Asset Management  
Block Week Course  
(B7323-001 -- Winter 2014)

Professor: Geert Bekaert  
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Classroom: TBD  
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Practical Details:  
Class times: See schedule on Canvas and outline below.  
Prerequisites: Students must have taken or exempted from B6301 Corporate Finance.  
Students must have taken or exempted from B6302 Capital Markets and Investments or  
take it as a co requisite.  
TAs: Andrey Ermolov will be the TA for the class. The TA will hold a review session on  
basic statistical and finance concepts. He will also help with potential problems with the  
mean-variance optimization software I use for the class.

COURSE DESCRIPTION AND COURSE OBJECTIVE:

The course provides students with a fundamental understanding of the principles and  
analytics of asset management as applied to both institutional and private clients. This  
course will be of great interest to anyone aspiring to a career in asset, portfolio, private  
wealth, endowment, or pension fund management. A fundamental understanding of the  
issues in asset management, whether institutional or private, will also be helpful in other  
areas of finance such as investment banking, insurance, accounting and personal  
finance. In addition, students will learn how to better manage their future personal  
wealth.

All investors face three main problems, which will be covered to varying degrees in the  
course:

1. Asset Allocation – How do investors decide on the level of capital to allocate to  
   individual asset classes?  
   • Strategic asset allocation of pension funds/endowments  
   • Global asset allocation (Quantitative asset management)  
   • Individual's asset allocation
2. Implementation issues-How to implement the asset allocation?  
   • Portfolio Manager Selection: Asset owners usually delegate management of  
     their portfolios to financial intermediaries, which may invest across a broad array  
     of assets or specialize in a certain investment style or asset class.  
   • Investment Vehicles – passive versus active management, mutual funds, ETFs,  
     hedge funds and private equity.
3. Performance Measurement – How do investors determine how well money  
   managers have performed?
The course will include finance theory, statistical analysis and basic optimization theory, mirroring the investment management industry’s increased reliance on quantitative methods. The class will attempt to bring students to the frontier of best practice, but also introduce new relevant concepts from academic research. In addition, throughout the class I will point out puzzling behaviors or empirical facts, motivating why they are puzzling, and outlining the most recent academic thinking regarding these puzzles.

The organization of the class is roughly as follows:

I. **Institutional Asset Allocation**

This section starts by reviewing modern portfolio theory and applying it to the problem of strategic asset allocation (relevant for pension funds or endowments). We then discuss the state-of-the-art techniques used by quantitative asset managers, including the Black-Litterman model developed at Goldman Sachs. Globalization is a major trend affecting the asset management industry and we devote special attention to the international diversification of portfolios and the problem of global asset allocation. We also use international data to illustrate the quantitative tools employed in the industry.

II. **Performance Measurement and Investment Vehicles**

We cover standard performance measures such as Sharpe ratios, Treynor measures, Jensen’s alpha and information ratios. These measures were mostly developed for standard long only portfolios, such as those offered by mutual funds. Mutual funds run both portfolios for both individuals and institutions but we will cover the mutual fund industry from the perspective of individual investors. We also analyze the state-of-the-art and popular technique of style analysis and apply it to the performance of the legendary Magellan Fund. We also discuss performance evaluation techniques for hedge funds. We use a case on active currency managers to discuss the emergence of a new asset class, performance measurement for active managers using technical analysis, and the value of an asset management business. The hedge fund industry is discussed more generally as well.

III. **Asset Management for Individuals**

With the increasing importance of defined contribution plans, the responsibility of asset allocation has shifted to the individual. Financial planning for individuals has been revolutionized recently as more and more sophisticated advice has become available. We discuss special issues regarding individual asset allocation, including alternative preferences, life cycle investing, human capital, dynamic investing, taxes and retirement planning. We also discuss Private Wealth Management, the asset management for the very rich. Although Private Wealth Management relies on the concepts and analytics of institutional asset management, it has developed as a field of research and practice that is distinctly separate from portfolio management and institutional asset allocation. The challenges introduced by the need for tax efficiency, including issues relative to wealth transfer, as well as psychological and behavioral issues differentiate the practice of Private Wealth Management. An experienced practitioner will present to the class as the instructor has no special expertise in this area.
CONNECTION WITH THE CORE:
The class will utilize build on, and extend concepts covered in the following core
courses:
Corporate Finance:
• Efficient markets
• Risk
• The CAPM
Managerial Finance:
• Statistics data analysis (means, correlations,…)
• Normal distribution
• Linear regressions
Global Economic Environment
• Material on exchange rates
• Interest rates and inflation

The course builds heavily on and deepens much of the material covered in Capital
Markets.

