Student funds tackle a bear market

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Student-managed portfolios at MBA and undergraduate business programs have taken a hit, but many have held up surprisingly well amid the economic wreckage.

Katherine Avery and her MBA classmates knew they were facing a bear market when they made their first investments as a class last October. So as managers of the Student Managed Fund at the University of Connecticut School of Business (Connecticut MBA Profile), Avery's class analyzed, plotted, and planned for all possible market outcomes. But amid a nearly unprecedented market meltdown, the MBA class found that finance classes can only prepare you so well.

The Student Managed Fund, once worth more than $1 million, is one of an estimated 200 graduate and undergraduate student-run portfolios in the country operated with very little faculty involvement. The funds research companies and decide which stocks to buy and sell, using a chunk of cash that usually comes from the university's endowment. The idea is to let students experience first-hand what it's like to play the market—and learn from their mistakes.

This year the learning curve is steeper than most. Two days after the SMF class's first purchases, the Dow Jones industrial average tumbled 800 points and finished the day below 10,000 for the first time since 2004. The class's meticulous mathematical modeling and historical analysis suddenly meant nothing as the MBAs saw stocks they thought were safe bets—Johnson & Johnson (JNJ), Procter & Gamble (PG), Exxon Mobil (XOM), and IBM (IBM)—crash and burn.

Losing less than the S&P 500

"It was just so far outside what any of us anticipated," Avery said. The second-year finance student says she now regrets not buying back in immediately to catch the subsequent bounce, but at the time the uncertainty was too great. "Oh my God," she remembers thinking. "Is this going to drop another 20% overnight?"

The fund—worth more than $897,000 when Avery's group got its hands on it on Oct. 3—has since shrunk to about $672,000. Even so, once the worst days of the crisis were over, Avery's class would go on to outperform the Standard & Poor's 500-stock index by an impressive margin in many areas. Heavy losses are a common tale this year at student-managed funds, at both the graduate and undergraduate level, with many losing several hundred thousand dollars. But given the economic calamity, what may be more remarkable is how much student-run funds didn't lose.

At the University of Dayton's annual forum on student investing, 50 different funds entered the student portfolio competition, which David Sauer, an associate finance professor at Dayton, oversees. He says that of those entrants, about 75% beat the S&P 500 last year—meaning they lost less than 38% in 2008. Of course, contest entrants represent the funds which performed well, and many others fell short. Of the contest winners though, all beat their benchmarks and some posted overall gains in 2008, besting some of the most respected—and highest-paid—portfolio managers in the country.

Take for example, the professionally invested endowments at most colleges and universities. From July to November, university endowments fared better than the S&P 500, which lost 30%, but still sustained crippling 23% losses on average, according to a recent study by the National Association of College and University Business Officers and TIAA-CREF Asset Management. The bulk of the losses were the result of the market's decline, but a weakness

for risky investments on the part of big endowments and the machinations of at least one well-known predatory investor didn't help. New York University, for one, lost $24 million to Bernie Madoff.

Outperforming college endowments

At this point, NYU may be wishing it had entrusted more funds to the MBA students who manage the Michael Price Student Investment Fund at the Stern School of Business (Stern MBA Profile). The fund is having a good year, but only if you consider losing money at a slower pace than your benchmarks a good year, says Richard Levich, faculty director of the fund. Falling only 19% during that July to November timeframe, it beat the S&P 500 by 11 percentage points and the average university endowment by four.

"You know how much these [professional] investment managers make? One to five million dollars each," said Richard Davis, a benefactor of the University of Dayton's Davis Center for Portfolio Management, where undergraduate business students manage $9 million of the endowment. Davis, also a university trustee, says the students outperformed all of the endowment's other investors, and beat the S&P 500 by 4.4% in 2008. "The students are like our basketball players or our football players," he said. "They work very hard, earn a lot of funds for the university, and don't get paid."

For undergrads without the career experience of an MBA fund manager, working on a student portfolio can be a particularly intense experience. When they come in as freshmen, Davis says, "They're kind of like babes in the woods." At the funds, they slog through technical papers, "not exactly light reading," says Benjamin Earley, a senior at Tulane University's Freeman School of Business (Freeman MBA Profile) where an honors seminar allows students to invest a chunk of the endowment. They also devote much of their time to stock picking. Kyle McLaughlin, a senior finance major at the University of Connecticut's fund, says he's consulted with the fund's faculty adviser at 7 a.m. and reviewed fund business on his BlackBerry at 2 a.m. The students may arrive uneducated about financial markets, Davis added, but when they graduate, he says, "They are professionals."

Far from tightening their grip on student funds as money becomes scarce, Sauer says most universities' administrators appreciate the reliability of the funds, as well as their educational value. At Dayton, the students may or may not receive another $1 million to invest next semester as they have for the past two years, but Sauer predicts that Dayton's fund and student funds elsewhere will see enduring administrative support.

