

**Introduction**

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# W. P. Carey School of Business

**Undergraduate Maroon & Gold Fund**

Semi-Annual Meeting

May 1<sup>st</sup>, 2009

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## Today's Agenda

- Team introduction and fund objectives
- Economic outlook and market overview
- Portfolio: changes in portfolio style & management, and current composition
- Performance vs. benchmarks
- Asset allocation: GS & GENZ
- Thesis Overview and UCO Position
- Lessons learned and discussion

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# INITIAL ECONOMIC OVERVIEW

Daniel McAuley & Jeff LaFrance

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## Economic Outlook – January 2009

- Economic Figures
  - Consumer Confidence Index : 37.7 (historic low)
  - Consumer Price Index (Core): -0.7% YoY since December; 2008 yearly change of +0.1%
  - Case Schiller Home Index – 19.1% YoY drop; 2.2% drop since October
- Outlook
  - We believed that equities would have a positive and volatile year
  - Projected that oil would also rise in price due to slight increase in growth from present level, and due to a reversion to fair value
  - Inflation would remain flat throughout the year and quantitative easing would prevent a deflationary spiral
  - Housing market critical for overall market recovery

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# PORTFOLIO

Jeff LaFrance



# Management Changes

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- Educational
  - Analysts assigned new sectors
- Operational
  - Sector weightings
- Position Execution
  - Laddering into positions
- Focus on Economic Outlook
  - Foundation for trades



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## PORTFOLIO

- Diversified, large-cap value fund
  - Defensive strategy amidst tough economic climate
  - Bargain hunting opportunities
  - Information widely available, help with learning process
- Investment selection criteria
  - Market cap: 8+ billion, Price to Book: < 3, Price to earnings: < 20
- Seven stocks, three sectors excluded
  - Materials
  - Consumer Discretionary
  - Information Technology
- Limited initial exposure to financials

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## Benchmark Analysis vs. Last Sem.

Most recent vs. Last Semester

- S&P 500 Value Index Fund (IVE)
  - P/E: 14.14 vs. 15.31
  - P/B: 2.53 vs. 2.23
  - Beta: 1.09 vs. 0.98
- Our Fund
  - P/E : 16.29 vs. 10.02
  - P/B: 2.24 vs. 2.67
  - Beta: 0.86 vs. 0.90

How well are we correlated to the benchmark?