COURSE MATERIALS:
• Class notes, Case materials (to be made available through Canvas);
• Course Readings, bound volumes of readings, cases.
• Some chapters in Bodie, Kane and Marcus, (Irwin McGraw Hill), the text for Capital
Markets (B6302), should prove useful for a better comprehension of investment
analytics.
• Recommended books:
  -The Intelligent Portfolio by Christopher L. Jones. This book will be a nice
    complement to a number of classes and provides a free try – out of the Financial
    Engines financial advice product.
  -International and Financial Management by Geert Bekaert and Robert Hodrick;
    some classes built heavily on some chapters in the book.

METHOD OF EVALUATION/COMPONENTS OF THE GRADE
Most assignments for this class will be conducted within groups of 3 to 5 people. The
groups are to be the same for all cases / assignments and the group members will rate
each other’s contribution at the end to avoid free riding. The groups should be formed
as soon as possible, preferably in the first week.

1) Case Write Ups (40%)
There will be 6 to 7 Cases. This could be a genuine Harvard case (for example the
Harvard Management Company case) or it could be a mini-case or exercise written by
the instructor (for example the G7 Global Asset Allocation Case). Each case is
accompanied by a set of questions to be answered. Because of the concentrated nature
of the class, only 2 to 3 cases will have to be solved and written up in a formal document
outside class hours. The remainder of the cases will be solved in break-out rooms
during class time under my supervision. The grade will be largely based on the written
documents, but I will also judge the in-class work of the various groups.
All class write-ups are Type A!

2) **Class Participation and Attendance (15%)**

Class participation is an important part of your grade. You will be graded on attendance, thoughtful participation in class, and overall contribution to the learning of your peers.

3) **Final Quiz (45%)**

The Quiz will be organized as a “take home.” It will be an open-book, written exam, which will primarily test your knowledge of the concepts taught in class. The exam should at most take two hours to complete. If you attend class and do the work, it should be rather straightforward to pass with flying colors.

Finally, I have prepared a number of questions (a “testbank”) designed to help you prepare for the final exam. You can solve these questions on your own but the TA or I will hold a review session based on the testbank material.

**PRELIMINARY OUTLINE:**
The outline is highly preliminary and subject to change. Readings will be added as we go on and the outline will be updated on Canvas. Classes denoted with an asterisk are likely to be “equation-intensive,” extra caffeine dosage highly recommended. Readings marked as “Background materials” are not required reading.

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**Day 1: MARCH 16th**  
**Morning Session: 9:00 – 12:00: Introduction and MVO**

**Introduction to Asset Management**  
The Asset Management Industry  
Introduction to Wealth Management

**Concepts and Techniques**  
Review of Concepts/Techniques of Modern Portfolio Management  
Review of Mean Variance Optimization (with Matrix Algebra), using the Harvard Management Case as an illustration*  
Introduction to Strategic Asset Allocation

**Materials:**
- READ BUT DO NOT SOLVE THE HARVARD MANAGEMENT CASE  
- Class Notes

**Background Material:**
- Bodie, Kane, Marcus (9th Edition), Chapters 5, 6, 7  
- Jones, Chapters 1, 5  
- Bekaert-Hodrick textbook Chapter 13 on International Capital Market Equilibrium, Section 13.3
Review Session on Statistics by Andrey Ermolov; TBA

**Afternoon Session: 1:00 – 5:00: Strategic Asset Allocation**

**Solve the Harvard Management Case in Break-out Rooms**

**Strategic Asset Allocation**

**TIPS**
- Capital Market Assumptions Equities/Bonds
- Endowments versus Pension Funds
- Puzzle: The Fed Model

**Materials:**
- Class Notes
- Harvard Case 9-201-053: The Harvard Management Company and Inflation-Protected Bonds

**Background Material:**
- Bodie, Kane, Marcus (9th Edition), Chapters 6, 7
- Jones, Chapters 2, 8

**DAY 2: MARCH 17th**

**Morning Session: 9:00 – 12:00: Global Asset Allocation**

**The Case for International Diversification**
- The “Case for International Diversification”
- Puzzle: Home Bias

**Global Asset Allocation and the Black-Litterman Model: Intro**
- The G7 Case

**Materials:**
- WRITE UP G7 CASE DUE IN CLASS
- Class Notes

**Afternoon Session 1:00 – 5:00: The Black-Litterman Model**

**Global Asset Allocation and the Black-Litterman Model: Intro**
- Review of CAPM*
- Revisiting Home Bias
- The Black-Litterman Approach to Asset Allocation (Introduction)*

