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Chair's Corner
Scott Besley

First, I would like to ask for a favor. If you are an alumnus of USF who graduated with an *undergraduate* degree in finance, please take a minute to complete the enclosed Alumni Survey and return it to us (we pay the postage). By completing the survey, you will help us improve the quality of the education we offer. You will also help us determine whether our curriculum is meeting the goals we have established for accreditation purposes.

Members of the Department of Finance are looking forward to an exciting new academic year. Although we are not yet certain what our budget will be for the 2002/2003 academic year, it appears that USF will end up better than was expected at the beginning of the legislative session. (We hope this is the case when the final numbers are known.)

Ken Wieand will rejoin the department in the fall semester. Ken originally joined the faculty in 1980, but he has served as the director of the Center for Economic Development Research (CEDR) for the past four and one half years. While director, Ken did an outstanding job developing CEDR, growing the organization to where it is today, and developing relations with local businesses. We are glad Ken is returning to his academic roots—teaching and research.

The faculty continues to publish in prestigious academic journals. Chris Pantzalis and Jianping Qi recently had research articles accepted for publication in the *Journal of Finance*, which is rated as one of the top journals in the area of finance. Other faculty members continue to produce projects that they hope will be published in similar journals. More information about the research in which members of the faculty are involved can be found on the faculty Web site located at <http://www.coba.usf.edu/departments/finance/faculty/>.

You probably have already heard that the College of Business Administration has started a \$3.5 million campaign to raise funds for a new 40,000 square foot addition to the existing building (Chester Ferguson Hall). The new addition, which will include technologically advanced facilities, will help us to meet the growing needs of our academic programs and attract quality faculty and students from all areas of the country and the world. The fundraising campaign focuses on

naming gifts for the new facility. Donors will be recognized on a “Wall of Pride” and a designated space, such as a room, will be appropriately named. The state’s matching gift program will add to the amount raised for the building addition. Many companies in the Tampa bay area also have matching gift programs in which they match contributions of employees. If you would like more information about the building addition or the fundraising campaign, contact Dick Bowers, Associate Dean for Development, at (813) 974-3175 or dbowers@coba.usf.edu.

In the Department of Finance, we continue to improve the quality of the education we offer. In the near future, we plan to add a new two-semester investments course (program) that requires students to apply skills acquired in their business curriculum to professionally manage an investment portfolio. The portfolio will include investments made with “real” money rather than “hypothetical” money. The purpose of the new course is to provide students with hands-on experience that leads to successful careers in financial services organizations. Emphasis will be on investments research, portfolio management, and financial consulting, but students will be exposed to tools required in other financial service areas as well. The program will combine classroom pedagogy with real-world experience, which will provide students with a high quality “real-world education.” The experiences students attain from the program will significantly enhance their marketability in the financial services industry. Currently, we are trying to establish the investment fund that the students will manage. If you are interested in helping or have suggestions about how to best raise the necessary funds, please contact me at (813) 974-6341 or sbesley@coba.usf.edu.

Thank you for your support of the department, the college, and USF!

If you graduated from USF with an *undergraduate* major in finance, please complete the enclosed Alumni Survey (it is very short). By completing the survey, you will help us improve the quality of the education we offer and collect necessary data for the re-accreditation of the college and university. All responses will be held in confidence—only aggregate numbers will be reported. Thank you for your help.

Earnouts in Mergers: Agreeing to Disagree and Agreeing to Stay

*Ninon Kohers, Associate Professor
(with James Ang, Professor, Florida State University)*

