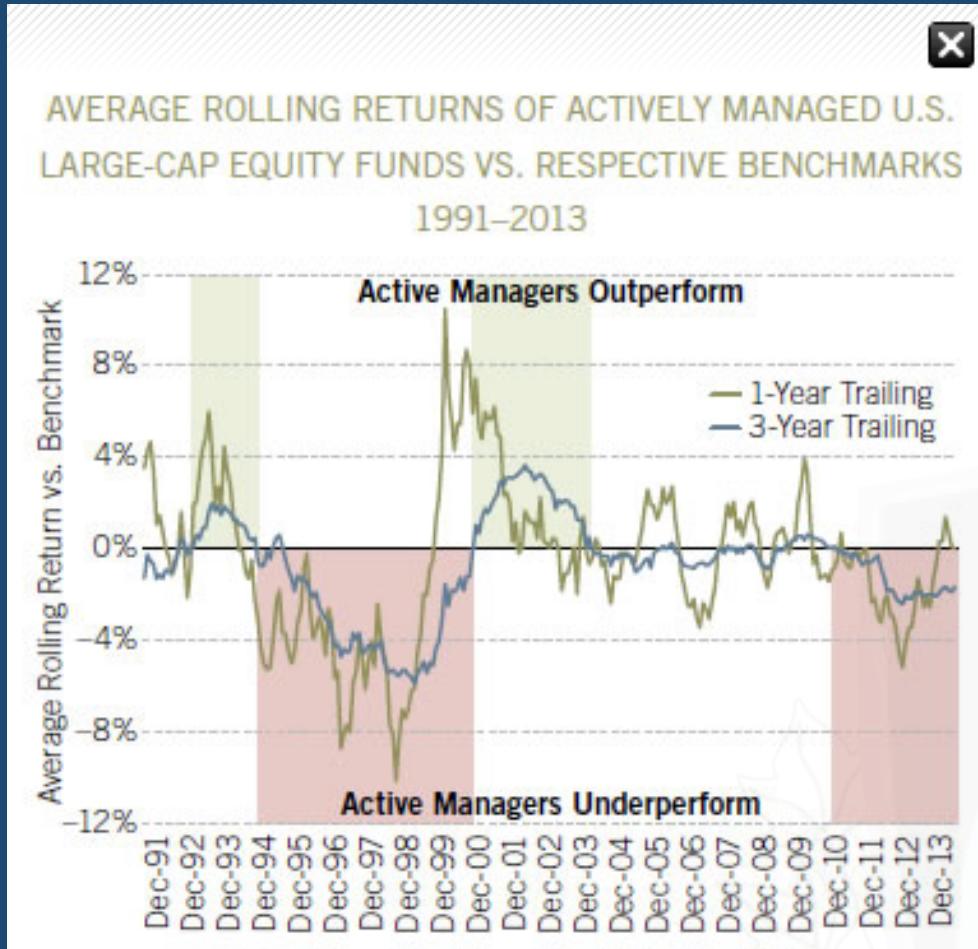
Indexing & Buy and Hold



Index Investing

- Believe markets are efficient
 - alpha (mispricing in the market) is believed to be 0
- Design a portfolio that tracks an index, like the S&P 500 or Dow Jones to earn the return of the market, not to beat it
- The belief is that over the long term, and after all expenses are accounted for, the net return for the passive investor is higher than for the active investor.
- **Is this true?**

The Debate: Active vs Passive



43% of time underperform

26% of time overperform

31% of time neutral

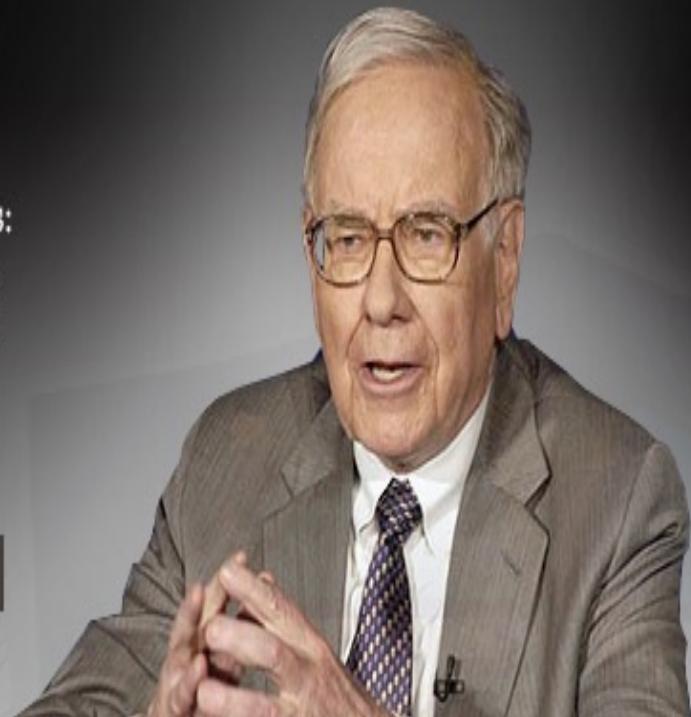
The studies also show active management works better in assets where research is an advantage, such as small cap stocks, international, emerging markets and Real Estate Investment Trusts. Logically, this makes a lot of sense.

