W. P. Carey School of Business

Undergraduate Maroon & Gold Fund
Semi-Annual Meeting
May 1st, 2009
Today’s Agenda

• Team introduction and fund objectives
• Economic outlook and market overview
• Portfolio: changes in portfolio style & management, and current composition
• Performance vs. benchmarks
• Asset allocation: GS & GENZ
• Thesis Overview and UCO Position
• Lessons learned and discussion
INITIAL ECONOMIC OVERVIEW

Daniel McAuley & Jeff LaFrance
Economic Outlook – January 2009

• Economic Figures
  – Consumer Confidence Index: 37.7 (historic low)
  – Consumer Price Index (Core): -0.7% YoY since December; 2008 yearly change of +0.1%
  – Case Schiller Home Index – 19.1% YoY drop; 2.2% drop since October

• Outlook
  – We believed that equities would have a positive and volatile year
  – Projected that oil would also rise in price due to slight increase in growth from present level, and due to a reversion to fair value
  – Inflation would remain flat throughout the year and quantitative easing would prevent a deflationary spiral
  – Housing market critical for overall market recovery
PORTFOLIO

Jeff LaFrance
Management Changes

• Educational
  – Analysts assigned new sectors

• Operational
  – Sector weightings

• Position Execution
  – Laddering into positions

• Focus on Economic Outlook
  – Foundation for trades
PORTFOLIO

• Diversified, large-cap value fund
  – Defensive strategy amidst tough economic climate
  – Bargain hunting opportunities
  – Information widely available, help with learning process

• Investment selection criteria
  – Market cap: 8+ billion, Price to Book: < 3, Price to earnings: < 20

• Seven stocks, three sectors excluded
  – Materials
  – Consumer Discretionary
  – Information Technology

• Limited initial exposure to financials
Benchmark Analysis vs. Last Sem.

Most recent vs. Last Semester

• S&P 500 Value Index Fund (IVE)
  – P/E: 14.14 vs. 15.31
  – P/B: 2.53 vs. 2.23
  – Beta: 1.09 vs. 0.98

• Our Fund
  – P/E : 16.29 vs. 10.02
  – P/B: 2.24 vs. 2.67
  – Beta: 0.86 vs. 0.90

How well are we correlated to the benchmark?
Biotech overweighting
PERFORMANCE

Don Bowen
Fall Performance vs. IVE

ECONOMIC OUTLOOK
PORTFOLIO PERFORMANCE
ASSET ALLOCATION
THESIS
DISCUSSION
APPENDICES
Spring Performance vs. IVE
Dividend Persistence

- Fall Stocks
  - EXC
  - NOC
  - PFE
  - TSCDY
  - VZ
  - USB

- Spring Stocks
  - ABT
  - LQD
Performance

- Fall Performance
  - SIM Fund: -19.77%
  - IVE: -27.23%

- Spring Performance
  - SIM Fund: -5.07%
  - IVE: -5.35%

- Overall return during academic year
  - SIM Fund: -23.78%
  - IVE: -32.93%
SELECTED STOCKS

• Selected stocks
  – GS & DBB vs. USB: Exposure to Financials
  – GENZ: Genzyme
  – UCO

Jazmin Medina & Jesse Mayfield
Goldman Sachs

Why we chose Goldman
- Believe they will be the first bulge bracket to return TARP funds
- Strong financial strength
- Bad year for company – Trading Revenues were down 71%
- Sector benefit from mark-to-market rule changes

How did it fit in the portfolio?
- Financials: Fundamentals have returned

Holding period highlights:
- Beat first quarter earnings
- Publicly announced plan to repay TARP

Comparison relative to competition:
- Weaker financial position
- Goldman has always been an industry leader & first mover
Genzyme

Why we chose Genzyme
• Strong cash position $1.5B
• Products provide enormous benefits to small number of patients
• Revenue diversification & no debt
• Expansion plans with Myozyme in US

How did it fit in the portfolio?
• Biotechnology: Solid drug demand

Holding period highlights:
• President Obama’s 2010 budget proposal sought to initiate major health care reform
• FDA regulatory setback with Myozyme

Comparison relative to competition:
• Celgene’s revenues concentrated in one drug
• Amgen most vulnerable to biogeneric competition
UCO: Ultra Crude Oil ProShares

- Leveraged ETF designed to track twice the daily return of West Texas Sweet Crude Oil
- Gave direct exposure to increasing oil prices
- Closed position due to increasing understanding of risks in leveraged ETFs
- 26% gain between Feb 13th and March 27th
Thesis

Investigation into Leveraged Exchange Traded Funds from a Portfolio Management Perspective

Daniel McAuley & Adam Michelow
Why Investigate Lev. ETFs?

