



# **Undergraduate Student Managed Fund Fall 2018 Portfolio Report Team Terrion-Wilkos**

Student Managed Fund

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# Introduction

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**Co-Lead Managers:** Matthew Arons & Austin Langer

**Portfolio Manager:** Alana Phillips

**Communication Manager:** Trent Nobile

**Web Manager:** Sean Homa

Matthew Arons

Sean Homa

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Sharon Liu

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John Quevreaux

Zachary Yellen




**Undergraduate Supervisor:** Patrick Terrion & Christopher Wilkos

**Fund Director:** Chinmoy Ghosh

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# Agenda

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-  Portfolio Overview
-  Investment Process
-  Economic Overview
-  Portfolio Performance & Sector Overview
-  Current Holdings & Future Outlook

# Portfolio Overview

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# Portfolio Overview

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## Philosophy

Managers invest with a 10-year time horizon to outperform the S&P 500 by finding investments that have been inefficiently valued by the market



## Investment Style

Managers use a bottom up security selection to find investments which are fundamentally undervalued by the market through research and financial modeling



## Strategy

Managers review their specific sector assignments to find companies with strong balance sheets and business models that have a sufficient margin of safety

# Investment Process

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# Investment Process

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We look for companies that exhibit strong financials, attractive valuations, and many of the following **competitive advantages**:

*Innovative*



*Brand Leadership*



*High Barriers for Entry*



*Growth-Oriented Business Model*



# Investment Process

## Key Points of Emphasis During Weekly Pitches

### Competitive Advantage

- Is their recent success a fad or new trend?
- Example: Corporate strategy that has made ULTA unique in the beauty space

### International Demand

- How can a name brand company keep growing consistently?
- Example: AXP can benefit from the increasing use of cards globally

### Perpetuity Growth Rate

- SMF Managers started the year in a valuation-high environment
- Example: PLD was pitched at a previous all-time high





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# Investment Process

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## Risk Management

### Detailed Analysis

- Careful financial research conducted in advance of investment decisions



### Stop-Loss Orders

- 25% minimum stop-loss orders to account for recent market volatility



### Margin of Safety

- Utilize the Graham-Dodd concept of margin of safety



# Economic Overview

## Economic Outlook - U.S

| GDP Growth  | Employment  | Consumer Confidence  | Inflation   | Private Fixed Investment  |
|---|---|--|---|---|
| 3.5% Q3 growth<br><br>Projections of 3.1% 2018 GDP growth | 3.7% Oct (Update for Nov soon)<br><br>2.8% Q3 Wage Growth | 135.7 in Nov.<br><br>Close to the previous 18-year Oct. high | 2.0% Core PCE YoY<br><br>10 year TIPS spread at 1.91% | Up 8.1% YoY Q3<br><br>Manufacturing output increased for 5 <sup>th</sup> straight month in Oct. |

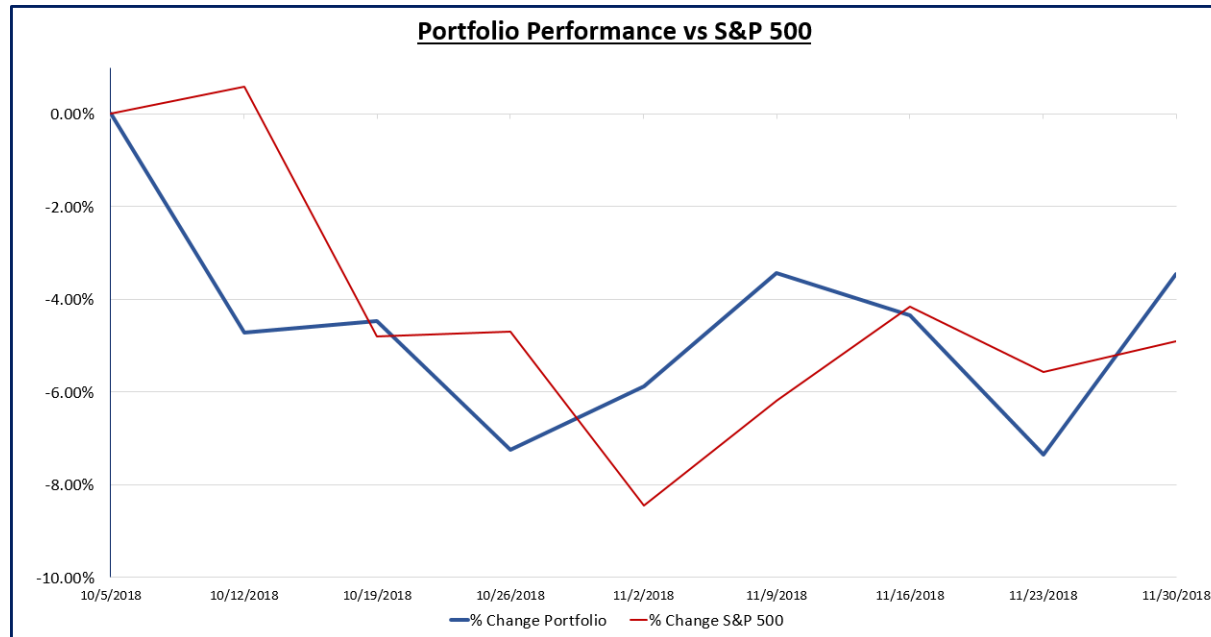
*Modest growth with tightening labor market below the natural rate of employment expected to keep inflation at the Federal Reserve target of 2%*

