

FIN 4504 - Project #1

Stock Selection and Security Trading

The purpose of this assignment is to first select a specific industry (such as Clothing, Financial Services, Health Care, Restaurants, etc.) that you are interested in and/or believe will perform well in the current economy. From that industry, you will pick a specific company that you will follow throughout the semester. In this assignment, you will also begin building your STOCK-TRAK portfolio, in which you will be given \$100,000 to trade with. There will be approximately \$25,000 of required trades, while the remainder is yours to invest as you wish with no restrictions.

With regard to the specific company, no two students may follow the same company and companies will be assigned on a first-come, first-served basis. Therefore, all students must pick four companies (from the same industry), list them in order of preference (with ticker symbols), and email them to me (please put "stocks" in the subject line) for approval. I will notify you of the company that you have been assigned.

The companies you select must be publicly traded and must meet the following requirements:

- have a market cap of over \$1 billion
- pay a dividend
- have bonds outstanding
- have options traded on the stock

All of this can be quickly ascertained on Yahoo! Finance and other financial websites. Ideally, your companies should currently trade for more than \$10 but less than \$100 per share and have positive earnings. Note that gathering data for your analyses will be much easier if investment analysts follow the company (e.g., a research link exists for the stock at financial websites such as Hoover's Online, Thomson Analytics, or Yahoo Finance).

Part I: Stock Selection

1. Email me your four stocks in order of preference, with ticker symbols - please put "stocks" in the subject line of your email. I will reply and let you know which company is "yours" (i.e., the one company that you alone will follow and do a corporate valuation report on later in the semester). If you procrastinate in doing this, it is very possible that all four of your selections will have already been chosen by other students and that you will have to continue looking for a company. You must complete this portion of the assignment by **Tuesday, January 19th** and there is a 20% penalty for failing to do so.

2. Establish your investment goals for the STOCK-TRAK portfolio simulation. In your write-up for this assignment, state assumptions that would be a part of these goals. Specifically, identify how your STOCK-TRAK portfolio should be weighted (percent held in stocks, bonds, cash, etc.). Describe how the current state of the economy and current stock price levels may affect your investment performance.

Part II: Trading in your STOCK-TRAK account:

1. Go to your STOCK-TRAK account. If you have not registered for this account, you must do so immediately. Take a long position (buy) of at least \$10,000 of the company that you have been assigned. You should purchase these shares in round lots (100 shares). This will be your first stock purchase. You may purchase shares of some other companies as well.
2. Next, buy two different mutual funds. One must be a closed end fund while the other must be an open-end or "retail" fund. The closed end fund can be a closed-end (actively managed) stock mutual fund, an ETF (exchange traded fund), or a REIT. The open end fund can be either an actively managed stock fund or an index fund. If you do not choose a REIT, then one fund should be actively managed and the other a (passively managed) index fund. To find funds, check out CNN Fund Screener, MSN Money, TheStreet.com, Quicken Investments, Yahoo Finance, or any of the hundreds of other mutual fund websites on the Internet. The total value invested in each fund should be between \$5,000 and \$10,000.

Note: in STOCK-TRAK, ETFs and REITs are traded as stocks - only open-end mutual funds are traded as mutual funds.

3. Take a short position for a security. The initial value should be at least \$5,000. Obviously, you cannot short a stock that you already hold in your portfolio. The short should be initiated by January 19th and held until at least January 26th so that your account can be verified. Funds associated with the short sale will show in the cash balance of your portfolio, but cannot be used.

As discussed in class, covered call writing is an investment strategy to generate income from a stock that you already own. The call premium will be credited to your account and as long as the stock stays below the exercise (or strike) price, you also keep the stock. The only risk is that if the price of the stock rises above the exercise price, the stock will get called away from you. Thus, this is an excellent strategy for generating income from a stock that you are considering selling anyway.

4. Purchase a stock that you plan to sell calls against. This should not be the stock that you have been assigned to follow unless you hold more than 200 shares and want to risk having some of it called away.
5. Sell covered calls against that stock. The sale of relatively short-term options (1 or 2 months to expiration) is recommended.

In addition to these transactions, invest in a minimum of two additional securities (stocks, bonds, and mutual funds) or derivatives (options and futures). You may invest up to the \$100,000 account limit (or more if you choose to buy on margin). You are expected to continue adjusting your portfolio throughout the semester and will be penalized if you leave excessive amounts of cash or have an inactive account.

Your Stock-Trak account will be checked on the due date of this assignment to confirm that these trades have been executed. If you have not completed these transactions or your Stock-Track account does not exist, you will receive a grade of zero on this assignment.

In your write-up for this assignment, identify the company that you have chosen, as well as all other companies that you purchased. Note the purchase price, P/E ratio, dividend yield, market cap, and a brief explanation of why you made these purchases. There are many sources on the web that provide information on the economy, industry, company, and/or stock price. Give brief summaries of the companies you purchased using information from these sources.

Prepare a 2 to 3-page report that incorporates all of the above. Describe why you selected your primary stock, any additional stocks, the mutual funds, the short sale, and the covered call strategy. Specifically:

- Describe in detail the company that you have chosen to follow this semester. Why did you choose this company?
- Download monthly closing prices for your stock and create a graph of price volatility over the past five years. You are encouraged to also download market closing prices (i.e., for DJIA or S&P 500) and compare. At a minimum, you should create a comparative index using Yahoo! Finance and include that graph in your report.
- What other stocks did you purchase? Which mutual funds did you purchase, and why?
- Describe why you selected the stock for the short sell and how this transaction complements your investment objectives. If you shorted this stock in an account with only the initial margin, how much could the stock rise before you got a margin call? Assume the maintenance margin is 30%.

- Describe why you selected the stock for writing call options on and how this transaction does (or does not) complement your investment objectives. How much do you stand to make if the options expire worthless? What would be your profit or loss if the options are exercised?

Your report should be professionally written, and leave little doubt that you clearly understand your trading activity. In conclusion, explain why your selections were made and how they fit into your investment goals.

This assignment is due at the beginning of class on **Tuesday, January 26th** and will not be accepted late. To receive credit, your STOCK-TRAK account must show all of the above transactions (a minimum of six trades).