Warren Buffet's Note on Indexing...

“ ”

Over the years, American business has delivered terrific results. It should therefore have been easy for investors to earn juicy returns: All they had to do was piggyback Corporate America in a diversified, low-expense way. An index fund that they never touched would have done the job. Instead many investors have had experiences ranging from mediocre to disastrous.

Warren Buffett - Chairman, Berkshire Hathaway



But then Buffet also says this...

A portrait photograph of Warren Buffett, an elderly man with white hair and glasses, wearing a dark suit and red tie.

Wide diversification is only required when investors do not understand what they are doing.

(Warren Buffett)

izquotes.com

One of the few people that can say this...

So...what's the answer?

- Passive Investing has an increasingly powerful argument...
 - Markets should get more and more efficient as time goes on.
- But...
 - New technologies may be developed which may unconventionally yet more accurately determine alpha in ways that we cannot now.

Active Investing

- Value Investing Strategy



Value Investing

- What is it?
- Buy intrinsically great companies that are currently cheap
- Value investing requires a lot of homework & discipline, but those who have the insight and put in the time can reap HUGE rewards
- Buffett's strategy that he took from Graham and Dodd...his conglomerate holding company, Berkshire Hathaway has beat the S&P 38 of the last 44 years...
 - <https://www.youtube.com/watch?v=dX2L7JhpXI8>

Value Investing: Relies on Quantitative Analysis

- Earnings (P/E)
- Book value (B/M)
- Dividends (DDM)
- Cash flow (DCF)

Understanding Financial Ratios and being able to apply and analyze them efficiently will be imperative to your success!

If the fundamentals of the company seem stronger than its current stock price, then the stock is considered **undervalued**

Fundamental Analysis

Explained.



Fundamental Analysis is a method of valuing securities such as stocks & bonds that attempts to discover their true value by examining related economic and financial factors

Todd uses fundamental analysis to help him select a stock and determine its price direction.

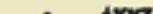
Todd is deciding between **TWO** different companies. Which should he pick?



Todd looks at the Financial Statements of both companies to see which company is undervalued and which is overvalued

Todd uses ratios to compare both company's numbers to the numbers of similar stocks.

Todd studies company financial statements, & past and current news as part of the fundamental analysis. Todd does further extensive research and visits the stores in person.



After his extensive research, Todd finds that stock \$XYZ is truly overvalued... meaning the price per share of stock, is more expensive than it should be based on the company's true worth. Due to this, Todd believes the price will fall.

Todd also believes that stock \$ABC is undervalued and that its per share stock price will rise to match the value of the company

Todd does the following based on his analysis:
Buy 100 shares of \$ABC
Short Sell 100 shares of \$XYZ

We'll expand on this two lectures:
February 26th!

Value Investing:

Also Relies on Qualitative Analysis

Buffet's Four Filters

1. **Understand the Business-** Invest in companies that you understand--Buffett's largest holdings have typically been in large companies that sell everyday stuff. Simple does not mean they are bad investments.

2. **Enduring Competitive Advantage-** Companies with Strong Brand Image and that have an advantage that will last...you have to identify it

3. **Demand good management-** Strong, reliable management. You want able and trustworthy managers.

4. **Bargain Price & Margin of Safety-** the company is selling at a price that is less than its intrinsic value suggests it could be a buy...but it needs to be a considerable price away from its intrinsic value (~25%).

Value Investing Wrap up

A Typical Value investor:

- Researches companies thoroughly
- Invests in companies he or she understands
- Can tolerate volatility (fluctuations in the market)
- Stays invested for the long term

PROS

- Can provide superior returns.
- The most sound way to determine a company's true worth
- Eliminates emotions from investing.
- Discourages excessive trading—which can cost investors a lot in fees and capital gains tax.