Differing expectations about target value are a prominent source of disagreement between bidders and targets in merger negotiations. In addition, these valuation disagreements may be even more severe when the realizable target value depends uniquely upon human capital, such as key target managers who may or may not agree to stay after the merger occurs. Our research shows that these two problems can be mitigated, if not solved, when the bidder and the target utilize a two part payment contract—a front end payment at the time of the merger and a deferred payment, or earnout, that is contingent upon the target's ability to achieve certain measurable pre-specified performance standards. These earnout contracts allow bidder and target firms to disagree on their valuations at the same time they manage to reach an agreement on the transaction. The high quality target, holding high expectations, would accept the contingent payment, while the less informed bidder is able to shift the risk of misvaluation to the more informed target, thus achieving more efficient risk sharing. Furthermore, when the target manager possesses valuable human capital and is a significant owner of the firm, deferring part of the merger premium until the post-merger period will help to retain the target manager. As a result, an earnout would act as an inducement for the target manager to stay and may also work as an effective retention bonus. When comparing large samples of mergers involving earnouts with those involving other methods of payment, we find evidence that earnout contracts are indeed more likely to occur in situations when these two problems are of greater importance.

In our study, we examine a large sample of merger transactions that involve two-part payments made by bidders to target shareholders. In analyzing 938 earnout offers, we find that the use of this type of contract is associated with these two explanations, which are not mutually exclusive. Specifically, an earnout contract, if feasible, serves as a risk reducing mechanism for bidders by hedging against the risk of misvaluing targets with potentially high asymmetric information. Earnouts also act as deferred compensation mechanisms to retain valuable owners/managers of target firms. Accordingly, we observe that this two-part payment scheme is more likely in mergers with high asymmetric information, mergers involving targets with distinctly valuable human capital, or both. In particular, acquisitions of privately-held targets, acquisitions of divested subsidiaries, and takeovers involving bidders and targets from different industries are prominent examples of mergers in which earnouts play an important role.

Furthermore, consistent with the pricing of valuable human capital in merger premiums, we find a high incidence of earnout contracts and manager retention among private

targets, and a high correlation between actual earnout payments and the retention of target managers beyond the earnout period.

The feasibility of writing and enforcing earnout contracts is also a critical issue. For example, the results show that earnouts are more common when there are fewer target stakeholders, such as in private firms and parent-owned subsidiaries, as opposed to public targets with dispersed ownership. We also find that targets in earnout mergers are more likely to operate as separate subsidiaries of the acquirer after the merger occurs, which facilitates the ability to measure target performance. Foreign bidders employing earnouts to acquire U.S. targets tend to be from countries with English-based court systems, which enhances the ability of enforcing these contracts, if necessary.

In addition to analyzing the types of mergers suitable for the use of earnouts, our study also examines the shareholder wealth effects of the earnout choice. We find that acquiring firms using earnouts exhibit significant positive event period abnormal returns, and the premiums paid to targets in deals involving earnouts are, on average, significantly larger than the premiums paid in cash or stock offers. Furthermore, in mergers with high asymmetric information between the buyer and seller, the event period abnormal returns for bidders using earnouts to purchase privately-held targets significantly exceed those for bidders using other methods of payment.

A Test of the Errors-in-Expectations Explanation of the Value/Glamour Stock Returns Performance: Evidence from Analysts' Forecasts

*Christos Pantzalis, Associate Professor
(with John Doukas, Professor, Old Dominion University and NYU, and Chansog Kim, Queens College, CUNY)*

For many years academics and investment professionals have argued that investment strategies that call for the purchase of stocks with low prices relative to dividends, earnings, book value, or other measures of value, produce higher returns. While recent empirical evidence shows that value (or out-of-favor) stocks earn higher returns than growth stocks, the interpretation as to why value outperforms growth strategies remains controversial.

Previous research has shown that value strategies produce superior returns because investors consistently overestimate future growth rates of growth stocks relative to value stocks.¹ The essence of this argument is that investors are excessively pessimistic (optimistic) about value (growth) stocks because they tie their expectations of future growth in earnings to past bad (good) earnings. Essentially, investors extrapolate past performance into their forecasts of future performance. Alternatively, value strategies outperform growth strategies because actual future growth rates of earnings of growth stocks relative to value stocks turn out to

be considerably lower than they were in the past or than what the multiples of those stocks suggest the market expected them to be. This implies that investors make systematic errors in predicting future growth in earnings of out-of-favor stocks. Namely, investors' excessive pessimism about future earnings of value stocks is responsible for the superior performance of value stocks relative to growth stocks. Consistent with this view, earlier research has shown that selling stocks with high forecasted earnings growth and buying low projected earnings growth stocks produces excess returns. These studies, which examined stock price reactions around earnings announcements, show that size-adjusted announcement returns are significantly more positive for value stocks than for growth stocks. These findings are consistent with the view that investors are too optimistic about stocks that have had good performance in the recent past and too pessimistic about stocks that have performed poorly. This is referred to as the *extrapolation hypothesis*.²

