

# FAQs About Student Managed Funds

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*Trinity University's Student Managed Fund (SMF) began operation in 1998 with \$500,000 allocated by the Board of Trustees from the endowment fund. The SMF managed just over \$3,000,000 in 2012, most of which was invested in common stocks. Students in Trinity's SMF, all undergraduates, are responsible for preparing and presenting analyses of stocks to the SMF class and by vote make investment decisions on behalf of the university. Throughout the two-semester program students monitor and manage the SMF portfolio and present reports to the Board of Trustees. In this article the faculty leader answers frequently asked questions (FAQs) about the background, academic content, and administration of the program. Specific FAQ's include, among others, sources of funding for an SMF, use of returns, an appropriate dollar amount for initiating an SMF program, student enrollment policies, academic preparation of students, practices regarding investment decision-making, and faculty advisory responsibilities.*

## INTRODUCTION

In 1998 Trinity University's Board of Trustees established the university's Student Managed Fund (SMF) with an allocation of \$500,000 from the university's endowment. The Trinity University SMF, which is an undergraduate program, is viewed by the university's Board of Trustees, students, faculty, alumni, benefactors, and other constituents as an extraordinary academic success and one of Trinity University's signature academic programs. Trinity's SMF has also succeeded financially in providing the university with consistently competitive if not superior returns relative to the stock market. Additions to the fund from the Board of Trustees plus returns have increased the SMF to a market value exceeding \$3,000,000. The purpose of this paper is to offer answers to frequently asked questions (FAQs) about SMFs. The answers will allow institutions that are considering adding an SMF or revising their SMF to benefit from the experience in founding and running a successful SMF at a small, predominantly undergraduate institution. The answers are based on SMF literature and the experience of the senior author.

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FAQs and associated answers below are divided into three categories: background, academics, and administrative issues. Background FAQs provides a brief history of Trinity University's SMF program. Academic FAQs answer common questions regarding academic credit for the SMF program, how investment decisions are made, curriculum for the courses, blending theory with practice, how students are enrolled in the course, suggested background for the instructor/advisor, and others. Administrative FAQs address brokerage arrangements, who places the buy/sell orders, number of students suggested for an SMF, suggested beginning amount of funds, investments that are allowed in the SMF, data resources that have been helpful, what happens to earnings, how performance of the SMF is measured, and others.

## LITERATURE REVIEW

Literature on the subject of student managed funds divides into two topic areas, survey articles that typically list the surveyed programs and provide information on age of the program, funding sources, total value, investment alternatives, faculty staffing, and methods of analysis. Another genre of related literature focuses more on administrative issues related to SMFs. The essence of survey literature regarding SMFs is found in Lawrence (1990, 1994, and 2008), Neely and Cooley (2004), and Peng, Dukes, and Bremer (2009). The early survey by Lawrence (1990) reported characteristics of 22 SMFs including year funded, total value, investment alternatives, and how the income was used. The 1993 survey by Lawrence (1994) updated and expanded the earlier survey by including additional universities, information on course credit, class size, number of faculty advisors, and expenses paid by the fund, if any. In his 2008 survey Lawrence (2008) again updated and expanded his survey research to include 314 SMFs, 25 of which were non-U.S. funds.

Neely and Cooley (2004) reported the results of a survey of 61 instructors of SMFs in which they inquired about year of inception, current value, sources of funding, course structure, and investment policy. Funding of SMFs tends to be provided by individuals and university endowments; most SMFs focus on investing in equities, and most programs are structured as academic courses rather than extracurricular activities. They concluded that the growth of SMFs in general is the result of the benefits of experiential learning, popularity with local business leaders, and the value of the SMF experience to prospective employers. Peng, et al. (2009) analyzed data from a sample of 35 SMFs for information on databases used by students in their analysis of securities and also methods of security analysis and investment decision-making. The authors found that the most widely used sources of information were the *Wall Street Journal* and *Value Line Investment Survey*. Most of the sample SMFs applied the capital asset pricing model when estimating risk-adjusted required returns and many relied on discounted cash flow models for calculating expected returns to securities.

