UNIVERSITY OF WASHINGTON
FOSTER SCHOOL OF BUSINESS

Alternative Investments: Hedge Funds and Private Equity

Quarter:	Fall 2015
Class:	Finance 566
Class Time:	Thursdays at 6:00 p.m. - 9:20 p.m.
Course Website:	Canvas
Classroom:	Paccar Hall 395

Professor:	Jonathan Brogaard
E-mail:	brogaard@u.washington.edu
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Office:	Paccar Hall 434
Office Hours:	Tuesdays and Thursdays 12:30-1:30 pm and 5:30 – 6:00 pm

COURSE DESCRIPTION

This course is designed for students who want to learn about the fascinating, multi-trillion dollar alternative asset management industry. The only requirement is a passion to understand how financial markets work. The skills learned in this class will be useful for students who intend to pursue a career in asset management but will also be of interest to those who want to better understand how financial markets operate. In addition, students will learn tools utilized by financial experts that they can use to improve the risk management, performance, and analysis of their personal portfolios.

This course studies the activities, structure, and role of the alternative asset management industry. Students will learn about hedge fund investment and hedging strategies and the changing investment activities of the private equity industry. We will discuss the legal and structural arrangement of these investment vehicles. Finally the class will cover the influence hedge funds and private equity firms have on corporate decision-making and measures taken to counter threats and exploit opportunities represented by these investors.

REQUIRED MATERIAL

Investments, by Zvi Bodie, Alex Kane, Alan Marcus, 9th edition. ("BKM") You are welcome to buy earlier versions at a substantially lower price.[1]

My Course Pack, which is available for purchase from Ram Copy on University Ave (http://ramscopy.com/index.html).[2]

RECOMMENDED MATERIAL

Hedge Funds: An Analytical Perspective, by Andrew W. Lo.

A subscription to ***The Wall Street Journal*** and ***The Economist***

Complete the *Foster Excel for Business* Canvas course[3]

COURSE STRUCTURE

Prerequisites: You do not need an extensive background in finance to succeed in this course. However, I will assume that you know all materials covered in the introductory business finance course. Either the book *Corporate Finance* by Jonathan Berk and Peter DeMarzo, or *Fundamentals of Corporate Finance* by Jonathan Berk, Peter DeMarzo, and Jarrad Harford, both published by Pearson / Addison-Wesley, cover this material. If you need to review basic statistics, mathematics, or finance, very useful materials can be found on Professor Thomas Gilbert's website (faculty.washington.edu/gilbertt/teaching.shtml).

Office Hours: If you have been attending class but still need additional assistance, please come visit me. I do not hold scheduled office hours for this class. If you would like to meet, email, call, or see me for an appointment (give me alternative times that would be convenient for you). I am available to you anytime I am on campus and am not in another meeting. These meetings will be much more productive if you come well prepared and you can express your difficulties in terms of a specific problem or concept covered in class. Be familiar with the definitions and notation related to a topic even if you are having conceptual difficulties. Most importantly, do not tell me that you understand something when you are still perplexed. It's okay to come to my office confused, but you should never leave in that state.

Professionalism: Please refrain from use of phones, PDAs, and similar technologies during class that could distract your fellow students. To get the most out of the lectures, read the course pack before class. Please be sure to display your name plate during class, be punctual to class, and be respectful of your fellow students. While I allow laptops, they are only to be used for

[1] I have also made copies of the textbook available through the library reserve system.

[2] I have done my best to forecast the future timing and direction of the lectures. However, we will inevitably take some detours and make some changes throughout the course. Please allow for some flexibility in note-taking in the course pack as we move throughout the quarter.

[3] https://canvas.uw.edu/courses/873225

classwork; I will disallow them upon seeing Facebook, email, Twitter, and other such unrelated (but fun) websites open.

Form and Substance: Even though form without substance is meaningless, please remember that form still matters. You should prepare all graded materials in a form that meets professional standards.

Honor Code: I employ the principles and procedures espoused by Foster School of Business Honor System to maintain academic integrity in the course. The Honor Code of the Foster School expressly prohibits cheating, attempted cheating, plagiarism, and lying to administration or faculty as it pertains to academic work. Suspected violations of the Honor Code will be handled by referral of the matter to the Foster Honor Council.