CONS

- Requires discipline
- Involves a lot of research
- Increases risk: value portfolios tend to be less diverse than other portfolios, and that can make their value fluctuate more.
- Is very subjective

Active Investing

- Growth Investing Strategy



Growth Investing

- What is it?
- A strategy whereby an investor seeks out stocks with what they deem good *growth potential*. In most cases a growth stock is defined as a company whose earnings are expected to grow at an above-average rate compared to its industry or the overall market.
- Signs of Growth Stocks:
 - No dividends
 - High P/E ratio relative to industry average (i.e. they are expensive)
 - High growth in revenue, profits, and expansion
 - Example = CMG (Chipotle)

Phillip Fisher's 15 points...

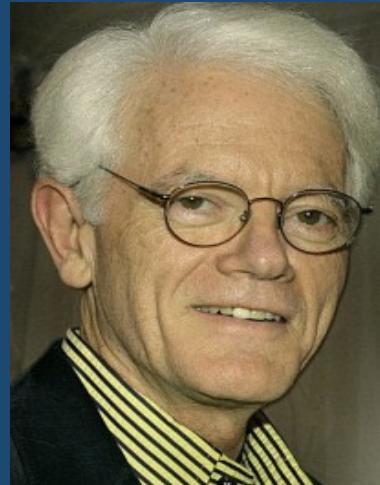
- The 15 Points to Look for in a Common Stock:
- Does the Company have products or services with sufficient market potential to make possible a sizable increase in sales for at least several years?
-
- Does the management have a determination to continue to develop products or processes that will still further increase total sales potentials when the growth potentials of currently attractive product lines have largely been exploited?
- How effective are the company's research and development efforts in relation to its size?
- Does the company have an above average sales organization?
- Does the company have a worthwhile profit margin?
- What is the company doing to maintain or improve profit margins?
- Does the company have outstanding labor and personnel relations?
- Does the company have outstanding executive relations?
- Does the company have depth to its management?
- How good are the company's cost analysis and accounting controls?
- Are there other aspects of the business, somewhat peculiar to the industry involved, which will give the investor important clues as to how outstanding the company may be in relation to its competition?
- Does the company have a short-range or long-range outlook in regard to profits?
- In the foreseeable future will the growth of the company require sufficient equity financing so that the larger the number of shares then outstanding will largely cancel the existing stockholders' benefit from this anticipated growth?
- Does the management talk freely to investors about its affairs when things are going well but "clam up" when troubles and disappointments occur?
- Does the company have a management of unquestionable integrity?

Pros/Cons

Advantages of growth investing	Disadvantages of growth investing
Potential to realise substantial returns in a shorter time span than value investing.	Market downturns usually affect growth stocks more than value stocks.
Potential to generate good income streams if one manages to invest into those growth stocks whose dividends grow in line with rapidly rising earnings.	High expectations built into the companies' prospects increase the probability of disappointing investors if the companies did not exceed the investors' expectations (note: it is not enough to meet the investors' expectations since they have priced in much growth).
	Absence of a large margin of safety increases the probability of loss on investments.

Active Investing

GARP



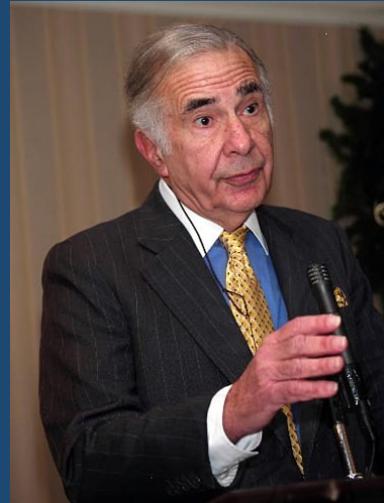
GARP Strategy

- GARP = Growth At a Reasonable Price.
 - Pioneered by Peter Lynch
 - Combines the tenets of value and growth investing
 - Growth is relatively high but the price is still relatively low



Active Investing

-Contrarian Strategy



Contrarian Investing

- https://www.youtube.com/watch?v=L1zIW_1-4c

Icahn has stated, "My investment philosophy, generally, with exceptions, is to buy something when no one wants it."

