
CASE STUDIES

“Case Studies” presents a case pertinent to contemporary issues and events in investment management. Insightful and provocative questions are posed at the end of each case to challenge the reader. Each case is an invitation to the critical thinking and pragmatic problem solving that are so fundamental to the practice of investment management.

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FINANCIAL LITERACY

All the employees of the state had their retirement funds managed by a single entity. Its staff had played an active role in the governance of corporations whose shares it owned on behalf of state employees. One of its frequent complaints was that most members of corporate boards did not have the training or background to understand the impact of corporate decisions on the shareholders.

In order to increase awareness of the problem, the staff had approached business faculties in the colleges around the state asking for their suggestions regarding what board members of publicly held corporations ought to know. From their suggestions, the staff had compiled a tentative series of questions.

DISCUSSION

Name the three potential nonfinancial sources of a company's investment value.

What market statistic is the best measure of investors' expectations for inflation?

What are the two macroeconomic variables with the broadest investment impact?

What are the two main limitations on a country's sustainable output and employment?

How does a widely publicized research report affect the accuracy of a company's stock price?

True or false: the best way to measure performance of a professionally managed fund is to consider the rate of return, not merely for last year, but for the last 2-, 3-, 4-, and 5- year periods.

Lenders require higher yields to maturity on junk bonds because the borrower enjoys a special advantage over the lender. Explain.

When a fund manager makes bigger bets on the same information his performance/turnover/beta increases.

The main cost of trading is

- Commissions
- Dealer spread
- Bid–ask bounce
- None of the above

“Although active investors couch their trades in the prices of specific securities, they are actually buying and selling time.” Explain.

As investors’ estimates of its value improve, the liquidity of a stock gets better. True or false?

How does the value of a publicly held company typically divide between shareholders and management? How will a change in the dividend yield affect that division?

How does a change in a company’s debt–equity ratio affect its market value? Ignore taxes.

How does a change in the rate at which it is produced affect the current value of a capital good?

How does a company’s growth rate affect its investment value?

List some examples of “commodity” stocks. How will the economic outlook affect their value?

The staff wondered if they were on the right track. Were some of these questions too tough for the average director? Or should they be confined to the chairman of the audit committee? And had they overlooked some important questions? The staff was uncertain how to proceed.