# Portfolio Performance

## Sector Allocation

| Sector                 | Target %       | % of Total Portfolio | % of Invested Portfolio | S&P 500 Sector Weight |
|------------------------|----------------|----------------------|-------------------------|-----------------------|
| Basic Materials        | 2.00%          | 0.00%                | 0.00%                   | 2.50%                 |
| Consumer Discretionary | 15.00%         | 5.30%                | 12.38%                  | 10.16%                |
| Consumer Staples       | 7.00%          | 0.00%                | 0.00%                   | 6.74%                 |
| Energy                 | 7.00%          | 0.00%                | 0.00%                   | 6.02%                 |
| Financials             | 12.00%         | 7.87%                | 18.39%                  | 13.71%                |
| Industrials            | 10.00%         | 6.32%                | 14.78%                  | 9.73%                 |
| Technology             | 15.00%         | 4.26%                | 9.97%                   | 20.84%                |
| Healthcare             | 10.00%         | 0.00%                | 0.00%                   | 14.90%                |
| Real Estate            | 7.00%          | 6.12%                | 14.30%                  | 2.65%                 |
| Utilities              | 5.00%          | 0.00%                | 0.00%                   | 2.82%                 |
| Communication Services | 10.00%         | 12.91%               | 30.18%                  | 9.93%                 |
| Cash                   |                | 1.31%                |                         |                       |
| <b>Total</b>           | <b>100.00%</b> | <b>44.10%</b>        | <b>100.0%</b>           | <b>100.0%</b>         |

# Portfolio Performance



| Undergraduate Portfolio   |              | S&P 500 ETF (SPY) |            |
|---------------------------|--------------|-------------------|------------|
| Beginning Value           | \$ 1,368,035 | Beginning Value   | \$ 289.84  |
| Current Value             | \$ 1,321,015 | Current Value     | \$ 275.65  |
| Absolute Change           | \$ (47,020)  | Absolute Change   | \$ (14.19) |
| % Change                  | -3.44%       | % Change          | -4.90%     |
| Difference in Performance |              | 1.46%             |            |

| Equity vs. S&P 500 Performance |        |
|--------------------------------|--------|
| Total Portfolio Performance    | -3.44% |
| S&P 500 Performance            | -4.90% |
| Equity Performance             | 0.80%  |

# Total Portfolio Unrealized Gains

| Portfolio |                             |                        |                |                |        |                |             |              |                 |                |                |          |
|-----------|-----------------------------|------------------------|----------------|----------------|--------|----------------|-------------|--------------|-----------------|----------------|----------------|----------|
| Ticker    | Name                        | Sector                 | Dividend Yield | Date Purchased | Shares | Purchase Price | Price       | Cost Basis   | Market Value    | % of Portfolio | Change         | % Change |
| SPY       | SPDR S&P 500 ETF            |                        | 1.83%          | 10/1/2018      | 2,679  | \$ 289.84      | \$ 275.65   | \$ 776,481   | \$ 738,466      | 55.90%         | \$ (38,015)    | -4.90%   |
| ULTA      | Ulta Beauty Inc             | Consumer Discretionary | 0.00%          | 10/3/2018      | 235    | \$ 279.77      | \$ 297.79   | \$ 65,746    | \$ 69,981       | 5.30%          | \$ 4,235       | 6.44%    |
| AXP       | American Express            | Financials             | 1.41%          | 10/3/2018      | 926    | \$ 108.96      | \$ 112.27   | \$ 100,897   | \$ 103,962      | 7.87%          | \$ 3,065       | 3.04%    |
| DIS       | Walt Disney Co.             | Telecommunications     | 1.40%          | 10/9/2018      | 700    | \$ 117.03      | \$ 115.49   | \$ 81,921    | \$ 80,843       | 6.12%          | \$ (1,078)     | -1.32%   |
| EA        | Electronic Arts             | Technology             | 0.00%          | 10/29/2018     | 670    | \$ 93.99       | \$ 84.07    | \$ 62,973    | \$ 56,327       | 4.26%          | \$ (6,646)     | -10.55%  |
| PLD       | Prologis Inc                | Real Estate            | 2.98%          | 11/6/2018      | 1,200  | \$ 64.99       | \$ 67.34    | \$ 77,988    | \$ 80,808       | 6.12%          | \$ 2,820       | 3.62%    |
| LMT       | Lockheed Martin Corporation | Industrials            | 2.50%          | 11/8/2018      | 75     | \$ 309.32      | \$ 300.43   | \$ 23,199    | \$ 22,532       | 1.71%          | \$ (667)       | -2.87%   |
| LMT       | Lockheed Martin Corporation | Industrials            | 0.00%          | 11/13/2018     | 203    | \$ 304.76      | \$ 300.43   | \$ 61,866    | \$ 60,987       | 4.62%          | \$ (879)       | -1.42%   |
| GOOG      | Alphabet Inc. Class C       | Communication Services | 0.00%          | 11/15/2018     | 82     | \$ 1,049.96    | \$ 1,094.43 | \$ 86,097    | \$ 89,743       | 6.79%          | \$ 3,647       | 4.24%    |
| CASH      |                             |                        |                |                | 17,366 |                | \$ 1.00     |              | \$ 17,366       | 1.31%          |                |          |
|           |                             |                        |                |                |        | Total          |             | \$ 1,337,169 | \$ 1,321,015.27 | 100.00%        | \$ (33,518.85) | -3.44%   |