School of hard knocks

Student-run funds' triumph over major indexes doesn't mean they aren't hemorrhaging cash, however. At UCLA's Anderson School of Management (Anderson MBA Profile) the Student Investment Fund, formerly a $2 million portfolio, is now worth roughly $1.5 million. The University of Iowa's Henry Fund at the Tippie College of Business (Tippie MBA Profile), whose growth-style portfolio took top honors at the University of Dayton forum, was worth more than $1.5 million around this time last year, but is now closer to $973,000. And NYU's fund, which was valued at more than $1.85 million last May, was down to about $1.4 million in March. All three often beat their benchmarks, but this year—the least forgiving in many funds' histories—major losses are par for the course.

"The beauty about this is [students] really feel the pleasure and pain of running money," said Sanjeev Bhojraj, faculty director of the Cayuga MBA Fund at Cornell University's S.C. Johnson Graduate School of Management (Johnson MBA Profile). "At the same time, if you're down, it can really hurt if you lose $40,000 or $50,000."

In the classrooms-turned-boardrooms, groups are feeling added pressure. Students who might otherwise be sleeping in or eating lunch are finding themselves checking stocks or conferencing with fellow investors. Steve Katchur, a second-year MBA at NYU and portfolio manager of the Michael Price Investment Fund, says fund meetings that were laid back in bull markets, "definitely get heated up" as students pitch and defend their picks in front of the class. Raised voices are not uncommon. "People are cordial when the class is over with, but people are passionate in their opinions," he said. "If you have a point, then you raise it."

Risk averse

Lenny Buzik, also on the fund, admitted to being nervous before he pitched a $20,000 investment in J.M. Smucker Company (SJM) to the group in late April. Most of his prep time, he said, was spent "getting ready for what questions might be flying at me." Standing at a podium in front of a dozen students with laptops scouring Smucker's records, Buzik had reason to be nervous. Deftly fielding questions that were technical and often pointed, Buzik managed to convince the students to invest $10,000 by only a two-vote margin—a victory, but a close one.

At Villanova University's School of Business (Villanova Undergraduate Profile), where the Haley Group Mid-Cap Fund won the University of Dayton forum's award for best undergraduate growth portfolio, faculty adviser David Nawrocki said the prevailing mood after the fall's market turmoil was one of determination. "They weren't going to be the class that wiped out the funds for future generations," he said.

One of the reasons many student fund losses may have been limited is that most of the portfolios are particularly risk-averse—often kept in check by stop-loss orders (which sell shares when they fall to a predetermined price) and mandates for diversification. Most make long investments only, though some, like Cornell University's Cayuga MBA fund, now valued at about $14 million, used aggressive short-selling to take advantage of the downturn. Cayuga posted a small profit for 2008 and only a 1% decline for the first quarter of 2009.

Also, whether or not they're earning a grade, students are often dedicated and proficient researchers. "An analyst will spend weeks—40, 50, 60 hours—developing a pitch," says Akash Ghiya, an MBA investor for the Wharton Investment Management fund at the University of Pennsylvania's Wharton School (Wharton MBA Profile). Ideas, Ghiya said, come from "anywhere and everywhere." A few of Wharton's best-performing picks have been Jos. A. Bank (JOSB), an upscale men's clothier gaining fame now for its recession specials, the Corrections Corporation of America (CXW), a prison operator, and Hanesbrands (HBI), the underwear company.

Unparalleled experience

Ben Biddle, an MBA student investor at the University of California at Berkeley's Haas School of Business (Haas MBA Profile) says his fund's strategy has been to focus on quality, not short-term returns. "If you believe in the company you're investing in, then market noise is easier to tune out," he says. Biddle's first pick, Cisco Systems (CSCO), dipped 13% the week after he bought it. Instead of backing down, Biddle lobbied classmates to double their investment directly after the dip. They can now claim a $7,000 profit on the stock.

Several funds have been trying to play the downturn—picking recession favorites like TJX (TJX), owner of the T.J. Maxx discount clothing chain, which performed well for the University of Connecticut students. Others have stuck to downturn-resistant industries. For example, NYU put $10,000 each into budget-friendly Smuckers products, a soap company called Ecolab (ECL)

and a LED technology company called CREE Inc. (CREE). "People are still eating, people are still cleaning, and people are still lighting," Levich says.

And for the first time in years, student investors are contemplating possible bankruptcies of companies when they eye their choices. In a market where credit is limited, low debt and high cash flow have become far more important. Faculty advisers say students are scouring balance sheets in a way they never have before.

"This period is, from a historical perspective, very, very, very, significant," Sauer said, adding that the learning experience is virtually unparalleled by other classes. "They might not realize the significance now, but they really realize that it's extremely difficult and challenging. It's never easy, but it's even more difficult now."

VANDERMEY, Anne. Student funds tackle a bear market. **BusinessWeek**, New York, 4 maio 2009. Disponível em: <www.businessweek.com>. Acesso em: 6 maio 2009.