Active Investing

- Behavioral Investing Strategy

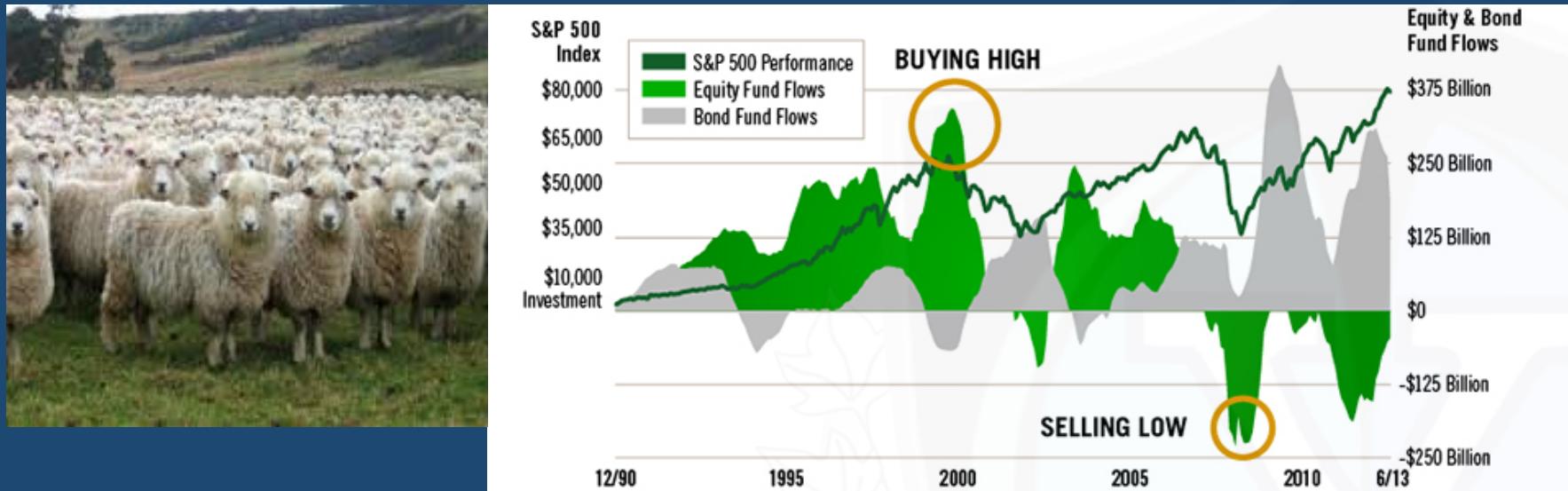
Behavioral Finance Strategy

Plays off of contrarian investing but focuses on the *psychology* behind investment decisions!



Behavioral Finance Strategy

- As you should remember, this was the topic of Professor Barberis's lecture.
- He mentioned how Behavioral Finance was a description of herd mentality in the market place, causing temporary mispricing's which could be taken advantage of to generate alpha.



Active Investing

- Size & Sector Investing Strategies

- Size & Sector Investing Strategies

- Some Investors specify the ***size*** of their investments... tilting their portfolio to small, medium, large, or mega cap stocks if desired. Since small cap stocks have historically outperformed large cap stocks, many choose to have a larger percentage of small cap.
- Some investors also decide that they don't want to pick individual stocks themselves, so instead they pursue a strategy of investing in ETFs and or mutual funds to that track certain ***sectors*** of the economy. More of a passive approach...

Active Investing

- Technical Investing Strategy

Investment Strategy—Making Choices

Technical Analysis

- A technical analyst looks at historical price data in search of indicators that a stock is going to continue or reverse its current trend
- Technical analysis investors look at past data and identify trends that predict future outcomes
- The red line is called "resistance", generally it's unlikely a stock will increase at a rate that will put it above that line.
- The blue line is called "support". If there are dips in the stock price, it is unlikely to drop below that line.



Mixed Strategies: Core & Satellite



Core & Satellite

- Simple Idea...
- Simply combine passive and active management...
- The **core** of your portfolio represents a broad index (i.e. S&P500) while the **satellites** represent the individual, specific, active investments of your portfolio



Wrapping Up!



Wrapping Up!

- Developing an investment philosophy will not happen overnight... if you do it right, it can, will, and should take you many years. You need to experiment, read, and see for yourself what feels right. Now you know the majority of philosophies and strategies out there, it's time for you to keep practicing and applying different strategies to your portfolios! See what clicks for you!

Keep Practicing!

“No matter how great the talent or efforts, some things just take time.
You can't produce a baby in one month by getting nine women pregnant.”

Warren Buffett
www.geckoandfly.com