| Equity Portfolio |                             |                        |                |                |        |                |             |            |              |                |            |          |
|------------------|-----------------------------|------------------------|----------------|----------------|--------|----------------|-------------|------------|--------------|----------------|------------|----------|
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| CASH             |                             |                        |                |                | 17,366 |                | \$ 1.00     |            | \$ 17,366    | 3.07%          |            |          |
|                  |                             |                        |                |                |        | Total          |             | \$ 560,687 | \$ 565,183   | 100.00%        | \$ 4,496   | 0.80%    |

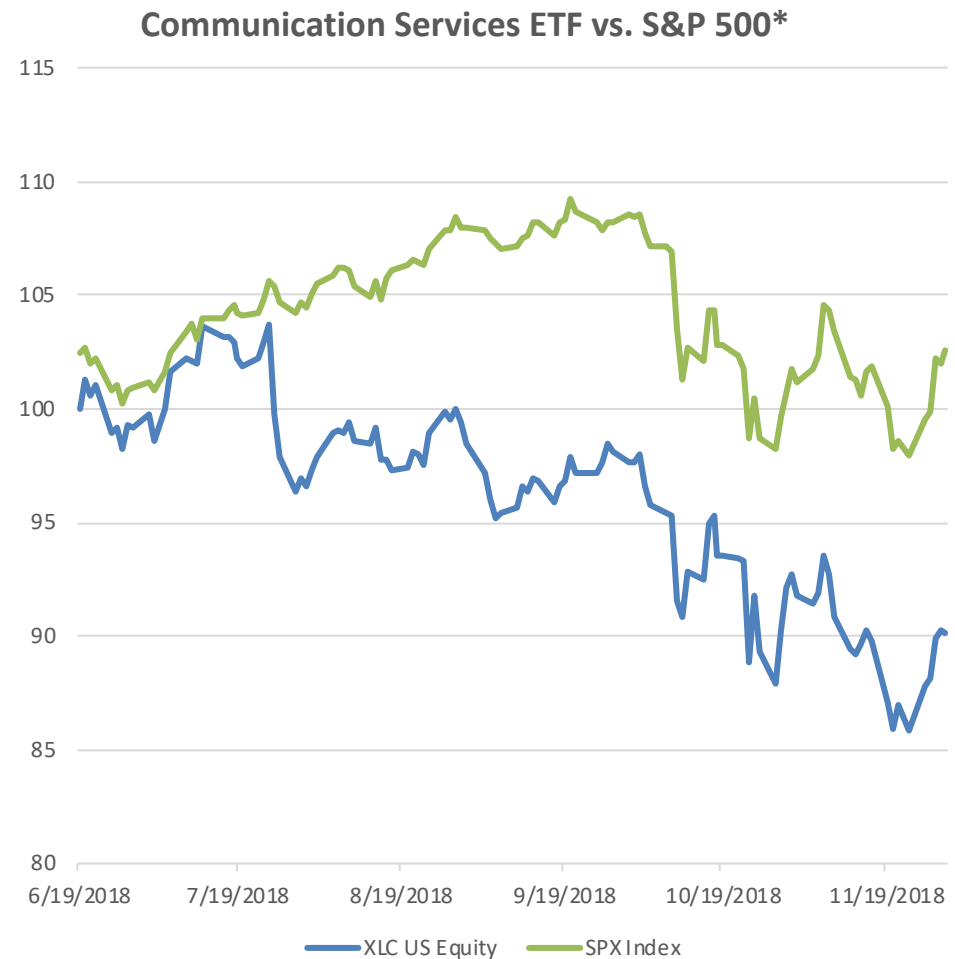
|                       |       |
|-----------------------|-------|
| Total Dividend Yield  | 1.44% |
| Equity Dividend Yield | 0.99% |

# Sector Overview



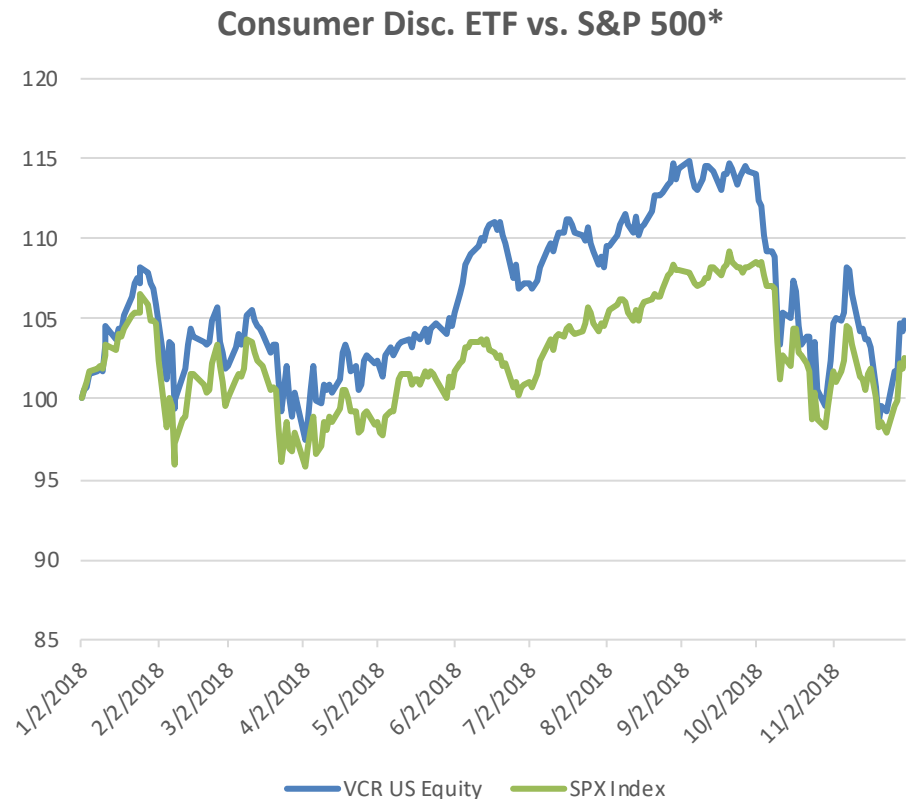
# Communication Services

- **Performance:**
  - Decreased 9.91% since 6/19/18
- **Future outlook:**
  - Saturation of top performers
  - More wireless product demand
- **Risks:**
  - New expenses with faster networks
  - Content creation slowdown
- **Current Holdings:**
  - Disney (NYSE: DIS)
  - Electronic Arts(NASDAQ: EA)
  - Alphabet (NASDAQ: GOOG)



# Consumer Discretionary

- **Performance:**
  - Increased 4.87% YTD
- **Future outlook:**
  - Increasing wage growth
  - Shift from retail to online
- **Risks:**
  - Consolidation of industry
  - Trade disputes could raise prices
- **Current holdings:**
  - Ulta Beauty (NASDAQ: ULTA)

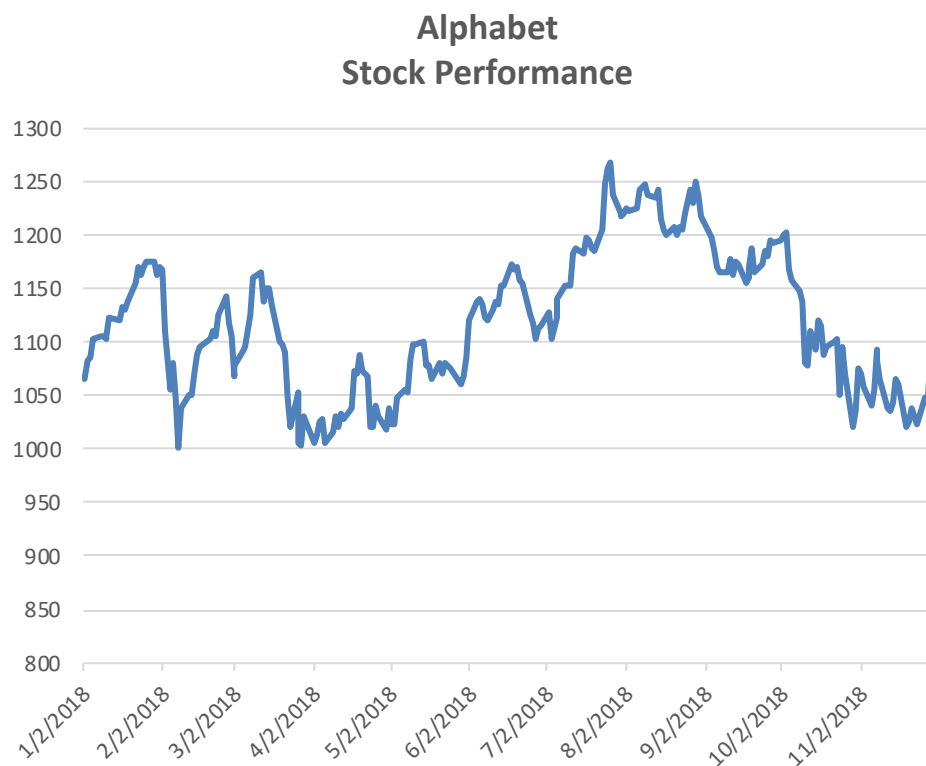


# Individual Holdings

## Alphabet – Basic Metrics

Alphabet

| Basic Metric          |            |
|-----------------------|------------|
| Purchase Price        | \$1049.96  |
| Current price         | \$1094.43  |
| 52 Week High          | \$1273.89  |
| 52 Week Low           | \$980.64   |
| Market Capitalization | \$766.04 B |
| Dividend Yield        | NA         |



## *Thesis*

We recommend GOOG based on:

- **Strong Business Model:** Alphabet is an industry leader that will continue to expand their reach as it generates free cash flow
- **Future Focused:** Alphabet is focused on investing in artificial intelligence and cloud software to make data of the world easily accessible to everyone
- **International Growth:** Alphabet is looking east to Asia to continue their growth. Alphabet recently launched a new app called Google Pay in India which has already processed over a billion dollars in payments

## *Risks*

- **Internal Start-Ups:** The majority of Alphabet's "other bets" business segment are in risky markets
- **Competition:** New companies continue to emerge to compete with Alphabet and could capture some of Alphabet's predominant market share
- **Regulation:** Alphabet is the number one search engine in the world, and therefore has the risk of being considered a monopoly

# Ulta Beauty – Basic Metrics



| Basic Metric          |           |
|-----------------------|-----------|
| Purchase Price        | \$279.77  |
| Current price         | \$297.79  |
| 52 Week High          | \$322.49  |
| 52 Week Low           | \$191.70  |
| Market Capitalization | \$17.94 B |
| Dividend Yield        | NA        |

ULTA  
Stock Performance



## *Thesis*

We recommend ULTA based on:

- **Largest Beauty Retailer:** ULTA is the premier beauty destination for cosmetics fragrance, skin, hair care products and salon services
- **Unmatched Product Breadth:** Mix of high and low end products and beauty salon for “the beauty enthusiast”
- **Store Growth:** Increased its number of stores in the US by 10% in 2018

## *Risks*

- **Real Estate Strategy:** Most stores are located in off-mall shopping centers, a decrease in traffic to big-box stores can slow down customer traffic
- **Vendor Partner Relationships:** ULTA needs to maintain good relationships to keep access to their exclusive products
- **Recognition of Beauty Trends:** Market trends move fast, not being update can affect ULTA’s “cool” factor

## Electronic Arts – Basic Metrics



| Basic Metric          |           |
|-----------------------|-----------|
| Purchase Price        | \$93.99   |
| Current price         | \$84.07   |
| 52 Week High          | \$151.26  |
| 52 Week Low           | \$80.42   |
| Market Capitalization | \$25.69 B |
| Dividend Yield        | NA        |

Electronic Arts  
Stock Performance







## *Thesis*

We recommend EA based on:

- **Franchise Strategy:** Well known, strongly branded franchises that can cheaply be leveraged into additional content
- **Improving Margins:** Growth in digital sales as a percentage of total revenue is driving stronger gross margins by decreasing operating expenses
- **Market Overreaction:** Delay of Battlefield V title resulted in a market overreaction that was not rooted in long-term business fundamentals

## *Risks*

- **“Hit” Driven Industry:** Highly competitive with respect to consumer attention
- **Rapid Technological Changes:** Older products become outdated and act as an overall disruptive force
- **Cybersecurity & Piracy:** Poses constant risks due to the digital nature of EA’s products

# Future Outlook

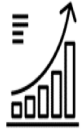
# Portfolio Expectations

We will continue to monitor both marker-wide and company specific trends.

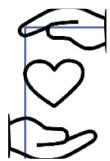
As we move on, we will carefully monitor our current events and actively pursue new investments that fit out investment philosophy



HealthCare to be steady during volatility



Increased infrastructure spending



Corporate social responsibility



Global trade risks

## *Potential Investment Ideas*



## Lessons Learned

*The case method taught in FNCE 4301 along with actively managing over \$1 million develops a key set of soft and hard skills in all student managers:*



### Soft Skills

Higher level thinking

Present and defend a thesis

Working as a team to challenge each other



### Hard Skills

Financial modeling: DCF, DDM, and Comparable

Individual company analysis

Data analysis: Bloomberg and Value Line

# Appendix

Questions?

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# Economic Outlook – Central Banks and Global Economy

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## Federal Reserve

- Expected rate hike in December
- Approaching the neutral rate
  - 3 more hikes = 3.0%
- Watching for global demand and fading fiscal stimulus

## ECB and Euro Area

- Asset purchase program ending in Dec.
- Rates to stay at zero in near-term
- Q3 Real GDP growth slowest since 2014
- Inflation expected to dip below 8% in 2019

## China

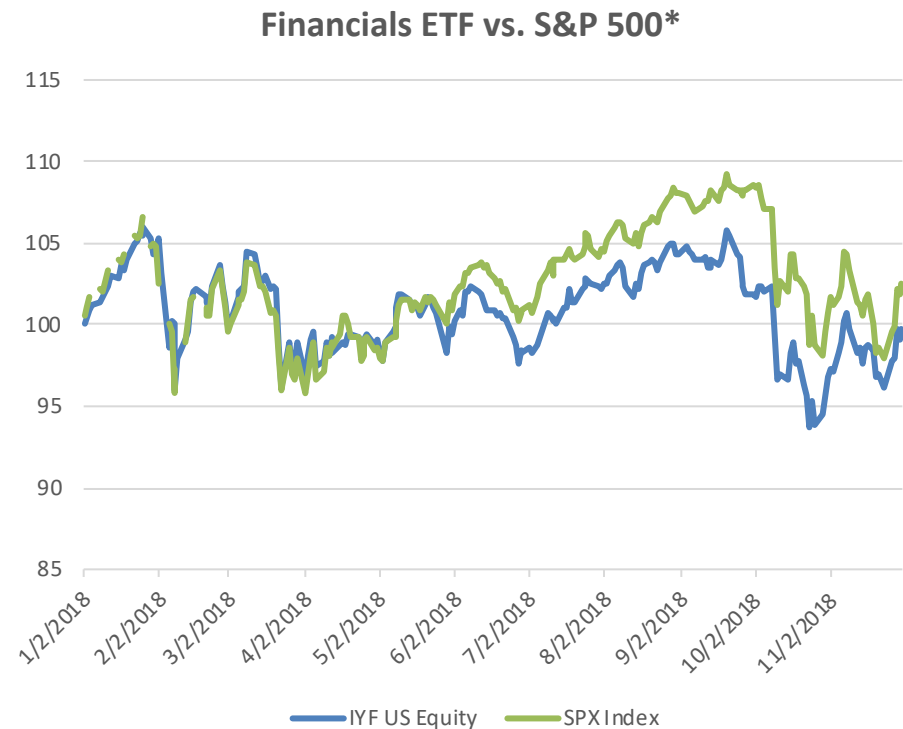
- Slowing GDP Growth – 6.5% YoY
- Deleveraging campaign
- Improved Credit Quality
- Long-Term Growth Plans
  - China 2025
  - Belt and Road Initiative

