Applied Fundamental Investing
Spring 2018
Course Description and Syllabus

Instructors: Yiting Liu, Bobby Murphy, Harsh Acharya, Josh Barber, Suken Patel (from Diamond Hill Capital Management Inc.)

Professor: Kewei Hou
Office hours: By appointment only

Course Description:
Over $40 trillion are invested in mutual funds worldwide. Roughly $17 trillion is invested in U.S mutual funds alone, up from just ~$3 trillion in 1995. Exchange-traded funds (ETFs) now manage approx. $4 trillion, and the number of ETFs has grown from 2 in 1995 to over 2,000 today. U.S. Hedge funds, including Funds of Funds, manage over $3.5 trillion. Private equity, including venture capital, manages over $4.5 trillion.

To find employment in this industry, it is necessary to know some of the specialized skills that are required, skills above and beyond those taught in typical Investments and Corporate Finance courses. The goal of this course is to provide an introduction to the tools needed to enter the field of professional money management.

You are expected to have already completed all the base courses in finance. You should also be familiar with using Excel.

The main goals for this course are:
1) Increasing your ability to identify attractive investment ideas.
2) Honing your ability to research potential investment ideas by employing a comprehensive research process and make investment recommendations and decisions.
3) Gaining a better understanding of portfolio management.
4) Improving your financial modeling skills.
5) Improving your understanding of current issues in the field of investment management.

The course will be both lecture and project based and will mainly be conducted by analysts from Diamond Hill Capital Management Inc. with oversight from Professor
Kewei Hou. Throughout the course students will learn all the key aspects of investment research and portfolio management. Concurrently, students are expected to form teams of 3 people and to identify attractive investment opportunities in equities, long or short and across all geographies (developed and larger emerging markets). It is this combination of guidance from the instructors who have many years of industry experience and project based approach where students can apply everything they have learned in class that will prepare them to have a good understanding of how the investment industry works.

**Course Material:**

*Slides:*

Slides and other supporting materials will be distributed to the students via email.

*Wall Street Journal or Financial Times:*

Not required, but you should either have your own subscription or have regular access to the Journal if you are interested in a career in finance. We will go over many articles from the WSJ and/or FT and other news-sources in class, to both keep up with current events in the field, as well as to tie the course material to real-life examples.

**Course Format:**

This class meets twice per week. We will be following the flow of topics and concepts selectively, but we will also spend time on related examples. Questions are always welcome; please don't hesitate to interrupt at any point. Students will form teams of 3 people to work collectively on their research report/project, which is due by EOD Wednesday, Feb 28, 2018.

**Grading**

Grading will be comprised mainly of two aspects. 20% of the grade will depend on a 5-minute group presentation of an investment idea (Elevator-pitch) AND a 1-page written report/outline that explains the rationale behind the chosen investment idea. The other 80% will be based on the research report/project submitted at the end of the course (by EOD Wednesday, Feb 28, 2018) and students will be graded on the quality of analysis and the reasonableness of the investment idea. Class participation is highly encouraged.

**Class Calendar:**

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| **Wk 1** | Introduction to course, asset management industry  
Diamond Hill investing philosophy and framework | Introduction to course. Key characteristics of asset management industry. What’s the role of an analyst and PM? What’s Diamond Hill’s investing philosophy and research process? |
|      | **Homework: Read “Superinvestors of Graham-and-Doddsville”** |                                                                            |
| **Wk 2** | Common behavioral biases  
Valuation concepts | What are common myths about valuation? What are different valuation models & metrics? Signs of valuation traps? How to spot investment opportunities? |
Wk 3 | Business analysis | Why is it important to analyze an industry? How to analyze a business and industry using Porter’s Five Forces?
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Industry analysis

**Homework:** Read “Accounting for Aircraft Engines” and “Impact of Electric Vehicle Adoption on the Electric Utility Industry”

Wk 4 | Industry analysis cont’d | Examples and case studies on analyzing a business and industry
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Group Presentations (Elevator-pitch)

Wk 5 | Group Presentations (Elevator-pitch) | Types of filings and where to find them? What to look for in filings? Evaluating earnings quality
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SEC filings overview & Related accounting concepts

Wk 6 | Introduction to modeling | Primary modeling techniques. What are modeling shortfalls? Real value of modeling? How to assess management quality? Introduction to short-selling
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Management quality and short-selling

**Homework:** Read “Charlie Munger: Turning $2 Million Into $2 Trillion”

Wk 7 | Key value drivers and risk factors | How to think about value drivers? What are moats and competitive advantages? How to identify risk factors?
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Recommendation

**Research Report/Project due by EOD Wednesday, Feb 28, 2018**

**Other interesting materials (not required, but good reading):**

“The Intelligent Investor” by Benjamin Graham
For investors who are intimidated by Graham's prior groundbreaking work, “Security Analysis”, this book makes a good introduction to the difference between making investments and capitalizing on speculation – a risky business. Another favorite book of Warren Buffet's (who wrote the introduction), it covers emotional decision-making versus rational analysis of markets and their fluctuations. Forbes magazine author Jason Zweig also counts it at the top of his favorite book list, calling it “prophetic”. Graham's own history as a survivor of the Great Depression stock crash, and master of detailed company research yielding 14% annual returns, qualifies him to mentor others down the investment path.

"The Essays of Warren Buffett: Lessons for Corporate America" (2001) by Warren Buffett and Lawrence Cunningham
Although Buffett seldom comments on his current holdings, he loves to discuss the principles behind his investments. This book is actually a collection of letters that Buffett wrote to shareholders over the past few decades. It's the definitive work summarizing the techniques of the world's greatest investor.


“The Blind Side”, “Moneyball” and several other books, worked at Solomon Brothers (now part of Citigroup, but at the time the most profitable firm on Wall Street) during the mid-1980’s. He takes a broad look at other financial calamities over the past quarter-century and compares/contrasts them to the subprime crash of 2008-09.

“Liar’s Poker: Rising Through the Wreckage on Wall Street” by Michael Lewis, 1989, ISBN: 0140143459. A bit dated, but still a fun read. The inside story of a guy working in sales and trading Solomon Brothers in the mid-1980’s. (They were on top because they created the market for mortgage-backed securities, ironically.) Great stories about the firm’s reaction to the 1987 Crash, the pranks traders play on each other, the attitudes, and the story of the Human Piranha.

“When Genius Failed: The Rise and Fall of Long-Term Capital Management” by Roger Lowenstein, 2001, ISBN: 0375758259. The story of how the best minds of finance—including Nobel laureates Robert Merton and Myron Scholes (rightly lauded in Capital Ideas), along with John Meriwether from Liar’s Poker—began a hedge fund that could not possibly fail, until it did. A very valuable story about how even the absolute greatest minds can be brought to their knees by the market. After reading how these titans of finance were humbled, it is much less of a surprise when we hear how “ordinary” Wall Street CEOs bankrupted their companies in 2008.

**Websites and Blogs:**
(Note: links do change/break—let us know if any of these are no longer accurate.)

Wall Street Journal: [www.wsj.com](http://www.wsj.com)
Bloomberg: [www.bloomberg.com](http://www.bloomberg.com)

2. Farnam Street: [https://www.farnamstreetblog.com/](https://www.farnamstreetblog.com/)
4. Graham & Doddsville: [http://www.grahamanddoddsville.net/?page_id=689](http://www.grahamanddoddsville.net/?page_id=689)