Block and French (1991) shared their experiences as faculty advisors to the SMF at Texas Christian University. They give advice on how to get an SMF started including the importance of a program manual that states the educational objectives, admission policies, investment objectives and policies, accountability, and reporting requirements. The authors list investment information sources, discuss the importance of a two-semester SMF program rather than just one semester, and discuss academic requirements for admission to the program. Johnson, Alexander, and Allen (1996) compared the advantages of an electronic meeting system (EMS) environment for a SMF with that of the traditional classroom. They found the EMS to be a viable alternative that resulted in greater student participation and more in-depth discussion than the traditional classroom environment. The data were not sufficient to conclude whether the quality of the analysis and decision making were enhanced by the EMS. According to Kahl (1997) the SMF at the University of Akron was funded from an external source and was a one semester course each for undergraduates (fall) and MBA students (spring). At that time the Akron SMF invested in common stocks, bonds, money market instruments, and investment company shares. Also the Akron SMF course was uniquely a platform for integrating tax law, marketing, legal and ethical standards, and portfolio management in one course. Macy (2010) offers steps in forming an SMF class at a smaller, regional university. Those steps include establishing asset allocation guidelines, the decision-making process, report preparation, and a suggested use of the returns to the SMF as scholarship funds. The author also suggested a process of assessment that is linked to the subject areas of CFA Level I and CFP exams. Mallett, Belcher, and Boyd (2010) provide a history of successes and failures of the Roland George SMF program, which began in 1980 at Stetson University. Their purpose in the article was to share lessons learned for other universities who may be considering a SMF program.

## **BACKGROUND**

What motivated the creation of an SMF at Trinity University?

The Board of Trustees of Trinity University, the Trinity University administration, and the faculty in Business Administration wished to provide an unusually valuable learning experience for students who are interested in security analysis and portfolio management. The experience of analyzing stocks, making investment decisions, and managing a real portfolio provides unique experiential learning that adds significant value to a college education.

How large was the fund at creation, how was it funded, and how large is it today?

The Trinity University SMF was created by action of the university's Board of Trustees on February 17, 1998. Later that year \$500,000 was allocated from the

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university's endowment for the SMF. Additions from the Board totaling about \$365,000 were made in 2005. Trinity University's Board of Trustees reaffirmed the SMF program in 2011 by allocating an additional \$1,533,000. Some dividends were taken by the university in the early years of the SMF. In early 2012, the fund's value exceeds \$3,000,000. Alternatives to the university endowment as the funding source for an SMF are the following: foundations, alumni, businesses, and benefactors.

### *Academics*

What is the course structure? (3 semester hours or 6-semester hour sequence)

The Student Managed Fund at Trinity University is a 2-course, 6-semester hour sequence that begins with new enrollment each fall semester. Knowledge, experience, and sophistication in investment analysis and decision-making build through the year in a 2-course sequence that could not happen in a single 3-semester-hour course. Also the learning objectives of the SMF regarding literature review and report preparation and presentation require a full-year, 6-semester-hour sequence. As discussed below, the fall SMF course begins with intensive study of security analysis. The first security analysis reports are presented by students to the class in October. The class meets for 75 minutes two times each week, later in the afternoon after the markets in New York have closed. Additional meetings may include visits to local corporate headquarters or may be called in response to unusual market volatility. The spring course begins with additional reading assignments, which are followed by security analysis reports and presentations.

How do you blend the academics of investing with practice?

The SMF course is primarily experiential with a blend of traditional academic requirements. Students are required to complete reading assignments, security analysis teams of three students each make presentations of their analyses to the class, and each student is required to complete special projects. Five books are assigned in the two-course sequence. *One Up on Wall Street* by Peter Lynch and *Security Analysis on Wall Street* by Jeffrey C. Hooke are assigned in the fall. *Financial Statement Analysis: A Practitioner's Guide*, 4<sup>th</sup> ed., by Martin Fridson and Fernando Alvarez, *Stocks for the Long Run*, 4<sup>th</sup> ed., by Jeremy J. Siegel, and *Equity Asset Valuation*, 2<sup>nd</sup> ed., by Jerald E. Pinto, Elaine Henry, Thomas R. Robinson, and John D. Stowe are assigned reading in the spring. In both semesters student must remain current in the *Wall Street Journal* and *Barron's*. Special projects that students undertake include maintaining the SMF website, preparing the SMF newsletter, making brief presentations to basic finance classes promoting the SMF, reports and presentations to the Board of Trustees, brief research reports to be presented to the class, preparing the classroom for the class meeting (having CNBC

on the screen at the beginning of class, etc.), and others that students may propose. Very little lecturing is done in these courses. Students are expected to prepare for discussions of assigned readings and to be familiar with current stock market conditions. As the course progresses, student teams make security analysis presentations during class meetings. Students' grades in the courses are based on the quality of their presentations, completion of special projects, and their class participation. There are no examinations in the SMF courses at Trinity University.

