Portfolio Management Assignment

Finance 4763 - Financial Futures and Options Markets

Fall 2007

Objective of the Assignment

- The objective of this assignment is to develop an understanding of futures and options contracts traded in the domestic capital markets, and the uses of those contracts. To that end each student will be required to trade options and futures contracts through Stock-Trak.
- These contracts will be traded within the context of an investment strategy not just for the purpose of completing an assignment. Thus, the choice of contract and timing of the transaction are important.
- This is a group experiential learning assignment. The object of the exercise is to participate in the market, and it is assumed that to fully immerse yourself in this learning experience you need to actively participate in the market throughout the simulation trading period. Dividing the syndicate’s funds equally among the syndicate members and then working independently to complete the assignment is not consistent with the purpose of the assignment and is not an acceptable trading strategy.
- Evaluation will not be based on the performance of the portfolio. However, groups that wait to the end of the semester to complete the required trades will be marked down.

Task List

1. After being assigned to a trading syndicate, register with Stock-Trak at a cost of $24 for the syndicate.

2. Read the Stock-Trak literature to get an understanding of the trading rules and costs associated with the game.
3. Meet with the members of your trading syndicate and develop investment and trading strategies for your portfolio given the constraints listed below. You have an initial balance in your account of $1,000,000.

During the course of the semester you may trade any of the derivative instruments available on Stock-Trak, however you must:

- Establish speculative positions using both call and put options written on individual shares of stock.
- Establish speculative positions using both call and put options written on stock indices.
- Establish speculative positions using both long and short positions in stock index futures contracts.
- Create a long straddle using options written on an individual share of stock.
- Create a short strangle using options written on an individual share of stock.
- Create a bull spread with call options written on an individual share of stock.
- Create a bear spread with put options written on an individual share of stock.

- The trades required to satisfy this part of the assignment may not be reversing trades. That is, you may not count the sale of an option/futures contract that closes a position as a short position. There is also no double counting allowed. That is, the trades made to establish a straddle cannot be considered as speculative positions in options.

- Purchase 2,750 shares of Fannie Mae stock, (symbol: FNM), and utilize either options written on individual shares of stock, or options written on a stock index to manage the risk of this stock position. The Fannie Mae position must be protected (hedged) from November 2 to November 21 using a dynamic hedging strategy. The hedge portfolio must be evaluated at least once a week during the hedge period. You will provide a written description of your risk management strategy to the professor. This description is due November 5.

- These requirements represent the minimum number of transactions required to receive an average grade on this assignment.
4. The trading period will last 12 weeks, beginning Tuesday, September 4 and ending Wednesday, November 21.

You must execute trades on at least fifteen (15) different days throughout the trading period.

During the trading period your syndicate must meet at least once a week for eight (8) separate weeks.

During the meeting the syndicate members will discuss and develop trading tactics and strategies which will be executed by a member of the syndicate. At each meeting a recording secretary must keep the minutes for the meeting. The minutes will include the date and location of the meeting, members present, (full names), and a brief record of your discussions and recommendations. (The tasks of recording secretary and trader will be rotated among the syndicate members, and shared equally.) The minutes from the meeting must be typed and emailed to StockTrakFall2007@Yahoo.com. The subject line must clearly identify the trading syndicate and the date of the meeting. Minutes without a date or listing of the syndicate members present (full names) will not be read. Minutes submitted via e-mail more than one week after the date of the meeting will not be accepted.

5. Trader’s Responsibility

It is the trader’s responsibility to confirm that the requested trades are completed, and to complete the required transactions. For example, if you wanted to buy a call and a put to establish a straddle and Stock-Trak sold a put and bought a call, it is the trader’s responsibility to “fix” the problem. Including a statement in your report saying, “we sent the order, but Stock-Trak did not execute the trade,” is not acceptable.
6. Prepare a written report that includes the following information and a discussion of your experiences with Stock-Trak throughout the semester. The report is due Friday, November 30.

a. A copy of your last portfolio statement from Stock-Trak.
b. A description and discussion of your portfolio management strategy.
c. A description and discussion of the risk management strategy employed to hedge your long position in Fannie Mae.
d. An explanation of why the syndicate made the specific purchases and sales, and an explanation of the timing of the transactions. Please explain, identify and link the trades and the trading strategies, e.g., the positions taken to establish the bull spread, the date of the transactions (the date the securities were purchased / sold), the securities traded, the ticker symbols of the securities traded, etc. I must be able to read the discussion of the trade in the written report and easily find the trade on the account summary statement, or no credit will be awarded for the trade. I do not want to have to hunt for your trades in your account statement.
e. A discussion of what you expected to happen.
f. An explanation of what actually happened, including a description of how events differed from your expectations.
g. A discussion of what you learned.
h. If you could do it again, what would you do the same, and what would you change?
i. If you were doing this with real money, what would you have done differently?

These are points be addressed in your written report, not simply questions to be answered.
7. Peer evaluation of the trading syndicate

Separately provide a written assessment of the members of your syndicate indicating their contributions to the syndicate. Additionally, assign each syndicate member a number grade for their efforts using the following scale. (You do not turn in a ranking for yourself.)

3 The individual contributed more to the completion of the project than other team members.
2 The individual made an equal contribution the completion of the project.
1 The individual contributed less to the completion of the project than other team members.
0 The individual made no contribution to the project. An individual who is evaluated by the entire syndicate as having made no contribution to the project, a free rider, will receive a score of zero, (0), for the Stock-Trak assignment.

The individual with the highest score will receive 100% of the points awarded to the syndicate for the assignment. (If everyone makes an equal contribution to the project, then everyone will receive 100% of the points awarded to the syndicate for the assignment.)

- The individual with the second highest score will receive 94% of the points awarded to the syndicate for the assignment.
- The individual with the third highest score will receive 87% of the points awarded to the syndicate for the assignment.
- The individual with the fourth highest score will receive 80% of the points awarded to the syndicate for the assignment.
- The exception will be for the individual who is given a grade of zero, (0), by 50% or more, (e.g., 2 or more group members in a syndicate of 5 people), of the traders in the syndicate. This individual will receive 25% of the points awarded to the syndicate for the assignment. This rating should be used for the individual who made little or minimal contribution to the syndicate’s activities throughout the semester on the assignment.
- An individual who receives a grade of zero, (0), by all syndicate members will receive none (0%) of the points awarded to the group. This rating should be used for an individual who has made no contribution to the syndicate’s work throughout the semester (a free rider).

8. Stock-Trak operates a web site at, WWW.STOCKTRAK.COM. On this site you can register your syndicate, execute trades, and review (confirm) your transactions.