

A Model for Incorporating Finance Literature Into Undergraduate Courses

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"If you reflect back, we never ask kids to really think. The secret to getting good grades in college is to memorize a bunch of stuff."

Steven Levitt - Freakonomics Radio (Episode 102)

INTRODUCTION

The reading of academic literature typically occurs at the graduate level - often at the masters level and certainly for doctoral students. This article presents a way in which undergraduate students at a regional state university benefit from reading and reporting on scholarly articles in finance. Undergraduates in the course on Security Analysis and Portfolio Management are required to present published papers as if the papers were their own research. Students have historically performed well on multiple choice, short answer and discussion questions that assess their knowledge of the papers. Student feedback has been very positive. This article serves to help instructors incorporate articles into their undergraduate curriculum and provide some suggestions learned from years of doing so.

FINANCE PROGRAM CURRICULUM

When students enroll in Security Analysis and Portfolio Management (Portfolio Management), what do they bring with them? In other words, what skills do they possess? At Sam Houston State University, finance majors may choose from several electives to complete their degree plans, and Portfolio Management is one of their options. Like most other universities, they first complete university core courses (42 hours) and then a series of core courses within the business school (42 hours). In order to take the core course in finance, students must first complete introductory accounting and a course in mathematics/statistics. After completing the core course in Business Finance, they are required to take a course in Investments, Commercial Banking, Managerial Finance, and Financial Statement Analysis (27 hours). Elective possibilities (6 hours) include courses in Derivatives, International Finance, Entrepreneurial Finance, Selling Financial Services, Commercial Bank Lending, Portfolio Management, and/or an Internship.

Students who choose to register for Portfolio Management must have completed the course in Investments. In that course, they are exposed to the typical topics of interest rates, risk and return, diversification, options, market efficiency, etc. Although I've occasionally allowed a few exceptional students to take Investments and Portfolio Management concurrently, I've stopped allowing it. Even

outstanding students struggle with the Portfolio Management curriculum if they don't already have the foundation of the Investments course prior to enrolling.

COURSE STRUCTURE AND GRADING

The Portfolio Management course is effectively broken down into three blocks of instruction: lecture (9 weeks), presentations on academic articles (2 weeks) and book reports on works by practitioners (2 weeks).

The majority of the course is lecture. We review valuation, risk, return, utility and uncertainty. We then discuss traditional portfolio objectives and statements of investment policy. An in-depth discussion of diversification follows - and this is perhaps the key point at which students develop the skills they'll need to understand their assigned journal articles. Students use algebra and calculus to derive the minimum variance portfolio. We discuss Harry Markowitz's portfolio theory and lay the foundation for asset pricing models - most notably the CAPM. The final lectures of the semester deal with screening securities, equity selection and bond selection.

Second, students are required to make an oral presentation on their assigned journal article - as if they were the author of the work (much like a typical doctoral seminar format).

Finally, students are required to submit a report on a book of their choosing. At the beginning of the semester, students must select a book in the area of portfolio management that was written by a practitioner (a portfolio manager - Mario Gabelli, Peter Lynch, John Bogle, etc.). Books by academics are specifically prohibited.

The course structure lends itself very well to a comparison of the academic literature with the message being sold and distributed by practitioners. Despite the students' choice of book, it is frequently the case that well-informed and successful portfolio managers give advice that contrasts what we know from the academic literature.

Grades in the course are curved, and there are two scenarios under which students are assigned grades. Under scenario A, exams 1-4 are worth 15% of the total course grade. The presentation on the journal article is worth 20% and the book report is worth 20%. Under scenario B, each of the first three exams are worth 10%. The comprehensive final exam is worth 30%. The journal article presentation and book reports are each worth 20%. If a student's grade on the comprehensive final exam is higher than the weighted average of all four exams, then students will be assigned a grade under scenario B. Otherwise, they are assigned a grade under scenario A. The reason students have two possible grading scenarios stems from the fact that grades are curved. There are no opportunities for bonus points or extra credit in a curved course; however, every student has the same opportunity to

improve their grade by doing well on the comprehensive final exam.

Articles are selected by the professor. Students draw a number out of a hat and are allowed to pick their article in the order in which they drew numbers. In other words, the student who selected #1 picks their paper from the instructor provided list, then #2 picks, etc. Examples of articles used in the course are provided in Table 1. Prior to assigning the papers, the list is reduced to the number of papers that equals the number of students in the class. There are no "left-over" unassigned papers - although I do list unassigned papers as optional/supplemental if there are not enough students registered for the course to cover the list in its entirety.

Grades on the journal article requirement are heavily weighted (20% - regardless of grading scenario) in order for the students to take the requirement seriously and put forth their best effort. The total requirement is worth 100 points - allocated as 30 points for Presentation Skills, 50 points for Content and 20 points for Participation. Presentation scores center on areas of "soft skills" often covered in courses on business communications. Many of our college's reviews of employer expectations rank soft skills just as importantly - or more importantly - than the content of a business degree itself. As such, these soft skills are evaluated as part of the requirement. Content includes how well the student covers the specifics of the paper itself. Typically students who have done well in statistics or business analysis perform well on this area - as do students who spend a lot of time attending office hours getting help on their understanding. Participation grades are dependent upon how many questions students ask and the quality of those questions. For the actual grading rubric, see Table 2.

Table 1. Assigned Scholarly Articles for a Recent Section (in Chronological Order).

<p>Black, F., M.C. Jensen, and M. Scholes. 1972. The capital asset pricing model: Some empirical tests, <i>Studies in the Theory of Capital Markets</i> (Praeger, New York).</p> <p>DeBondt, W., and R. Thaler. 1985. Does the stock market overreact? <i>Journal of Finance</i> 40: 793-805.</p> <p>Fama, E.F. and K.R. French. 1992. The cross section of expected stock returns. <i>Journal of Finance</i> 47: 427-465.</p> <p>Jegadeesh, N., and S. Titman. 1993. Returns to buying winners and selling losers: Implications for stock market efficiency. <i>Journal of Finance</i> 48: 65-91.</p> <p>McQueen, G., and V.V. Roley. 1993. Stock prices, news and business conditions. <i>Review of Financial Studies</i> 6: 683-707.</p> <p>Lakonishok, J., Shleifer, A., and R.W. Vishny. 1994. Contrarian investment, extrapolation, and risk. <i>Journal of Finance</i> 49: 1541-1578.</p> <p>Desai, H., and P.C. Jain. 1995. An analysis of the recommendations of the "superstar" money managers at Barron's annual roundtable. <i>Journal of Finance</i> 50: 1257-1273.</p> <p>Carhart, M. 1997. On persistence in mutual fund performance. <i>Journal of Finance</i> 52: 57-82.</p> <p>Fama, E. 1998. Market Efficiency, long-term returns, and behavioral finance. <i>Journal of Financial Economics</i> 49: 283-306.</p> <p>Ackermann, C., R. McEnally, and D. Ravenscraft. 1999. The performance of Hedge Funds: Risk, return, and incentives. <i>Journal of Finance</i> 54: 833-874.</p> <p>Metrick, A. 1999. Performance evaluation with transaction data: The stock selection of investment newsletters. <i>Journal of Finance</i> 54: 1743-1775.</p> <p>Barber, B.M., and T. Odean. 2000. Trading is hazardous to your wealth: The common stock investment performance of individual investors. <i>Journal of Finance</i> 55: 773-806.</p> <p>Barber, B., R. Lehavy, M. McNichols, and B. Trueman. 2001. Can investors profit from the prophets? Security analysts' recommendations and stock returns. <i>Journal of Finance</i> 56: 531-563.</p> <p>Gompers, P., J. Ishii, and A. Metrick. 2003. Corporate governance and equity prices. <i>Quarterly Journal of Economics</i> 118: 107-155.</p> <p>Martin, G., and J. Puthenpurackal. 2008. Imitation is the sincerest form of flattery: Warren Buffet and Berkshire Hathaway, Working Paper, Texas A&M University.</p>
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Table 2. Grading Rubric

I. Presentation (30 Points)						
Presentation completed within allotted time	0 (No)			6 (Yes)		
Enthusiasm/Passion	0	1	2	3	4	
Use of visual aids (Powerpoint, Handouts, etc.)	0	1	2	3	4	
Appropriate design template, color	0	1	2	3	4	
Use of eye contact	0	1	2	3	4	
Evidence of Preparation & Practice	0	1	2	3	4	
Overall quality compared with classmates	0	1	2	3	4	
Other Comments:						
II. Content (50 Points)						
Adequately covered main points of the paper	0	2	4	6	8	10
Introduction	0	1	2	3	4	5
Hypothesis/Hypotheses	0	1	2	3	4	5
Sample/Data Description	0	1	2	3	4	5
Results	0	2	4	6	8	10
Robustness Checks	0	1	2	3	4	5
Overall quality compared with classmates	0	2	4	6	8	10
Other Comments:						
III. Participation (20 Points)						
Number of questions asked in other presentations						
Rank in class						
Quality of questions	0	1	2	3	4	5
Overall quality compared with classmates	0	1	2	3	4	5
Other Comments:						
IV. Total Score: _____						

RESULTS

Historical grades for the journal article requirement are provided in Table 3. Grades have been relatively consistent. Over the ten year period, students have scored an average of 77.71%.