To test the extrapolation hypothesis, in our study we allow investors to classify stocks into value and growth portfolios based on available information first and then we assume that they form expectations about future earnings. If investors make systematic errors-in-expectations, as claimed by the extrapolation hypothesis, it is expected that their initial earnings expectations for growth stocks should be systematically larger than the actual earnings announced after the formation of expectations. The extrapolation hypothesis also predicts that the earnings forecasts for value stocks should be systematically smaller than the actual earnings announced after the formation of expectations. We examine analysts' earnings forecasts issued shortly after stocks are classified into value and growth portfolios, which we use as a proxy for the market's expectation of future earnings. We compare these estimates to the actual earnings across value and growth stocks in order to determine whether the market's initial optimistic forecast bias is more pronounced for growth stocks than value stocks as predicted by the errors-in-expectations hypothesis.

Financial analysts' forecasts are widely disseminated and are of substantial interest to investors and researchers. In particular, we analyze analysts' forecast errors and forecast revisions for firms with different price-to-book and size characteristics over the 1976-1997 period. The forecast error (defined as the median consensus forecast minus actual earnings) and forecast revision (defined as the recent forecast minus earlier forecast) are used to capture investors' errors-in-expectations when they forecast future earnings. The extrapolation hypothesis predicts that analysts' earnings forecasts for growth (value) stocks are expected to be initially overly optimistic (pessimistic). Therefore, positive (negative) forecast errors would be expected for growth (value) stocks. Furthermore, subsequent downward (upward) revisions in earnings' expectations for growth (value) stocks would provide additional evidence on whether investors were, indeed, excessively optimistic (pessimistic).

Our results fail to support the extrapolation hypothesis. Low price-to-book stock (value) portfolios display higher forecast errors and larger downward forecast revisions than high price-to-book stock (growth) portfolios, indicating that investors are more optimistic about value than growth

stocks. Furthermore, similar results are obtained when we compare extreme quintile portfolios of firms ranked by size. Finally, we conduct a two-by-two comparison analysis of extreme firm portfolios: (1) one that contains firms with the smallest size and lowest price-to-book ratios, and (2) one that contains firms with the largest size and highest price-to-book ratios. In contrast with the predictions of the extrapolation hypothesis, we find that investors make larger forecast errors in predicting future earnings for small-cap and value than large-cap and growth stocks, implying that they are less optimistic about large-cap and growth than small-cap and value stocks. These results hold for several forecasts issued at different time periods after the portfolio formation date.

¹ The research referred to here can be found in Lakonishok, J., A. Shleifer, and R. W. Vishny. 1994. Contrarian Investments, Extrapolation, and Risk. *Journal of Finance*, 49: 1541-1578.

² Specific tests and detailed results are contained in La Porta, R., J. Lakonishok, A. Shleifer, and R. Vishny. 1997. Good News for Value Stocks: Further Evidence on Market Efficiency. *Journal of Finance*, 50 (5): 1715-1742.

Smoke and Mirrors ... and Corporate Accounting

Murad Antia

Benjamin Disraeli, the prime minister of Britain from 1874 to 1880, was reported by Mark Twain to have stated this brilliant quote on statistical analysis: "There are three kinds of lies: lies, damn lies, and statistics." Given the recent rash of accounting irregularities, a contemporary version of this quote could substitute corporate financial statements in the quote for statistics.

Financial accounting requires that firms use the accrual rather than the cash basis method of accounting. The accrual basis, in theory, provides a better measure of operating performance than the cash basis because it measures income associated with activity during a particular time period. Its proponents would argue that the delivery of goods and services is viewed as the critical wealth-generating event, not the receipt of cash. