

# **STUDENT MANAGED ENDOWMENT FUNDS: PUTTING INVESTMENT THEORY & ETHICAL INVESTING INTO PRACTICE**

Abstract

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Stock market games and contests, simulations, and hypothetical portfolios have been used to teach college students investment principles. These techniques do promote learning and are, no doubt, superior to a pure lecture approach. But all of these approaches fail to provide students with the realism that makes instruction and learning most effective. In addition, hypothetical investing may promote investment behavior antithetical to classroom instruction. Even when told to focus on long-term results students inevitably focus on short-term performance because they want to be perceived as the “winner.” They are more likely to equate good short-term performance with being a savvy stock analyst rather than being lucky. The students who perform poorly over the short-run always tell their peers that they are in it for the long-term. So the behavior that instructors try to promote is used as an excuse. Furthermore, the stock market competitions we sponsor in our departments most often reward those who take big risks. These risks are taken without consequences other than not winning the game. In addition, the behavior exhibited in this type of portfolio management contradicts the teaching and admonitions found in *The Bible*.

The problems associated with games, simulations, and hypothetical portfolios can largely be overcome by permitting student management of college endowment funds. This paper examines the creation of the Student Endowment Management Group (SEMG) at Houghton College and the benefits and problems associated with this innovative instruction method.

Beginning in January 2001, select business and accounting majors were given \$25,000 of the college’s endowment fund to manage. During the first semester of existence, the students exhibited a high level of motivation, felt they learned a great deal about investing, grappled with ethical issues, and learned about group dynamics and teamwork. During a volatile and unstable market the total return on the student managed portfolio has fluctuated between –4% and 7%, meeting or exceeding market indexes and many professional money managers. Initial evaluation of the program indicates that permitting students to manage college endowment funds provides tremendous educational benefits to students with minimal downside risk to the college.

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PUTTING INVESTMENT THEORY &  
ETHICAL INVESTING INTO PRACTICE**

Presented at the National Conference of  
The Christian Business Faculty Association  
October 18-21,2001

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Stock market games and contests, simulations, and hypothetical portfolios have been used to teach college students investment principles. These techniques do promote learning and are, no doubt, superior to a pure lecture approach. But all of these approaches fail to provide students with the realism that makes instruction and learning most effective. In addition, hypothetical investing may promote investment behavior antithetical to classroom instruction. Even when told to focus on long-term results students inevitably focus on short-term performance because they want to be perceived as the “winner.” Furthermore, they are more likely to equate good short-term performance with being a savvy stock analysts rather than being lucky. The students who perform poorly over the short-run always tell their peers that they are in it for the long-term. So the behavior that instructors try to promote is used as an excuse. Furthermore, the stock market competitions we sponsor in our departments most often reward those who take big risks. These risks are taken without consequences other than not winning the game. In addition, the behavior exhibited in this type of portfolio management contradicts the teaching and admonitions found in *The Bible*. Ecclesiastes 5:13-15 provides good instruction when it says, “There is another serious problem I have seen everywhere – savings are put into risky investments that turn sour, and soon there is nothing left to pass on to one’s son. The man who speculates is soon back to where he began – with nothing.” (*The Living Bible*)

The problems associated with games, simulations, and hypothetical portfolios can largely be overcome by permitting student management of college endowment funds. This paper will examine the creation of the Student Endowment Management Group (SEMG) at Houghton College and the benefits and problems associated with this innovative instruction method.

### **Creating the Management Group**

The initial challenge in creation of SEMG on our campus involved winning the support of the administration and the Investment Committee, a standing committee of the Board of Trustees. The proposal (Appendix A) was recommended to the trustees by the Financial Affairs Council, a standing committee made up of members of the campus community. The Investment Committee approved the idea without dissent. Key factors in gaining approval included:

1. the academic nature of the activity with supervision from the business faculty;
2. accountability of SEMG to the Investment Committee;
3. the innovative nature of the program to promote experiential learning;
4. minimal downside financial risk for the college; and
5. the fact that others had done this with success.

Students selected to participate were chosen from applications submitted to the Department of Business & Economics. Preference was given to students who had excelled in prior coursework in the department, possessed strong quantitative and analytical skills, displayed a high level of maturity in interaction with faculty, and exhibited good team skills. In some cases students were invited to apply if the faculty perceived them as having potential for success in this type of activity and environment. Selected students were required to enroll in a one-hour special topics course. This helped to insure that students were committed to activity, since a grade was given for the course. Auditing the class was not permitted.