**Advanced Asset Management: Black-Litterman “Light”**
- The Black-Litterman Model*
- Revisiting the HMC Case*
Materials:
- Class Notes
- Bekaert-Hodrick textbook Chapter 13 on International Capital Market Equilibrium, Sections 13.4 and 13.5
- Read but do not submit G7 Case II

Background Material:
- Jones, Chapter 4
- Bodie, Kane, Marcus (9th Edition), Chapters 5, 8, 9

DAY 3: MARCH 18th
Morning Session: 9:00 – 12:00: Currencies and Currency Hedging
International Parity Conditions and Currency Risk
Solve Currency Hedging Case In Break-out Rooms

Materials:
- Class Notes
- **Read but do not solve Currency Hedging Case**
- Chapters 2, 3, and 6 in Bekaert-Hodrick Textbook

Afternoon Session: 1:00 – 5:00: Active Currency Management

Currencies and Hedge Funds
Active Currency Management/Hedge Funds
Technical Analysis
Currencies as an Asset Class
Puzzle: The Carry Premium
Commodities vs. Currencies

Materials:
- **Read for class discussion Active Currency Management Case (TOM vs USCB) and solve questions. I will give groups 20 to 30 minutes to prepare an answer to an assigned question for class discussion.**
- Nielsen, Bo. “Taylor Rules Currencies, Not to be Confused With the Other Guy,” www.bloomberg.com 2008
Background Material

- Bodie, Kane, Marcus, Chapters 24
- Bekaert-Hodrick textbook, Chapters 7,10

DAY 4: MARCH 19th
Morning Session: 9:00 – 12:00: Emerging Markets

Emerging Markets/Diversification Revisited
Emerging Markets and Asset Allocation
Globalization and Asset Prices

Materials:

- WRITE UP ON EMERGING MARKETS CASE DUE
- Class Notes

Background Material:

- Bekaert-Hodrick textbook, Chapter 12

Afternoon Session: 1:00 – 5:00: Performance Measurement and PWM

Performance Measurement
Standard Performance Measures
Style Analysis*

Materials:

- Class Notes

Background Materials:

- Bodie, Kane, Marcus, Chapters 4 (Mutual Funds), 24 (Performance Measurement), 26 (Hedge Funds)

Personal Wealth Management
Speaker on PWM Industry; Ann Kaplan, Circle Financial Management (former partner Goldman Sachs, Board of Trustees Columbia)

*Footnote: I will give groups 20 to 30 minutes to prepare an answer to an assigned question for class discussion.
DAY 5: MARCH 20th
Morning Session: 9:00 – 12:00: Idiosyncratic Risk

Idiosyncratic Risk
Measuring Idiosyncratic Risk
Quantifying the Cost of the Idiosyncratic Risk
Company Stock and Asset Allocation
Puzzle: Under-diversification

Materials:
- SOLVING THE IDIOSYNCRATIC RISK CASE IN BREAK-OUT ROOMS; PREPARE QUESTIONS
  - Class Notes
  - The BP-Amoco Case (Idiosyncratic Risk)
  - Harvard Case 9-201-052: The Harmonized Savings Plan at BP Amoco

Background Material:
- Jones, Chapter 6

Afternoon Session: 1:00 – 5:00: Mutual Funds and Personal Investments

Mutual Funds and Performance Measurement
Individual Asset Allocation/ Retirement planning
Revisiting market efficiency
The Magellan Case
Puzzle: Why are there so many active funds?
ETFs
The Stock Market non-participation puzzle
Individual Portfolio Management
The Annuity puzzle
Rev up your Financial Engines

Materials:
- SOLVING THE MAGELLAN CASE
  - Class Notes

Background Material:
- Jones, Chapters 3, 5, 7, 9-11
- Bodie, Kane, Marcus, Chapters 4, 5, 11, 24

When time is left: Testbank Review