Accommodations: To request academic accommodations due to disability, please contact Disabled Student Services, 448 Schmitz, 206-543-8924. If you have a letter from Disabled Student Services indicating that you have a disability that requires academic accommodations, please present the letter to me so that we can discuss the accommodations you might need in this class.

Feedback: It is important to me to know about any concerns or questions you might have. I also appreciate any comments on the course, in particular about lectures or assignments that you find particularly helpful or not. Please feel free to stop by my office or send me an email if you would like to talk to me.

Updates: As we go through the class I may occasionally adjust the syllabus. Any changes will be mentioned in class and/or on Blackboard.

Recordings: Neither audio nor video recordings are allowed of the class.

Email: I aim to respond to emails within 24 hours, however, this may not always occur and you should not depend upon it.

Discussion board: Canvas has a Discussions section. You should use this tool to discuss class content with your classmates. The teaching assistant will monitor the board and help answer questions. If you email me a content question and I think it is of general interest I will post the response here.

Fairness: My goals are to meet the course objectives and to ensure that the course is fair. In order to foster excellence and ensure fairness while achieving these goals, I run the course under the policies detailed below. The course is fair when the only way that one student gets a better grade than another student is when that student knows the material better. I will refuse any and all requests that have the effect of giving one student or a group of students an unfair advantage over the majority of students. Please do not create an uncomfortable situation for you and me by putting me in the position of refusing to make an exception for you when the effect of making that exception will be to give you an unfair advantage over your classmates. To ensure fairness to all students, there will be no exceptions to the course policies under any circumstances. By remaining enrolled in the course, you agree to abide by the policies detailed below. If you anticipate that you cannot abide by these policies (e.g., because you know that you have a conflict with an exam because of vacation travel or travel in connection with an interview), please either re-arrange your schedule or arrange to take this course in another quarter.

GRADING

Course responsibilities will consist of class participation, two cases, one group presentation, a midterm, and a final exam. Your performance in the components of this course will be weighted as follows:

Cases:	20%
Group Presentation:	10%
Midterm Exam:	25%
Final Exam:	45%

Participation: Participation is mandatory to receive full credit. Classroom comments and questions should demonstrate knowledge of the topic being discussed and facilitate learning for the entire class. I don't like to, but if necessary I will "cold call" so make sure you have completed the assigned readings prior to class. Class participation as determined by the professor with having your name plate displayed in each class is necessary, but not sufficient, to receive full credit. Coming in to class late will adversely impact your grade.

Cases: There will be two cases assigned. Each case will be worth 10% of your grade. The cases must be completed individually. The objectives of the cases are to have you learn by hands on experience and to test your understanding of material that is difficult to evaluate on an exam (and it gives you some added incentive to learn that material). Each case is due at the beginning of class on the due date. Late assignments will receive zero credit.

Group Presentations: On the first day of class you will form groups. Also, you will pick a trading strategy that you want to cover. Your responsibility is to be the expert on this trading strategy. You will be responsible for holding a 20 minute "pitch" to investors (your classmates) in which you will describe, analyze, and make an investment recommendation regarding the strategy. In addition to the presentation your group will be responsible for creating a two-page summary of the strategy, which is due on the same day as the presentation. At the end of the quarter each student in your group will complete a Group Evaluation survey, which factors in to your grade.

Midterm: The midterm exam will be closed book and closed notes, however, you will be given a formula sheet with all of the necessary financial formulae. Financial calculators will also be allowed during the exam. Exam questions will test your understanding of the topics covered in the related lectures.

Final: The final exam will be closed book and closed notes, however, you will be given a formula sheet with all of the necessary financial formulae. Financial calculators will also be allowed during the exam. The exam is cumulative. However, the material covered on the midterm exam is underrepresented. Exam questions will test your understanding of the topics covered in the related lectures.

Documented evidence that you were seriously ill at the scheduled time of an exam is the only valid excuse for missing an exam (final or midterm). In order to be excused from an exam, you must contact me prior to the exam and be ready to provide me with documentation after the exam.

Re-grading Policy: Mistakes can be made in grading. If you believe that there has been a significant mistake in the grading of your assignments or exams, you should contact me in writing within one week of the receipt of the grade. You should explain to me in detail where and why you think the grading was done incorrectly. I will re-grade your entire assignment or exam so your grade may go up or down as a result.

Median Grade: The target median grade for this course is 3.4.

Tentative Course Calendar: [4]

	Topic	Readings	Notes
10/01/2015	Welcome to class; Syllabus. Introduction to Hedge Funds	1	Form into teams for group work. We will start Topic 2 today as well
10/08/2015	Measuring Performance and Risk. Trading Costs	2, 3	
10/15/2015	Silver Creek Capital Visit. Efficient Markets	5	Bryan Weeks
10/22/2015	Backtesting. Midterm Review	4	James Stoner (Archon Capital Management). Bring a laptop with Excel
10/29/2015	**Midterm Exam.** Margin and Short Selling.	6	
11/05/2015	Limits to Arbitrage. Fund of Funds, Organization, and Regulations.	7, 9	**Performance Analysis Case Due.** Topic 8, Risk Management, is optional (and won't be tested)
11/12/2015	Steelhead Visit. Private Equity Introduction and Organization	10	Chris Brown & Nick Mcfarland.
11/19/2015	Newstone Visit. Valuing Young Firms	11	Rob Brougham
11/26/2015	**NO CLASS – Thanksgiving Day**		
12/03/2015	Maveron Visit. Leveraged Buyouts	12	Clayton Lewis, **Pairs Trading Case Due**
12/10/2015	Review Session for the Final		
	Final Exam		12/17/2015 6:30pm – 8:20pm

[4] I have done my best to forecast the future timing and direction of the lectures. However, we will inevitably take some detours and make some changes throughout the course. Please allow for some flexibility in note-taking in the course pack as we move throughout the quarter.

Readings:

1. BKM Chapter 5.4 – 5.7, BMK Chapter 7 Appendix B, BKM Chapter 26.1, 26.2, & 26.6

Fung, W. and Hsieh, D. (1999). A primer on hedge funds. *Journal of Empirical Finance, 6*, 309-331.

2. BKM Chapter 10, BKM Chapter 24

Malkiel, B. and Saha, A. (2005). Hedge funds: Risk and return. *Financial Analysts Journal*, *61*(6), 80-88.

Samarakoon, L. and Hasan, T. (2005). Portfolio performance evaluation. In C. F. Lee (ed.), *The Encyclopedia of Finance*, 617-622.

3. BKM Chapter 3.5

4. Backtesting Tutorial

5. BKM Chapter 11

Malkiel, B. (2003). The efficient market hypothesis and its critics. *Journal of Economic Perspectives*, *17*(1), 59-82.

6. BKM Chapter 3.6, 3.7

Karpoff, J. M., & Lou, X. (2010). Short sellers and financial misconduct. *The Journal of Finance*, *65*(5), 1879-1913.

7. Pedersen, L. (2009). When everyone runs for the exit. *The International Journal of Central Banking*, *5*, 177-199.

8. Lo, A. (2001). Risk management for hedge funds: Introduction and overview. *Financial Analysts Journal*, *57*(6).

9. August. J. and Cohen, L. (2006). Hedge funds structure, regulation, and tax implications. Part I. Structure and regulation, *Federal Library*, *8*(4).

10. Private Equity: An Overview. (2008). *Phillips, Hager, and North Investment Managemen*t.

(Optional) Fenn, G. Liang, N. and Prowse, S. (1995). The economics of the private equity market. *Board of Governors of the Federal Reserve System (US) 68.*

(Optional) Bain and Company. (2014). Global private equity report 2014. *Bain & Company*.

11. Damodaran, A. (2009). Valuing young, start-up and growth companies: estimation issues and valuation challenges. Working Paper.

12. Olsen, J. (2003). Notes on leveraged buyouts. Tuck School of Business Dartmouth, Case #-0004.

Each group must choose one strategy to pitch from the following list (or come up with one of their own). For each strategy I list one paper. You are welcome to use additional resources, but they must be credible and you must properly cite their work.

1. **Valuation Ratios:**
   Campbell, J. Y., and Shiller, R. J. (2001). *Valuation ratios and the long-run stock market outlook: An update*, *w8221*. National Bureau of Economic Research.

2. **Stock Issuances:**
   Pontiff, J., and Woodgate, A. (2008). Share issuance and cross-sectional returns. *The Journal of Finance*, *63*(2), 921-945.

3. **Earnings Quality**:
   Chan, K., Chan, L. K., Jegadeesh, N., and Lakonishok, J. (2006). Earnings quality and stock returns. *Journal of Business*, *79*(3).

4. **Momentum:**
   Jegadeesh, N. and Titman, S. (1993). Returns to buying winners and selling losers: Implications for stock market efficiency. *The Journal of Finance*, *48*(1), 65-91.

5. **Reversal**:
   Bondt, W. F., and Thaler, R. (1985). Does the stock market overreact? *The Journal of Finance*, *40*(3), 793-805.

6. **Convertible bond arbitrage:**
   Agarwal, V., Fung, W. H., Loon, Y. C., and Naik, N. Y. (2011). Risk and return in convertible arbitrage: Evidence from the convertible bond market. *Journal of Empirical Finance*, *18*(2), 175-194.

7. **Carry trade:**
   Burnside, C., Eichenbaum, M., and Rebelo, S. (2007). Exchange rate puzzles: The returns to currency speculation in emerging markets. *The American economic review*, *97*(2), 333-338.

8. **Bond arbitrage:**
   Duarte, J., Longstaff, F., and Yu, F. (2005). Risk and return in fixed income arbitrage: Nickels in front of a steamroller?” Working Paper.

9. **Mortgage backed securities:**
   Gabaix, X., Krishnamurthy, A., and Vigneron, O. (2007). Limits of arbitrage: Theory and evidence from the mortgage-backed securities market. *The Journal of Finance*, *62*(2), 557-595.

10. **Excess Comovement:**

Greenwood, R. (2008). Excess comovement of stock returns: Evidence from cross-sectional variation in Nikkei 225 weights. *Review of Financial Studies*, *21*(3), 1153-1186.

11. **Index options:**

Amin, K., Coval, J. D., and Seyhun, H. N. (2004). Index option prices and stock market momentum. *The Journal of Business, 77*(4), 835-874.

12. **Earnings announcement drift:**

Bernard, V. and Thomas, J. (1989). Post-earnings-announcement drift: Delayed price response or risk premium?" *Journal of Accounting Research*, *27*, 1-36.

13. **Distressed investing**

Savor, P. (2012). Stock returns after major price shocks: the impact of information. *Journal of Financial Economics, 106*(3), 635-659.

14. **Dedicated short bias**

Engelberg, J. E., Reed, A. V., and Ringgenberg, M. C. (2012). How are shorts informed?: Short sellers, news, and information processing. *Journal of Financial Economics*, *105*(2) 260-278.

15. **Mergers & Acquisitions**

Mitchell, M. and Pulvino, T. (2001). Characteristics of risk and return in risk arbitrage. *Journal of Finance*, *56*(6), 2135-2175.

16. **Technical Analysis**

Han, Y., Yang, K., and Zhou, G. (2011). A new anomaly: The cross-sectional profitability of technical analysis. Working Paper.

17. **Investor Sentiment**

Da, Z., Engelberg, J., and Gao, P. (2010). The sum of all fears: investor sentiment and asset prices. Working Paper.

18. **Intermediaries**

Adrian, T., Etula, E., and Muir, T. (2011). Financial intermediaries and the cross-section of asset returns. Working Paper.

19. **Accounting Restatements**

Dechow, P. M., Ge, W., Larson, C. R., and Sloan, R. G. (2011). Predicting Material Accounting Misstatements. *Contemporary Accounting Research*, *28*(1), 17-82.

20. **Idiosyncratic Volatility**

Fu, F. (2009). Idiosyncratic risk and the cross-section of expected stock returns. *Journal of Financial Economics*, *91*(1), 24-37.

21. **Implied Volatility**

Goyal, A., and Saretto, A. (2009). Cross-section of option returns and volatility. *Journal of Financial Economics*, *94*(2), 310-326.

22. **Limit Order Book**

Cao, C., Hansch, O., and Wang, X. (2009). The information content of an open limit-order book. *Journal of Futures Markets*, *29*(1), 16-41.

23. **Fundamental Analysis**

Bartram, S., and Grinblatt, M. (2015). Fundamental Analysis Works. Working Paper.

24. **FOMC Risk Premia**

Cislak, A., Morse, A., and Vissing-Jorgensen, A., (2014) Stock Returns over the FOMC Cycle. Working Paper.