How are investment decisions made for the SMF?

Security analysis presentations are made to the class by teams of students in the class. The basis for an investment decision is a fundamental analysis of a stock of interest to a team that concludes with an estimate of the value of the stock that is then compared to the current price of the stock. The investment decision made by the class ultimately is based on the valuation of the stock. Technical analysis may be employed for timing a buy or sell order, but there is no day-trading or buy/sell decisions made with charting or technical analysis methods. If a team makes an affirmative recommendation in their presentation, the class votes by secret ballot whether to make the investment. The secret ballot helps discourage "horse trading" among security analysis teams in the class. The professor has one vote, as does each student. A 2/3 vote of the class at a meeting subsequent to the day of the presentation is required to accept an affirmative investment recommendation by a team and proceed with the investment of funds. Some presentations conclude with "do not invest" recommendations. Sell recommendations are decided in the same manner as buy recommendations. Securities that are in the portfolio that no longer appear to offer a reasonable return relative to risk or when there is an unusual opportunity to cash in a profit, a team presents a sell recommendation to the class for a vote. The professor does have veto power over buy and sell decisions, but that authority is to be used sparingly in order to preserve the educational goals of the course, and this authority has never been used at Trinity University. The goal is to place firmly on the shoulders of students their fiduciary responsibility to the client – Trinity University.

What is the curriculum (i.e., do students focus on particular sectors, industries, investment strategies, and other factors)?

As suggested by the reading assignments referenced above, the curriculum focuses on teaching fundamental analysis of stocks where the goal is to arrive at an investment decision based on an estimated value of the stock as compared to its current price. Value per share is estimated via a pro-forma estimate of a company's earnings per share combined with such valuation metrics as Price/Earnings, Price/Sales, Price/Book, and Enterprise value/Earnings before interest, taxes, depreciation and amortization (EV/EBITDA). In the spring semester the student

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teams also include analyses of discounted cash flow values of the stocks in their presentations. The valuation process can fairly be viewed as a bottom-up or at most a blend of bottom-up and top-down analysis. The class comprises more than twenty student analysts seeking undervalued common stocks in whatever sector or industry that interests them.

Is the SMF structured as a class plus a lab?

The SMF class meetings begin in the fall with discussions of required readings, which, in order to move on to investment analysis presentations, must be completed very early in the course. So the early part of the fall semester is more like a traditional class but with student-led discussions of the assigned readings. Security analysis teams of three students each begin making presentations in October, about six weeks into the semester. At that point the course becomes quite experiential and perhaps similar to a lab, but it is not considered to be a lab. Each class meeting begins with an update of stock market conditions via CNBC and an update on the value of the SMF portfolio and individual stocks. The class meeting then proceeds with discussions of assigned readings (early in the semester), special project reports, if any, and security analysis presentations with investment recommendations.

#### *Administrative Issues*

How are students selected for the program? Open admission versus admission by application? Are only finance students admitted to the program?

Students must apply for admission by completing a 1-page application form and interviewing with the professor prior to registration in the spring for the coming fall semester. The professor then admits the students who are best suited for the course. A copy of Trinity's student application form is provided in Appendix A. Since completion of the investment principles course and its four prerequisite courses are required for participation in the SMF, most students in the program are seniors who have planned early in their time at Trinity University to participate in the SMF. However, not all students in the SMF are finance or even business majors, but the completion of prerequisite courses in accounting, basic finance, statistics, economics, and investment principles or equivalent experience is necessary to ensure that each student can contribute meaningfully to the courses. Since SMF class meetings are run by the students and guided by the professor, students selected for the course must be more capable and self-motivated perhaps than the average college student. At Trinity University enrollment in the SMF is considered a privilege and usually only about 60 percent of the applicants are accepted for enrollment.

Is there a complete turnover of student members, or do some remain for continuity?

Each fall there is a complete turnover of students. While a complete turnover of students has its drawbacks, Trinity University is primarily an undergraduate institution. Trinity University does not have an MBA program, and since most students are seniors, continuity with students from the prior year's SMF courses is not realistic. To help with continuity and corporate memory, an operations manual is maintained and updated annually, and all students are required to read it. In addition, students from past SMF classes visit on "Student Panel Day" in the fall semester to impart wisdom to the new class.