- These instruments are quickly gaining popularity
- Many investors are unaware of the lack of accurate tracking at the specified leverage ratio
- Our personal experience with UCO during the semester
Sources of Compounding Error

2 Day Compounding Error

<table>
<thead>
<tr>
<th></th>
<th>Beg. Value</th>
<th>Day 1 Perf</th>
<th>Day 2 Perf</th>
<th>Gain/Loss</th>
</tr>
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<tbody>
<tr>
<td>Index A</td>
<td></td>
<td>10%</td>
<td>-9%</td>
<td></td>
</tr>
<tr>
<td>Traditional ETF</td>
<td>10,000</td>
<td>11,000</td>
<td>10,010</td>
<td>0.10%</td>
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<tr>
<td>UltraShort ETF</td>
<td>10,000</td>
<td>8,000</td>
<td>9,440</td>
<td>-5.60%</td>
</tr>
</tbody>
</table>

- As holding period prolongs, compounding error becomes increasingly severe due to the leverage trap
- Increasing volatility only magnifies this compounding error
Comp. Error: Financials in ‘08

- IYF (financials): -50.40%
- SKF (2x inverse financials): +4.28%
- Causes of Tracking Error
  - Record Index volatility, compounding error, expenses
Conclusions

- Investors should not expect 2x or 3x returns in LT
- Higher returns are possible, but come with an excess amount of risk
- Investors should remain wary of holding leveraged ETFs longer than 1 day
  - These securities are only appropriate as speculative trading vehicles for short-term directional bets
- Policy Proposal
  - Greater disclosure
  - Limit trading to those who sign disclosure similar to a margin or option agreement
Lessons Learned & Discussion

JiaQi Bao
Lessons Learned

• The importance of
  – A flexible, structured framework
  – Due diligence in new financial products
  – Formulating and maintaining an independent view

• During our holding period (Jan. 13 – April 14):
    • Dropped below 700 for the first time since 1996
  – Dow Jones Industrial Average
    • Dropped below 6,800 mark for the first time in 12 years
Thank You!
Appendices

- List of Fund Holdings
- Transaction History
- Daily Fund Performance & Events
- Economic Overview
- Analyst Report
- Attribution Analysis
- Team Biographies
Fund Holdings

- Exelon Corporation (EXC)
  - Electricity generating and distributing company; leading U.S. nuclear operator

- US Bancorp (USB)
  - Financial services holding company; sixth-largest bank in the U.S.

- Verizon Communications (VZ)
  - Broadband and telecom company; Dow component

- Northrop Grumman Corporation (NOC)
  - Aerospace & Defense technology company

- Goldman Sachs, Inc (GS)
  - A global investment bank, securities and investment management firm

- IBoxx Investment Grade Bonds (LQD)
  - A fund that seeks to track the investment grade corporate bond market
Fund Holdings

- The Proctor & Gamble Company (PG)
  - Global branded consumer goods firm
- Genzyme Corporation (GENZ)
  - Bio tech firm focusing on genetic and lysosomal storage disorders
- Abbott Laboratories (ABT)
  - Engages in discovery, development, manufacturing & sale of health products
- The Kroger Co. (KR)
  - United States based retailer
- Exxon Mobil Corporation (XOM)
  - Global oil and gas company
Transaction History

• Buys (Returns current as of market close 4/28):
  – EXC (9/26): 210 shares @ $67.70, Return: -33.31%
  – NOC (9/26): 230 shares @ $62.99, Return: -23.37%
  – TSCDY (9/26): 685 shares @ $20.85 , Sold
  – PFE (9/26): 775 shares @ $17.96 , Sold
  – RIG (9/29): 100 shares @ $114.19 , Sold
  – USB (9/29): 375 shares @ $33.54 , Return: -47.29%
  – VZ (9/29): 400 shares @ $31.05 , Return: -0.29%
  – UCO (2/13): 1000 shares @ $7.61, Sold
  – PG (2/23): 250 shares @ $50.01, Return: -0.64%
  – GENZ (2/25): 180 shares @ $69.41, Return: -21.35%
  – LQD (3/16): 135 shares @ $92.77, Return: 3.27%
  
  (Continued on next page)
Transaction History

- **Buys (Continued)**
  - ABT (3/23): 250 shares @ $47.95, Return: -10.30%
  - KR (3/27): 590 shares @ $22.01, Return: -1.50%
  - GS (4/1): 110 shares @ $110.41, Return: 9.29%
  - XOM (4/8): 175 shares @ $68.67, Return: -2.32%

- **Sales**
  - SPY (10/24): 60 shares @ $90.48, Return: -21.85%
  - TSCDY (2/13): 685 shares @ $15.50, Return: -25.48%
  - RIG (2/13): 100 shares @ 61.13, Return: -46.47%
  - PFE (3/16): 775 shares @ $14.09, Return: -21.77%
  - UCO (3/27): 1000 shares @ $9.61, Return: 26.28%