Scores on presentation have diminished over the eight year period, most notably from an over-reliance on PowerPoint. Historically, students have prepared Executive Summaries for their peers and received reciprocal presentation and study aids in return. I've noticed fewer students putting forth that level of effort in recent years. Frequently, students also use PowerPoint as a visual crutch for themselves. Rather than making good eye contact and connecting with their audience, their eyes are trained on the screen in the front of the room rather than their peers in the audience.

The content of student presentations has diminished as well. I do not think that student knowledge of statistics/econometrics or finance has diminished - rather their willingness to come to office hours and discuss the paper prior to tackling it on their own has! Even with a good grasp of statistics, the literature can be rather cryptic and convoluted. I have historically helped students work through some of the minutia to really understand the main learning

points of the article. More recently, students have opted to go it on their own - despite my warnings to the contrary.

Scores for participation have been uniformly poor. It is very clear to the students that while they are required to be an expert at their paper, they are also required to read all of the papers presented in class and be prepared to ask intelligent questions of the speaker. Students routinely ignore this requirement, and their grades suffer. The overall average of 10.52 points is barely half of the 20 points offered for participation.

Table 3. Historical Grades.

Year	N	Presentation	Content	Participation	Total
2007	16				86.53
2008	11				84.00
2009	17	25.18	45.35	10.29	80.82
2010	11	24.82	43.45	8.91	77.18
2011	13	24.23	44.69	8.62	77.54
2012	12	23.83	43.42	11.50	78.75
2013	9	25.56	44.67	11.67	81.89
2014	13	24.23	43.54	12.23	80.00
2015	10	22.00	36.80	9.70	68.50
2016	9	22.89	39.56	11.67	74.11
Total/Avg.	121	24.18	43.01	10.52	77.71

Student feedback regarding the journal article requirement on course evaluations has been uniformly positive. I believe the positive comments stem from the fact that - despite our best efforts - they put much stock into the CAPM and other asset pricing models they learned along the way. Seeing how these pricing models perform in tests of various portfolios is an experience that cannot be fully appreciated except by wrestling with the primary article itself. As an example, an instructor can list and discuss anomalies to the Efficient Market Hypothesis, but a much deeper learning of overreaction and underreaction occur when the student wrestles with DeBondt and Thaler (1985) or Fama (1998). Verbal comments indicate that they are truly shocked to examine in-detail the puzzles that plague our field, and they are excited to learn that some things are not as cut and dry as they previously believed. Quotes from course evaluation forms are included in Table 4.

Table 4. Examples of Student Comments on Course Evaluation Forms.

"Great course, should be a requirement, not an elective!!"

"Should be required after the investments class"

"It should be a required class for any business related undergrad [degree]"

"It should be required of all finance majors. A great tying together of everything I've learned up until now."

"Journal article and book reports provided an interesting perspective on finance that I have not been exposed to..."

"I hated the journal articles at first, but now I really think they were great and helped me learn more."

CONCLUSION

What do students get out of their experience with the financial literature? More than anything, they gain an awareness into the beautiful and robust landscape of portfolio construction. It is nothing short of dumbfounding when students learn that forming zero-investment portfolios on the basis of governance mechanisms (idiosyncratic and firm specific characteristics) can generate positive alphas. Of

course, instructors have experienced this themselves and with their graduate students, but it is possible for undergraduates at a state university to have the same mental light bulbs illuminate. It just takes some careful planning on the part of the instructor. This article serves as a model for such a plan.

Given my success with introducing academic literature into Portfolio Management, I've extended my use of literature into the introductory corporate finance course as well. At the end of the semester of corporate finance, students are familiar with how corporate financial decisions should be made. On the last day of class, I assign all students to read Graham and Harvey (2001) to learn how corporate financial decisions are made in practice. They draw insights learning that they will not necessarily work for a firm who makes financial decisions in the right way. Their task is to slowly bring about change in their organizations in an effort to maximize long-term shareholder value. I continue to look for ways to expose my students to primary sources in our academic literature.

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