Do current student members assist in selection of future student members?

No. Student privacy must be respected. However, SMF students visit basic finance classes and other classes in the spring semester where they hand out brochures and SMF application forms and make brief presentations; that effort no doubt influences SMF enrollment.

What is the required background and experience of the instructor?

Ideally the professor should be both academically and professionally qualified. He or she should be well educated in finance, accounting, and the principles of investments. Experience in making investments is crucial in teaching an SMF course. The investments made by the SMF are not hypothetical or theoretical but are actual purchases and sales of common stock on behalf of the fund. Those with extreme opinions regarding market efficiency or absence thereof or who rely solely on technical analysis for investment decisions or who favor day trading should be avoided. Similarly, a simple buy-and-hold policy or passively indexing the market would fail to provide the analytical expertise, investment decision making, and portfolio management experience students should gain from a student managed fund.

Is the program led by one or multiple faculty members? What is the time commitment that is required to lead or advise an SMF course?

Only one professor has guided the SMF program at Trinity University thus far. It is our view that one professor must be responsible for the program including placing buy/sell orders. Multiple faculty members would more likely bring more confusion than value to an SMF. The time commitment will likely exceed that for many finance courses. For faculty members who are active investors, however, the time committed serves a dual purpose – professional and personal. Truly, it is helpful if the time spent is a "labor of love."

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How many students are required to form a successful class?

The goal of the Trinity University SMF is to have 21 students who form seven teams of three students each for security analysis reports and presentations. Also 21 students are sufficient to complete the required special projects that are important to the SMF. The usual enrollment in the SMF at Trinity University has been in the low 20s, with the smallest around 18. There also is an active alumni organization that has been very helpful in providing employment opportunities for seniors in the SMF. Of course, larger classes over the years help in this regard.

What portion of the SMF (in dollars) is managed by students? What is the minimum amount of funds required?

The students in the SMF course make all of the investment decisions for the SMF and thus are responsible for managing all of the funds. They are not advisors to a committee of the Board of Trustees or any other managers; the students in the SMF are investment managers for Trinity University and report the results of their investments regularly to the Board of Trustees. In our view the minimum initial amount for a student managed investment fund should be \$1,000,000. That amount gets the attention of prospective students and their parents and makes a statement of support by the Board of Trustees for the program. Also, SMF students feel the fiduciary pressure when the sums they manage are large.

What are the investments that are allowed in the SMF?

The Trinity University SMF invests in common stocks only and in long positions only. The stocks that qualify for the portfolio are those of U. S. companies and American Depositary Receipts (ADRs) of foreign company stocks that are traded in the U. S. There are no short sales, options, futures, or other derivative securities. There are no bonds or other fixed income securities in the Trinity University SMF. The cash position of the SMF is usually less than 5% of the value of the portfolio, and no more than 5% of the value of the portfolio may be initially invested in any one stock. The SMF may continue hold to securities that appreciate beyond 5% of the value of the portfolio, but if the value of a security increases to more than 15% of the portfolio, that position will be reevaluated by the class. The purpose of the SMF primarily is to build the students' knowledge of security analysis as applied to common stocks and also to help students learn how to manage a real portfolio of common stocks. Even with a 2-course, 6-semester hour sequence, time in class and outside of class is not sufficient to include all kinds of securities meaningfully in the SMF curriculum. Also, since common stocks represent the largest investment allocation in portfolios generally, the experience in common-stock investment analysis, decision making, and portfolio management provides the most important investment education students could receive in their nine months in



the SMF. The Trinity University SMF Investment Policy and Code of Ethics are published on the University's website at <http://www.trinity.edu/smf>.

What are the brokerage arrangements?

The Trinity University SMF has a discount brokerage account with Fidelity. The professor has trading authority and may move funds from cash to stocks and from stocks to cash, but he has no authority to transfer funds out of the SMF account. It is important in establishing the brokerage account that methods be in place for controlling cash and securities. Also, conflicts of interest must be avoided in establishing a brokerage account.

Who places the fund's actual orders?

The professor places the buy/sell orders, usually the next trading day after class approval through the brokerage account with Fidelity. All trading is done online.

How do you maintain records of buy/sell decisions?

Fidelity provides monthly statements, which contain a record of all buy/sell decisions and the contents of the current portfolio. Copies of all security analysis reports are kept by the professor and made available to future students. Examples of reports are available for review at <http://www.trinity.edu/smf>.