Biotech overweighting



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# PERFORMANCE

Don Bowen

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Performance

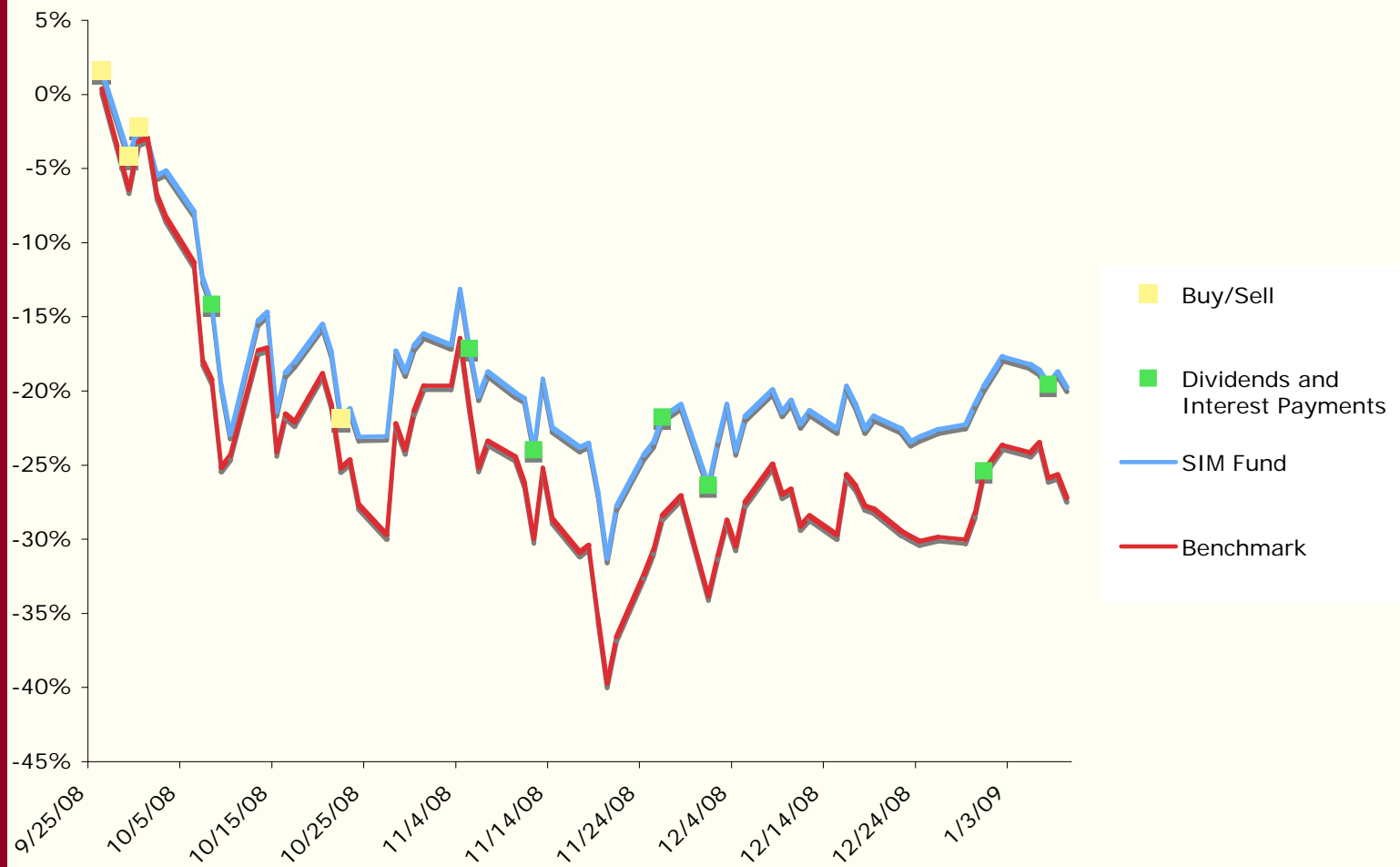
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# Fall Performance vs. IVE