## Japan

- GDP contracted 0.3% in Q3
- CPI rose 1.4% YoY
- BoJ revived down long-term inflation forecasts in Oct.

# Financials

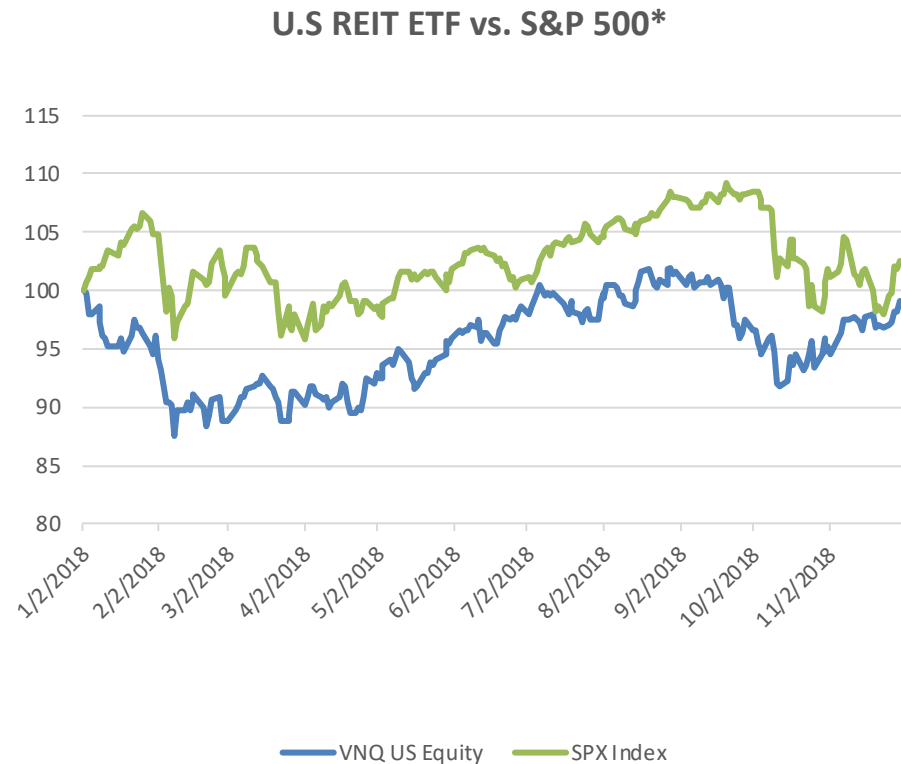
- Performance:
  - Decreased 3.58% YTD
- Future outlook:
  - Increasing interest rates
  - Deregulation and increasing technology
- Risks:
  - Trade war
  - Rising treasury yields
  - BREXIT fallout
- Current holdings:
  - American Express (NYSE: AXP)





