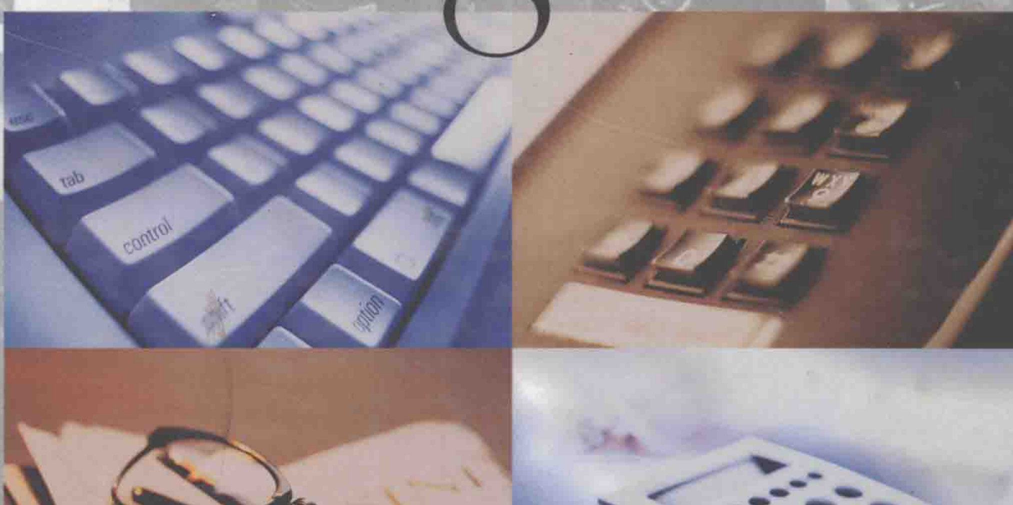
Practical Investment Management



Robert A. Strong

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Robert A. Strong
University of Maine

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Preface

Audience

Practical Investment Management is intended for people studying the capital markets for the first time. I assume that the reader is familiar with basic finance concepts such as the time value of money, the role of financial statements, and the concept of equity ownership.

Most adopters of this book will be teaching an undergraduate investments course at a four-year institution. Some others will teach in two-year or continuing education programs. Data collected by West Educational Publishing several years ago indicate about 112 faculty teach finance classes at two-year institutions, and another 1,700 teach at four-year institutions. My impression is that there is not much brand loyalty in the investments classroom. Most instructors seem willing to consider new approaches and new textbook products as they arrive in the office mailbox.

Content and Approach

The book is organized into twenty chapters. Many users will choose to go through the material in this order although most chapters stand alone and can be used independently.

The book contains all standard topics found in the typical modern investments text. Several chapters of *Practical Investment Management* are unique among the current crop of competitors. Chapters Three and Six, "The Marketplace" and "Market Mechanics," provide a thorough exposition on the nuts and bolts that make the marketplace work. These chapters are likely to be among the students' favorites as this material can be immediately useful.

I find that one of the most frequent questions is how securities are actually traded. What really happens when someone decides to buy or to sell? What if nobody wants to sell? How can you be assured that you will get a fair price when you sell? These are extremely important questions, and they are covered carefully and fluently.

The role of the stock specialist and the specialist's book are especially rich material. ***Market orders, limit orders,*** and ***stop orders*** are an important part of the investment world. Discussing this topic fosters an understanding of how shares trade and simultaneously deals with the specialist's book and its purpose. The role of the stock specialist is not well understood by the individual investor. Members of

Congress periodically launch an attack against the specialist system, causing the exchanges to have to send a team to Washington to educate our elected representatives. In this part of the book I show how the specialist can narrow the spread between buying and selling prices, make a profit, and improve prices for everyone else, too.

Discussion of the specialist leads logically to an exposition on the role and use of ***margin accounts.*** Many students will eventually have a margin account or be in a position to comment about them, and should know about things like ***buying power*** and ***margin calls.***

In class, I show a short segment of the Financial News Network to illustrate the ***tickertape.*** While understanding the tickertape is certainly not essential to successful investing, it is perhaps the most familiar icon of the marketplace, and anyone schooled in the capital markets should be able to explain that stuff that runs on the bottom of the television screen.

The examples above give a flavor of the *application orientation* to the material. I believe that a student's enthusiasm for study of the marketplace is encouraged by logical demonstrations of how textbook material is applied to practical applications or by using striking graphics. *Visual images* that are easily recalled help make learning a lasting phenomenon and can generate confidence during test taking. An attractive text layout with good graphics also increases the likelihood the book will be read efficiently.

Some images may seem like overkill, such as the Chapter Ten figure on folding the *Wall Street Journal.* I tell students that if they take the train or subway in a financial center, they will see people reading the paper folded in such a way that it is conveniently read with one hand. Using the educational edition of the *WSJ*, I have them learn this folding technique.

Features

Wherever possible I have tried to supplement equations with logic and a graphic. Investment valuation should not become a black box devoid of common sense. Helping construct analogies or cause and effect relationships is far more useful than prescribing a list of equations you must memorize.

Keeping the "big picture" in sight is not always simple to do when talking about technical items. Neither finance nor any other discipline is an end in itself. Our discipline helps people make better decisions about investment choices.