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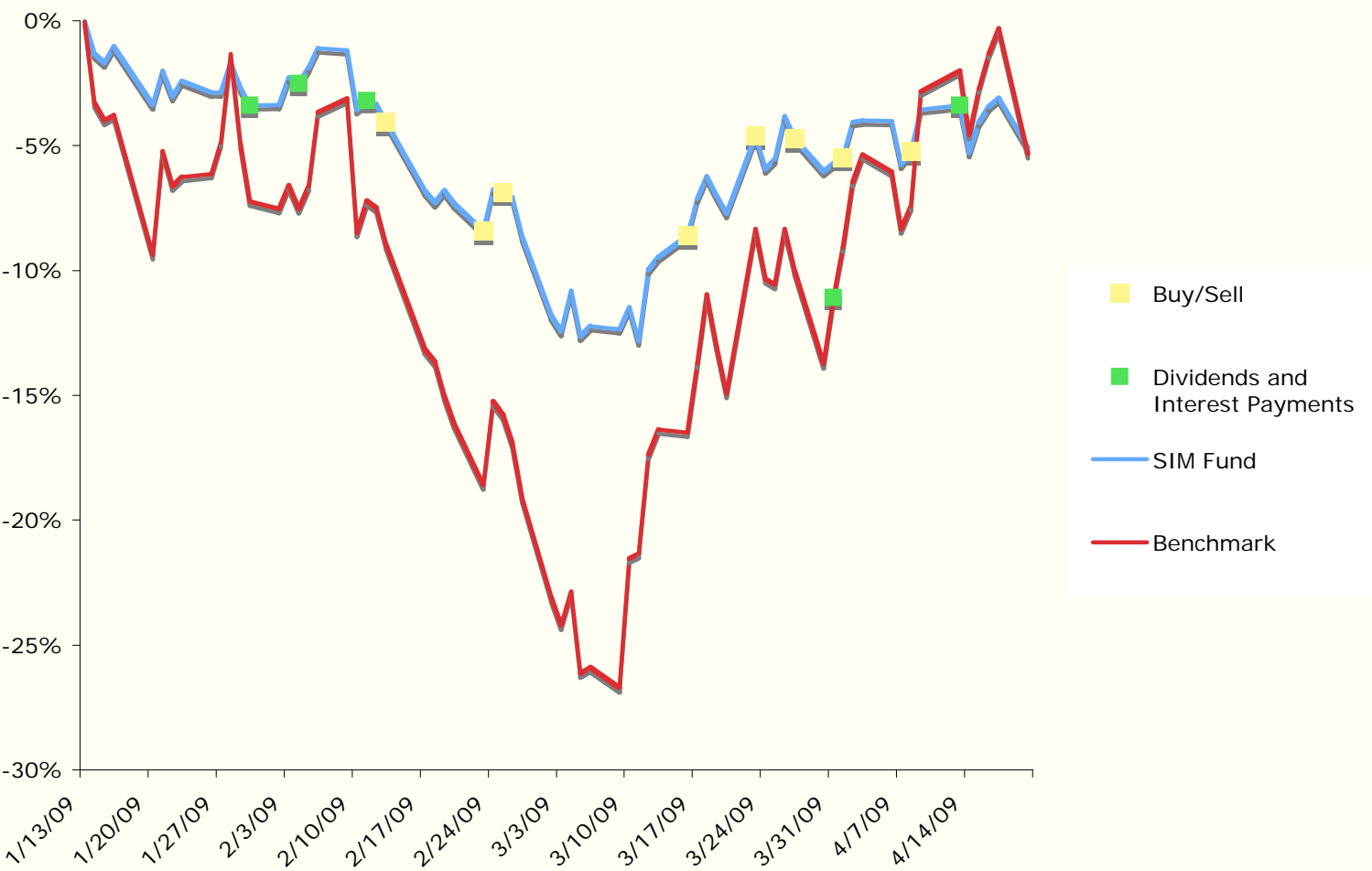
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# Spring Performance vs. IVE





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# Dividend Persistence

- Fall Stocks
  - EXC
  - NOC
  - PFE
  - TSCDY
  - VZ
  - USB
- Spring Stocks
  - ABT
  - LQD

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## Performance

- Fall Performance
  - SIM Fund: -19.77%
  - IVE: -27.23%
- Spring Performance
  - SIM Fund: -5.07%
  - IVE: -5.35%
- Overall return during academic year
  - SIM Fund: -23.78%
  - IVE: -32.93%

# SELECTED STOCKS

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- Selected stocks
  - GS & DBB vs. USB: Exposure to Financials
  - GENZ: Genzyme
  - UCO

Jazmin Medina & Jesse Mayfield

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# Goldman Sachs

Why we chose Goldman

- Believe they will be the first bulge bracket to return TARP funds
- Strong financial strength
- Bad year for company – Trading Revenues were down 71%
- Sector benefit from mark-to-market rule changes

How did it fit in the portfolio?