## Administration and Management of the Group

The students began their work by reviewing the *Houghton College Endowment Objectives, Policies, and Guidelines* as approved by the Board of Trustees. The group met with the Vice President for Finance who clarified the guidelines and responded to the group's questions. From the start SEMG was reminded that they were considered one of the college's money managers and that the group's performance would be measured alongside the other money managers as well as market performance indices.

SEMG began with \$25,000 cash in an account opened with a national, full-service brokerage firm. A successful alumnus of the department, who works for UBS PaineWebber, agreed to execute trades for a total of \$24.50 per transaction irrespective of the number of shares being traded. Cash not in equities is in a money market account. Monthly reports received from UBS PaineWebber indicate portfolio balances and dividends and interest earned.

For day-to-day tracking the portfolio was listed in an account online at <http://moneycentral.msn.com>, one of the leading comprehensive investment site based on research done by the American Association of Individual Investors. The site automatically updated stock prices of all holdings, financial information, company news, alerts, and stock screening. SEMG also maintained their watch list in this account. During SEMG meetings the group was usually online with the portfolio displayed for all to see. Class time was spent asking questions, looking at financial information and news items, and discussing the findings as a group. Other internet sites that SEMG used include: <http://www.mornigstar.com>, <http://www.bigcharts.com>, and <http://www.wsrn.com>. The students also suggested new sites that they found useful. In addition to online resources, *The Value Line Investment Survey* and *S & P Outlook* were available in the library as sources for ideas and second opinions.

To provide some objective basis for decision-making SEMG developed philosophy statements. (Appendix B) While these appear to be rather simple and straightforward, several drafts, group discussions, and revisions took place over the course of one semester. Initially, SEMG was divided into three groups and each group was asked to develop one portion of the philosophy. Each part was critiqued individually and as a group before a final philosophy was determined. Even now the students consider this document to be a guide but finished product. They expect that the document, especially the buy and sell philosophies, will continue to evolve and be refined as they learn more about buying and selling decisions. Nevertheless, the philosophy statements provide a foundation for new members who join the group.

During the first semester of existence SEMG meet for 50 minutes as a group each week. Outside of class time, students researched stocks individually in order to bring new companies to the group for addition to the watch list or purchase consideration. Small groups were also assigned stocks to research and discuss prior to large group discussion and purchase decisions. The members of the group also communicated throughout the week via e-mail. Any member was free to raise an issue of concern or suggest that a buy or sell be executed. Students in the group were exposed to various investment research philosophies through readings and visits from investment professionals, including a stockbroker who relies heavily on technical analysis and a mutual fund manager who focuses on fundamental analysis.

## **Benefits and Problems**

As already mentioned SEMG represents active learning in the truest sense. Student interest and motivation was extremely high as evidenced by a low rate of absenteeism from class, high participation in e-mail discussion, discussion by group members outside of class, and interaction with the instructor outside of class. Students recognized that their input was critical, since no decisions to buy or sell were implemented without group consensus. The knowledge that SEMG was accountable to the Board of Trustees also contributed to careful decision-making based on thorough research.

Class time involved little if any lecture time. Lecturing by the instructor was limited to responses to questions or issues raised by the students. So the instructor built on student knowledge. The instructor functioned as the group facilitator and this in turn enhanced student involvement. If someone had done little or no research, that fact became obvious to the group during class discussion. The students learned to be prepared for discussion so as not to be embarrassed by the questions of their peers. They learned to challenge each other in a non-offensive manner and to listen to the views of others. They learned when to yield to the will of the group and when to stand firm. They learned to value the wisdom and insights of others.

Not everyone in the group came with the same background even though all were business and accounting majors. Some had more experience in investments than others and so could speak with more authority. Some had more dominant personalities and as a result their views initially received greater attention. These issues subsided as the group became a more cohesive team.

In the first few weeks of the semester the group and the instructor struggled with the balance between developing a philosophy, developing a watch list to research, and actually making a decision to buy the group's first stock. The first purchase served to invigorate the group, since they had money at risk and the very real prospect of gain or loss. The first purchase also reinforced the need to have a buy and sell philosophy.

A major challenge for the group was to find the proper balance between research and action. The nature of the academic environment tends to promote the "paralysis of analysis." The students become reluctant to pull the trigger on a trade as they search for more information, desire more discussion, or simply wait to see if the stock will go lower.

Management of the portfolio during college breaks and the summer has been problematic. During the summer, some of the members continued to follow the portfolio and make buy and sell suggestions through e-mail, but not all members remained similarly engaged. As buy targets are established for watch list stocks and sell targets are established on holdings, the portfolio should be more carefully managed throughout the year, although the responsibility for initiating action will probably remain with the instructor.