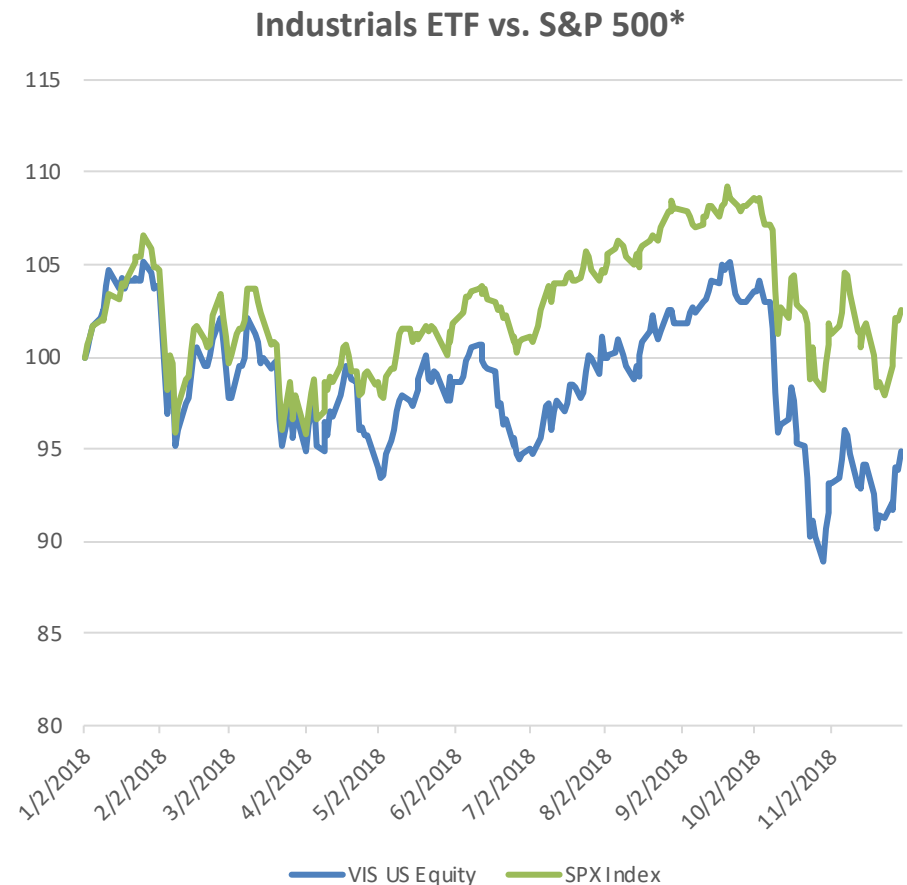
# Real Estate Investment Trust

- Performance:
  - Decreased 0.83% YTD
- Future outlook:
  - Consumer spending and distribution is high which promotes industrial segment
- Risks:
  - Increasing interest rates
- Current Holdings:
  - Prologis (NYSE: PLD)



# Industrials

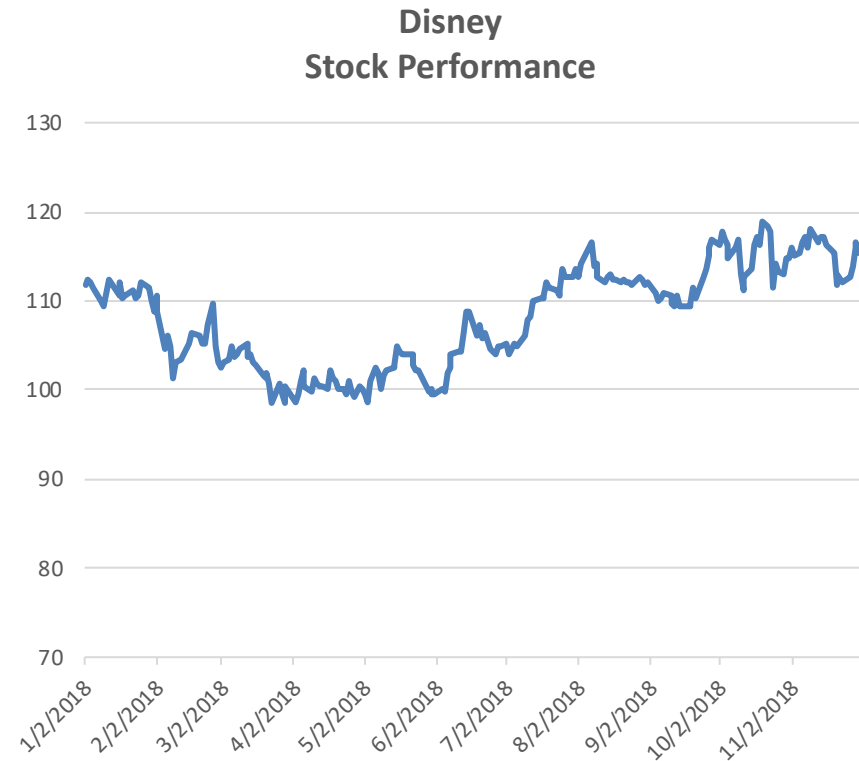
- Performance:
  - Decreased 5.19% YTD
- Future outlook:
  - Cash-rich environment leading to investment
  - Low manufacturing inventories imply demand drive rebuilding phase
- Risks:
  - Global fiscal austerity could dampen sector growth
  - Trade war
- Current Holdings:
  - Lockheed Martin (NYSE: LMT)



# The Walt Disney Company – Basic Metrics



| Basic Metric          |            |
|-----------------------|------------|
| Purchase Price        | \$117.03   |
| Current price         | \$115.49   |
| 52 Week High          | \$120.20   |
| 52 Week Low           | \$97.68    |
| Market Capitalization | \$171.93 B |
| Dividend Yield        | 1.49%      |



# The Walt Disney Company – Thesis & Risks



## *Thesis*

We recommend DIS based on:

- **Unique Business Model:** 4 interconnected business segments and branded entertainment across multiple segments
- **The Disney Experience:** strong brand, loyal customer base, and low sensitivity to price changes
- **Direct-to-Consumer Launch:** ESPN Plus streaming service, 2019 launch of direct-to-consumer streaming platform, and Fox acquisition assets will provide large content base to help compete with other direct to consumer models (Netflix, Amazon, etc.)

## *Risks*

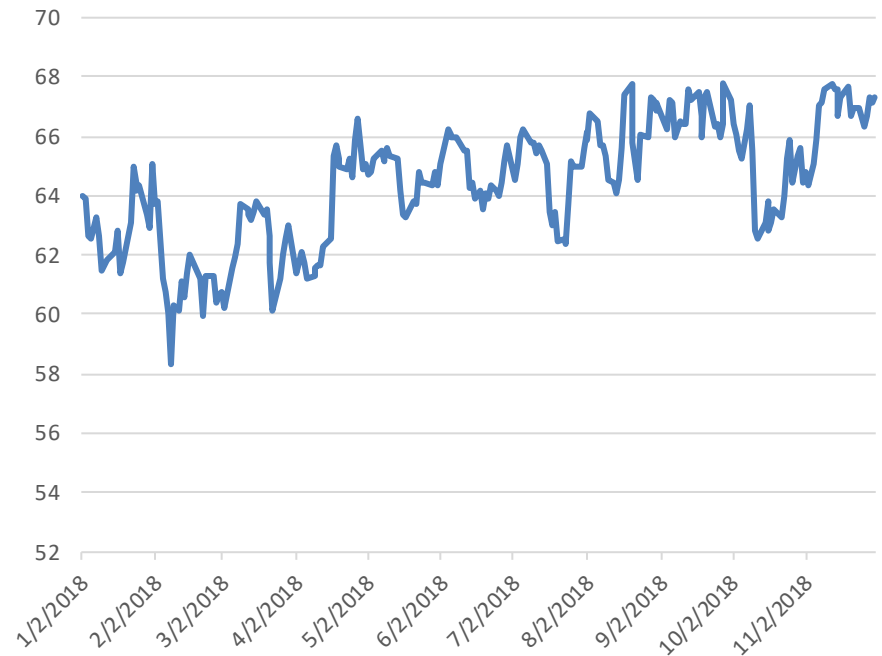
- **Economic Outlook:** Changes in U.S or Global economic conditions have an impact on consumer spending
- **Studio Entertainment:** Success of studio entertainment and direct-to-consumer content dependent on consumer tastes and preferences
- **Changing Consumer Preferences:** Reduction in consumer demand for some Media Network content, specifically decline in cable TV popularity among younger generations and households

## Prologis Inc – Basic Metrics



| Basic Metric          |           |
|-----------------------|-----------|
| Purchase Price        | \$64.98   |
| Current price         | \$67.34   |
| 52 Week High          | \$68.20   |
| 52 Week Low           | \$58.28   |
| Market Capitalization | \$42.39 B |
| Dividend Yield        | 2.89%     |

Prologis  
Stock Performance



## *Thesis*

We recommended PLD based on:

- **Built-to-Suit Model:** design customized distribution center, limits vacancies and productions expenses
- **International Expansion:** built new facilities in China, Germany, France, and more; diversified Prologis' holdings; and has a presence (ownership or joint-venture) in 19 countries
- **Inorganic Growth:** purchased one of their biggest competitors (DCT Industrial)

## *Risks*

- **International Relations:** Tariffs and trade disagreements
- **Rising Interest Rates:** Cost of borrowing makes it harder for business's to expand
- **International Demand:** A faster-than-anticipated rise in the supply of distribution facilities, which could lead to an excess capacity, a drop in demand for industrial space

# American Express – Basic Metrics



| Basic Metric          |           |
|-----------------------|-----------|
| Purchase Price        | \$108.96  |
| Current price         | \$112.27  |
| 52 Week High          | \$113.18  |
| 52 Week Low           | \$87.54   |
| Market Capitalization | \$95.91 B |
| Dividend Yield        | 1.41%     |

American Express  
Stock Performance



# American Express – Thesis & Risks



## *Thesis*

We recommend AXP based on:

- **Payments Industry Growth:** American Express's spend-centric business model will benefit from a positive macroeconomic outlook and the increased use of cards globally
- **Industry Leading Innovation:** American Express is staying above their competition with their improved rewards program, digital and mobile technology integration and capture of millennials
- **Premium Brand:** American Express will continue to benefit from their industry leading credit quality and closed loop business model

## *Risks*

- **Co-Branded Cards:** American Express's arrangements are entered into for a fixed period, generally ranging from five to eight years
- **Pricing Pressure:** In recent years, global weighted average merchant discount rate has been under increasing pressure
- **Credit Risk:** Provision for losses increasing in the industry



# Lockheed Martin– Basic Metrics



| Basic Metric          |                       |
|-----------------------|-----------------------|
| Purchase Price        | \$309.31 and \$304.76 |
| Current price         | \$300.43              |
| 52 Week High          | \$363.00              |
| 52 Week Low           | \$283.21              |
| Market Capitalization | \$85.45 B             |
| Dividend Yield        | 2.98%                 |

Lockheed Martin  
Stock Performance



## *Thesis*

We recommend LMT based on:

- **Profitable Business Model:** Highly competitive margins, consistent revenue growth, and achievable economics of scale
- **Significant Growth Potential:** Increase in European defense spending, increase in US defense spending, and strong government relationships
- **Game Changing Innovation:** Fostering innovative company mindset and potentially world-changing products under development

## *Risks*

- **Trade War:** International sales risks for abroad business, especially with tariff uncertainty
- **Customer Base:** They are very dependent on the US government for contracts and revenue, so any changes in government budgets can affect sales
- **Competition:** Bid protests among contracts have been increasing over the last few years