What software do you use to keep track of the investments, taxes, and research?

The SMF has one client, Trinity University, which is tax-exempt. The "My Portfolios" software on Yahoo! is sufficient for students to keep track of the portfolio informally. Of course, the brokerage account summary at Fidelity is the official report of investments and transactions related to the portfolio. Fidelity sends monthly statements not only to the SMF professor but also to the Endowment Office of the University.

What resources have been particularly helpful?

Free resources on the internet have been very helpful resources. Students can quickly research the economy, the stock market, industries, and companies by using various free online resources. The Trinity University library subscribes to Standard & Poor's Net Advantage and Value Line Investment Survey online, and those have been very important resources. A trading room with a Bloomberg terminal would be impressive and quite expensive; but such a luxury should not be considered a necessity for a successful SMF. Online sources of data on the economy, stock

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market, industries, and companies have proven sufficient. While reports tend to follow similar formats over time, templates for stock valuations are not used.

What about summer—do you close out positions in May or manage them during summer? Does a faculty member take over in the summer or during holiday breaks?

The professor is in charge during the summer; however, the SMF is basically inactive during that time. At the last class meeting of the spring semester students are asked which stocks in the portfolio they think should be sold, and the professor may be guided by those opinions. In late May after the close of the semester the professor sells off some stocks from the SMF that he believes should not be carried through the summer. The proceeds from stock sales in May are invested over the summer in SPDRs (Symbol: SPY) and thus remain invested in the stock market. By selling some of the stocks and investing the proceeds in SPYs, the next class has opportunity to sell SPYs and buy individual stocks, which reinforces the idea of beating the market as represented by SPYs.

What happens to earnings—go to scholarships, faculty endowment, School of Business, stay in fund?

So far almost all returns to the SMF have been retained in the SMF. The Trinity University Board of Trustees views the portfolio as an important investment in education, and the institution does not depend on cash flows from the fund. Some universities withdraw funds from SMFs for scholarships or other institutional purposes.

How is the success of the SMF measured?

Primarily the SMF is a learning experience, which is assessed by student achievement in the course and their placement in the corporate world and graduate school. Also, investment returns to the SMF are benchmarked against total returns to the S&P 500 Index. The priorities of the SMF are (1) education, (2) preservation of capital, and (3) investment returns for the university.

Are performance results reported at end of semester or at end of academic year?

Reports regarding investment performance of the SMF are made to the Board of Trustees three times each year. At each fall meeting the Board receives an emailed report from the SMF of the investment results as compared to the S&P 500 Index for the second and third quarters of the calendar year. Many other aspects of the portfolio are also reported to the Board at that time. At the February meeting of the Board, students in the SMF present a written and an oral report regarding the SMF investment performance for the recent fourth calendar quarter. At the May

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meeting the Board receives an emailed report of the first calendar quarter investment performance. Students prepare and present the reports with guidance from the professor. Also, reports of employment of graduates are important in evaluating the performance of the SMF.

## CONCLUSIONS

The SMF at Trinity University has been of great benefit to the students who have participated in the program and to the university. Their educations have been enriched by their active participation in managing a real portfolio for the university, extensive readings in investment analysis, and by experiencing the inherent uncertainty in the process of valuing a stock for a real investment decision. The SMF students' written and oral communication skills are sharpened and their employment opportunities are measurably enhanced. The SMF has become a program that the university can promote effectively to prospective students to the extent that the investments in the SMF may have earned substantial returns in student admissions. Thus the SMF has been a win-win proposition for students and for the university.

Similar to Mallett, et al. (2010) there are lessons learned from the FAQs and the answers above that deserve emphasis. The first is that an investment in an SMF is capital that simply has been transferred or reinvested in an alternative area of the education process at Trinity University and should not be viewed as funds that have been spent. Second, an SMF should be initiated with an investment amount that catches the attention of students and other constituencies and underscores the commitment of the university to the program. Third, students should make the investment decisions and therefore should be carefully screened for admission to the program. Fourth, investment policies of the SMF must be clear to all who are involved. Finally, faculty who advise and lead an SMF must be willing to make a time commitment to the program that exceeds the usual, which for many makes it a labor of love.

## ENDNOTE

<sup>1</sup>We acknowledge and appreciate the suggestions of some of the FAQ's by Dean K. O. Long, and others of the School of Business at McMurry University in Abilene, Texas.

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