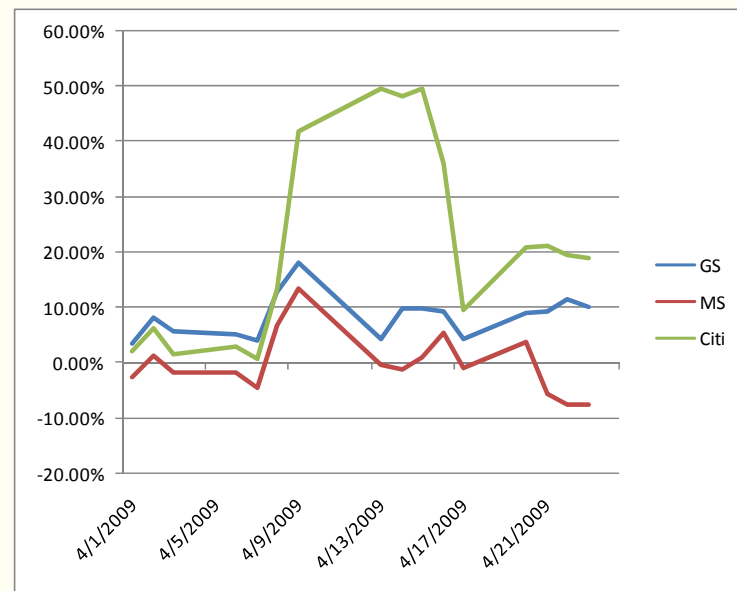
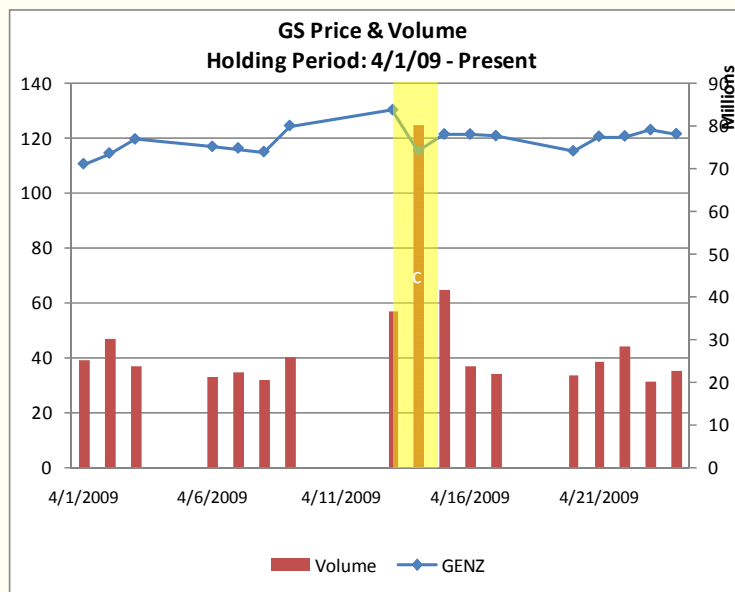
- Financials: Fundamentals have returned

Holding period highlights:

- Beat first quarter earnings
- Publicly announced plan to repay TARP

Comparison relative to competition:

- Weaker financial position
- Goldman has always been an industry leader & first mover





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# Genzyme

Why we chose Genzyme

- Strong cash position \$1.5B
- Products provide enormous benefits to small number of patients
- Revenue diversification & no debt
- Expansion plans with Myozyme in US

How did it fit in the portfolio?

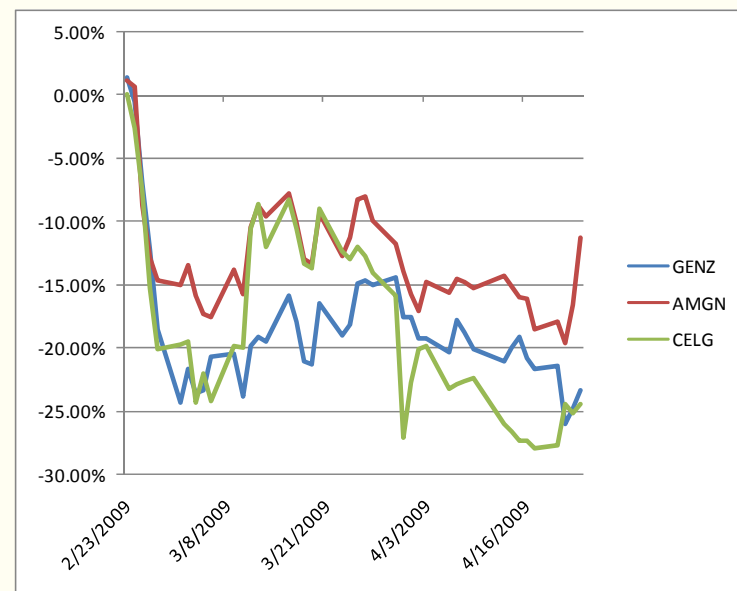
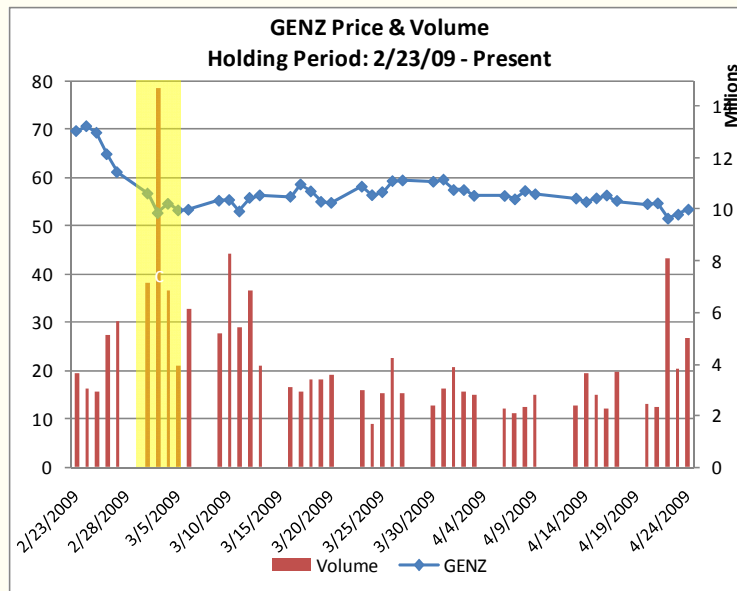
- Biotechnology: Solid drug demand

Holding period highlights:

- President Obama's 2010 budget proposal sought to initiate major health care reform
- FDA regulatory setback with Myozyme

Comparison relative to competition:

- Celgene's revenues concentrated in one drug
- Amgen most vulnerable to biogeneric competition





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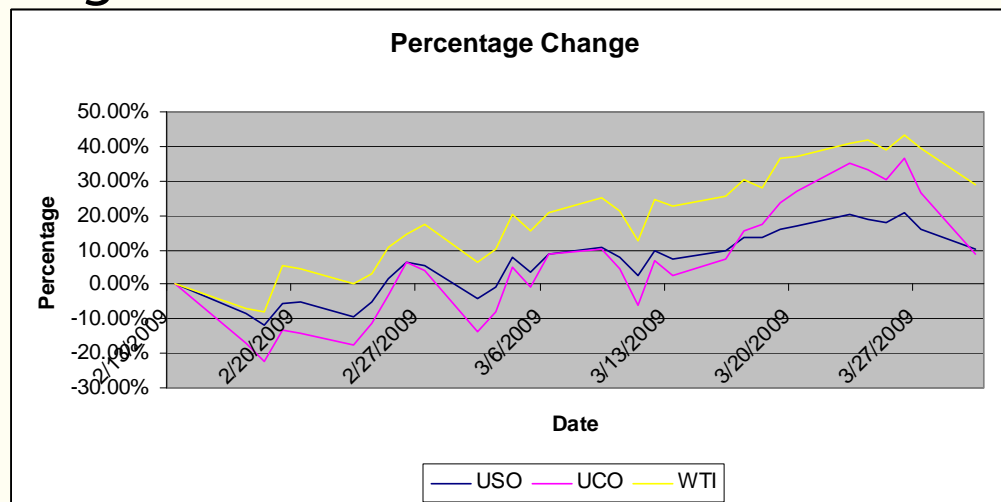
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# UCO: Ultra Crude Oil ProShares