Student assessment represents a challenge for the instructor in this type of course, since no exams are given and no research papers assigned. While students do a significant amount of stock research, it is entirely possible that any one student could spend time researching companies that showed little promise. During the initial semester of SEMG, grades were based

on the instructor's assessment of each student's level of participation and effort, evaluation of a reaction paper submitted at the end of the course, student self-evaluation, and peer evaluation. Two ideas for the future involve having the students maintain a research diary or develop a research summary sheet that could be submitted and provide a foundation for class discussion.

### **Student Participation, Feedback, and Performance Results**

Group meetings were spent focusing on investment philosophy and stock analysis. To generate a foundation for stock analysis students were asked to bring two or three prospective companies for the group to consider for addition to our watch list. These ideas were then assigned to small groups who investigated the stocks further using both fundamental and technical analysis and came back to the group with confirmation of the initial individual findings, additional questions or concerns, or rejection of a company. This approach fostered both individual and group work outside of class. During class students defended both individual positions and as well as group decisions.

Stock research and subsequent class discussion raised some interesting ethical issues. The students knew from the start that as money managers for Houghton College they were required to screen stock so as to "avoid investments in companies that are believed to derive a significant portion of their revenue from the following businesses: tobacco, alcohol, pornography, gambling, and abortion." (Houghton College Endowment Objectives, Policies, and Guidelines) One group brought a buy recommendation on Dave & Buster's, Inc. (DAB), a family restaurant and entertainment complex. Members of the group had even visited a Dave & Buster's and were impressed with the operation. During class discussion and research we discovered that the company generated 17% of its revenue from alcoholic beverage sales. Is 17% a "significant" portion? SEMG's decision was to not purchase the stock. A more interesting and timely question revolved around the work of a biotech firm recommended by one student. The company's financials were good and they were involved in promising cancer research. More thorough research by the student revealed that they also did stem cell research. She appropriately raised the question, "Does the college have a position on this? In addition, what is our position?" To date these questions are unresolved. These are both illustrations of the type of hypothetical case studies an instructor might bring to the classroom. The difference is that these were anything but hypothetical.

Student reaction to the program has been extremely positive and comments revealed an increase in investment knowledge along with an enhanced understanding of group dynamics and team skills. Student comments included the following:

*I learned the ropes of in-depth stock analysis in a group setting ... Before we buy any stock, I want to personally research the company and know everything there is to know about the company's stock, where it has been and what its projected future holds ... The level of intensity increases with the reality of the gains and/or losses ... As a result of this class, I have a serious interest in investing and pursuing possibilities as a money manager or stockbroker ... I learned many practical skills regarding group dynamics and communication... An enormous fiduciary responsibility comes with managing a portfolio for an institution ... I learned that it is important to not rush into being fully invested – to do this*

*would be especially foolish and dangerous... Research takes time and decisions need to be thought through ... I feel that being a part of the endowment group enhanced my teamwork skills ... The fact that real money was at stake in this undertaking was a major key in increasing my understanding of portfolio management ... The class was an excellent learning tool in effective communication and conflict resolution ... I learned the importance of communication with others... We learned humility... Overall, the endowment group has been a confidence builder in that I feel confident enough now to invest other people's money and get a good return.*

The primary suggestions for improvement focused on having students do more in-class presentations of investment research.

SEMG began during one of the rockiest times the market has experienced in the past several years. Tech stocks were especially volatile. By the end of the semester the group was approximately 40% in equities and 60% cash. During the semester, six stocks were purchased and one sold resulting in a 44% return on that investment. Total return on the portfolio has fluctuated from -4% to 7%. Overall, the performance of the SEMG portfolio at any point in time has met or exceeded that of the market indexes and most other money managers.

## **Conclusions**

Thus far the SEMG has achieved its primary purpose by providing a stimulating and challenging learning experience for a select group of promising, upper-level students. Whether or not the group can provide a satisfactory investment return remains to be seen and really can't be judged for 2-3 years. Other secondary benefits have resulted as well. The group's existence has generated good publicity for the business department and the college through articles in *Business First*, a weekly paper targeted to the business community in western New York, and the *Wellsville Daily Reporter*. As part of this four students participated in interviews with reporters. The college trustees were excited as they heard a report on how students benefited while achieving the college's goals. They were able to see that their action affected student learning. Finally, the activity may have also begun to establish a bond between the college and a small group of future alumni who understand the college's endowment program in a way most alumni do not.