I believe it is also important to stress that while we know many things about investment valuation, there are many things we do not know. Sometimes recognizing what you don't know is just as important as what you do know.

There is much in both the popular press and in academic literature about the "growth stock" versus "value stock" debate. I do not believe we have discovered everything there is to know about this area even in a market efficiency context. Similar comments can be made about the broad field of technical analysis. Market anomalies remain a puzzle, as do such modern developments as neural networks and chaos theory.

I am an advocate of the ***Chartered Financial Analyst*** program and make frequent reference to it in class. It seems that the CFA credential is rapidly becoming essential to a good career path in the investment management business. I make a number of references to the CFA program in the book. Chapter Nineteen, *Performance Measurement and Presentation,* references much of the

Association for Investment Management and Research material on presentation standards.

Each chapter begins with a short *quotation* and a list of *key terms* and concludes with several dozen *problems* (requiring numerical solution) or *questions* (short answer or essay). Consistent with many of the readings in the CFA program, each chapter also has a *self-test* immediately before the problems and questions. These are true/false questions with the answers at the back of the book, and false answers are explained. A *glossary* contains an explanation of each key term.

A *software disk* containing two directories of Lotus 1-2-3 templates comes with the *Instructor's Manual.* One directory has DOS based *.WK1 Æles, most of which can also be read by Microsoft Excel. The other directory has Lotus for Windows WK4 Æles with Lotus "click a mouse on the button" macros. For those students who have a choice of software, this latter option will be the most enjoyable to use.

Acknowledgments

The staff at West Educational Publishing gave me a great deal of technical support in writing this book. Arnis Burvikovs, the editor for my Ærst book (*Portfolio Construction, Management, and Protection*) convinced me that this project was a good idea worth pursuing. Susanna Smart, as usual, was efÆcient, reliable, and encouraging. Kara ZumBahlen guided the project through the production process in as efÆcient a manner as an author could ever wish. My good friend, G. Peirce Webber, is simultaneously an extraordinarily successful investor, a very generous man, and a superb role model for students. I appreciate his willingness to write the Foreword. In addition, Ufuk Ince of Georgia State University provided the excellent Internet Appendix and exercises, geared speciÆcally for this text.

Finally, the book received unusually thorough reviews from the following people:

Allen S. Anderson
University of Akron

Claire A. Bronson
Western New England College

Earl D. Benson
Western Washington University

Howard W. Bohnen
St. Cloud State University

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Foreword

G. Peirce Webber

In his new book, *Practical Investment Management*, Dr. Robert A. Strong has written a comprehensive, easy to read analysis of the investment world covering a spectrum of many complex and intriguing subjects. As we all know, investing is not an exact science and requires continuous study to improve one's judgment to achieve success.

Anybody interested in knowing and understanding financial matters has to acquire a tremendous fund of knowledge. *Practical Investment Management* will provide easy and satisfying answers to many baffling questions raised as to the mysterious workings and miracles of a financial world. A person's judgment is no better than one's information.

Dr. Robert A. Strong has obtained degrees in engineering from the United States Military Academy at West Point, a Master of Science in business administration from Boston University, and a Ph.D. in finance from Penn State. Bob is Professor of Finance at the University of Maine and Deputy Director of the Summer Economics Program at Harvard University. A few years ago, he founded an investment club for University of Maine students known as "Spiffy." He convinced the University of Maine Foundation to make a grant of $200,000 that could be invested by this group within certain constraints and guidance by the mentors. This experiment has proved to be extremely educational and successful—a novel and rewarding venture for all involved.

In the quest for successful investing there are several adages which are pertinent and timely. Somebody asked the elder J. P. Morgan, "What will stocks do?" The retort was "They will fluctuate." Other bits of wisdom include "Nobody ever goes broke taking a profit," and "The best time to invest is when your hand starts to tremble."

Many of the cardinal rules for successful investing are contained in this new publication *Practical Investment Management.* One of the most important is to embrace the advantages of diversification. This can be achieved by investing in certain promising stocks in various industries and countries. One popular method is to confine your purchases to securities Value Line rates 1 or 2 for timeliness and appreciation potential.

Another important investment technique is dollar cost averaging, which over time has proven to have great merit. The practice involves investing a certain amount every month during good and bad times. In that effort the investor obtains an average price which can be beneficial. It is extremely difficult to depend upon timing as nobody knows the vagaries of the stock market, the duration of its trends, or the extent of the right moves.

The best money managers place importance to the proper allocation of assets—how much should be invested in stocks, bonds, money funds, and CD cash equivalents. Most experts recommend an emergency fund in short term bills, saving accounts, and bank CDs. The need may arise from the loss of your job, bad health, and depressed financial conditions. This could be a reserve of 3 to 6 months of your earnings—a great source of comfort and security.

Practical Investment Management provides a financial dictionary—a real data treasure house to obtain important and pertinent information covering the financial world. It will be extremely beneficial as a study and reference source to answer one's quest for knowledge as well as a powerful tool to reach the cutting edge for successful investing—everybody's goal.

G. Peirce Webber
Former CEO, Webber Timberlands
Harvard '33

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