- Leveraged ETF designed to track twice the daily return of West Texas Sweet Crude Oil
- Gave direct exposure to increasing oil prices
- Closed position due to increasing understanding of risks in leveraged ETFs
- 26% gain between Feb 13th and March 27th



# Thesis

## *Investigation into Leveraged Exchange Traded Funds from a Portfolio Management Perspective*

Daniel McAuley & Adam Michelow

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# Why Investigate Lev. ETFs?

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## U.S. Volume Leaders 4/17

Symbol	Name	Last Trade	Change	Volume
C	CITIGROUP INC	3.65 Apr 17	↓ 0.36 (9.98%)	1,115,304,684
BAC	BK OF AMERICA CP	10.60 Apr 17	↑ 0.26 (2.51%)	487,364,187
FAS	FINANCIAL BULL 3X	9.40 Apr 17	↑ 0.36 (3.98%)	319,975,260
SPY	S&P DEP RECEIPTS	87.08 Apr 17	↑ 0.58 (0.67%)	262,648,937
FAZ	FINANCIAL BEAR 3X	8.90 Apr 17	↓ 0.42 (4.51%)	231,914,243
XLF	FINANCIAL SEL SPDR	11.11 Apr 17	↑ 0.14 (1.28%)	228,394,077
GE	GEN ELECTRIC CO	12.39 Apr 17	↑ 0.12 (0.98%)	223,472,721
WFC	WELLS FARGO & CO NEW	20.26 Apr 17	↑ 0.81 (4.16%)	166,941,535
AIG	AMER INTL GROUP INC	1.62 Apr 17	↓ 0.07 (4.14%)	162,389,027
UYG	ULTRA FINANCIALS PRO	3.79 Apr 17	↑ 0.12 (3.27%)	148,313,269
QQQQ	PowerShares Exchange-Traded Fun	33.31 Apr 17	↑ 0.07 (0.21%)	129,835,395
JPM	JP MORGAN CHASE CO	33.26 Apr 17	↑ 0.02 (0.06%)	104,962,031
DRYS	DryShips Inc.	7.17 Apr 17	↑ 1.62 (29.19%)	86,858,737
PFE	PFIZER INC	14.16 Apr 17	↑ 0.26 (1.87%)	72,737,787
FITB	Fifth Third Bancorp	4.83 Apr 17	↑ 0.51 (11.81%)	71,050,172
INTC	Intel Corporation	15.60 Apr 17	↓ 0.29 (1.83%)	67,299,624
RF	REGIONS FINANCIAL CP	7.23 Apr 17	↑ 0.53 (7.91%)	62,195,293
MSFT	Microsoft Corporation	19.20 Apr 17	↓ 0.56 (2.83%)	61,398,450
EFA	ISHARES MSCI EAFE FD	40.97 Apr 17	↓ 0.14 (0.34%)	61,325,753
SSO	ULTRA S&P500 PROSHRS	23.56 Apr 17	↑ 0.23 (0.99%)	57,211,387

- These instruments are quickly gaining popularity
- Many investors are unaware of the lack of accurate tracking at the specified leverage ratio
- Our personal experience with UCO during the semester



# Sources of Compounding Error

## 2 Day Compounding Error

	Beg. Value	Day 1 Perf	Day 2 Perf	Gain/Loss
Index A		10%	-9%	
Traditional ETF	10,000	11,000	10,010	<b>0.10%</b>
UltraShort ETF	10,000	8,000	9,440	<b>-5.60%</b>



Holding Period



Compounding Error



Volatility – Underlying Index



Compounding Error

- As holding period prolongs, compounding error becomes increasingly severe due to the leverage trap

Increasing volatility only magnifies this compounding error

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## Comp. Error: Financials in '08



- IYF (financials): -50.40%
- SKF (2x inverse financials): +4.28%
- Causes of Tracking Error
  - Record Index volatility, compounding error, expenses



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## Conclusions

- Investors should not expect 2x or 3x returns in LT
- Higher returns are possible, but come with an excess amount of risk
- Investors should remain wary of holding leveraged ETFs longer than 1 day
  - These securities are only appropriate as speculative trading vehicles for short-term directional bets
- Policy Proposal
  - Greater disclosure
  - Limit trading to those who sign disclosure similar to a margin or option agreement

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# Lessons Learned & Discussion

JiaQi Bao

## Lessons Learned

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- The importance of
  - A flexible, structured framework
  - Due diligence in new financial products
  - Formulating and maintaining an independent view
- During our holding period (Jan. 13 – April 14):
  - S&P 500: 870 - 670 – 860
    - Dropped below 700 for the first time since 1996
  - Dow Jones Industrial Average
    - Dropped below 6,800 mark for the first time in 12 years



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# Thank You!

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- List of Fund Holdings
- Transaction History
- Daily Fund Performance & Events
- Economic Overview
- Analyst Report
- Attribution Analysis
- Team Biographies

## Fund Holdings

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- Exelon Corporation (EXC)
  - Electricity generating and distributing company; leading U.S. nuclear operator
- US Bancorp (USB)
  - Financial services holding company; sixth-largest bank in the U.S.
- Verizon Communications (VZ)
  - Broadband and telecom company; Dow component
- Northrop Grumman Corporation (NOC)
  - Aerospace & Defense technology company
- Goldman Sachs, Inc (GS)
  - A global investment bank, securities and investment management firm
- iBoxx Investment Grade Bonds (LQD)
  - A fund that seeks to track the investment grade corporate bond market

# Fund Holdings

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- The Proctor & Gamble Company (PG)
  - Global branded consumer goods firm
- Genzyme Corporation (GENZ)
  - Bio tech firm focusing on genetic and lysosomal storage disorders
- Abbott Laboratories (ABT)
  - Engages in discovery, development, manufacturing & sale of health products
- The Kroger Co. (KR)
  - United States based retailer
- Exxon Mobil Corporation (XOM)
  - Global oil and gas company

# Transaction History

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- Buys (Returns current as of market close 4/28):
  - EXC (9/26): 210 shares @ \$67.70, Return: -33.31%
  - NOC (9/26): 230 shares @ \$62.99, Return: -23.37%
  - TSCDY (9/26): 685 shares @ \$20.85 , Sold
  - PFE (9/26): 775 shares @ \$17.96 , Sold
  - RIG (9/29): 100 shares @ \$114.19 , Sold
  - USB (9/29): 375 shares @ \$33.54 , Return: -47.29%
  - VZ (9/29): 400 shares @ \$31.05 , Return: -0.29%
  - UCO (2/13): 1000 shares @ \$7.61, Sold
  - PG (2/23): 250 shares @ \$50.01, Return: -0.64%
  - GENZ (2/25): 180 shares @ \$69.41, Return: -21.35%
  - LQD (3/16): 135 shares @ \$92.77, Return: 3.27%

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- Buys (Continued)
  - ABT (3/23): 250 shares @ \$47.95, Return: -10.30%
  - KR (3/27): 590 shares @ \$22.01, Return: -1.50%
  - GS (4/1): 110 shares @ \$110.41, Return: 9.29%
  - XOM (4/8): 175 shares @ \$68.67, Return: -2.32%
- Sales
  - SPY (10/24): 60 shares @ \$90.48 , Return: -21.85%
  - TSCDY (2/13): 685 shares @ \$15:50, Return: -25.48%
  - RIG (2/13): 100 shares @ 61.13, Return: -46.47%
  - PFE (3/16): 775 shares @ \$14.09, Return: -21.77%
  - UCO (3/27): 1000 shares @ \$9.61, Return: 26.28%