Work remains to refine the program. Student assessment can be improved so as to effectively evaluate student effort and contributions to the group. In addition, the group needs to build a spreadsheet that clearly summarizes portfolio holdings and performance.

In retrospect, beginning this program during a volatile and unstable market has proven beneficial. Permitting students to manage a portion of a college endowment portfolio has provided tremendous educational benefits to the students with minimal downside risk to the college.

# Appendix A

## Proposal for The Student Endowment Management Group

The Department of Business & Economics proposes that Houghton College establish the Student Endowment Management Group (SEMG) for the purpose of managing an initial \$25,000 of the Houghton College endowment. The guidelines would be as follows:

1. Each semester 6-10 students would be selected by the faculty of the Department of Business & Economics to participate in SEMG. The selection from student applicants would be based on previous coursework and experience with the stock market. Preference would be given to juniors and seniors who have excelled in their academic work. Participating students would enroll in a one-hour college course each semester with a maximum of three hours of credit. Grades would be given based on meeting the research requirements of the group.
2. All investments would be made according to the guidelines established for the college by the Investment Committee of the Board of Trustees. The SEMG would be accountable to the Investment Committee just like any of the college's money managers and the SEMG would provide regular performance reports. The group could use up to 1% per year of the assets managed to purchase research materials.
3. All trades would be executed by or through a faculty advisor recommended by the business department and approved by the investment committee. The department's current recommendation is Richard Halberg. He is a 25-year member of the business department, a CFP practitioner, teacher of investment management, and a member of the Investment Committee. In the absence of the faculty advisor, trades would be executed by the VP for Finance.

This would provide the Department of Business & Economics with a unique "honors" program that could be used to attract high caliber students to the department. It would provide the selected students with a unique addition to their resumes and thus enhance their marketability. Long-term benefits could accrue to the Advancement Office. Students who participate in the SEMG are likely to have increased earning capabilities along with a stronger affiliation with Houghton.

A number of colleges and universities have student groups managing a portion of their endowments. These include the Wharton School (\$250,000), Alfred University (\$100,000), University of Delaware (\$500,000), Notre Dame (\$300,000), California State University (\$50,000), and Virginia Tech (\$1,000,000).

Are there risks? Certainly, but the downside risk is small given that the students are likely to be diversified into 5-10 different stocks. Furthermore, this is not a game. It is a chance for our students to apply the theory they have learned in the classroom. This is reality-based education. And experts tell us that this is the best kind of education.

The Department of Business & Economics is enthusiastic about the potential of this program to enhance the stature of our department both on and off campus, while providing some of our best and brightest students with a unique learning experience.

## Appendix B

# Houghton College Endowment Management Group *Investment Philosophy*

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The Houghton College Endowment Group will maintain a balanced and diversified stock portfolio to provide both short and long-term returns. Attention will focus on the following goals:

- Capital appreciation
- Returns exceeding the college's rate of endowment spending plus inflation
- Investments that properly balance risk and return

The Endowment Group will only invest in stocks that agree with the beliefs and standards of the college as stated in the *Houghton College Endowment Objectives, Policies, and Guidelines* handbook under section three, “Non-Permitted Investments” and section four “Social Screens”.

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### *Buy Philosophy*

We will research both value and growth oriented stocks using the following guidelines to stock selection:

- Valuation ratios better than the industry average.
- Returns that are above the industry average (i.e. on equity and on capital)
- Purchase price below \$50 a share
- Prospects for growth within the industry
- Growth potential of the company and its customers
- Stock fits in with the overall portfolio philosophy and contributes to proper portfolio balance

Technical analysis will be employed to evaluate purchase timing and to affirm the conclusions drawn from fundamental analysis.

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## *Sell Philosophy*

Stocks in the portfolio must be reassessed on a continuous basis to determine whether to hold or sell. Generally a stock will be sold when it achieves the group's price target or if a better potential investment is found. Likewise, if the group feels that the portfolio is not properly balanced, shares may be sold to achieve a more ideal balance.

Stocks will be evaluated for sale if any of the following occur:

- a market price decline of 20%
- declining profits for more than three consecutive quarters or three out of five quarters
- a change in company management
- the company is involved in a merger, acquisition, or significant sale of assets
- company insiders sell large blocks of the stock
- the company fails to achieve its price target within 2 years
- the downside risk appears to exceed the upside potential

In every case a thorough analysis will be conducted and sale rationale clarified to assure that the reasons to sell the equity are well founded.

Revised May 7, 2001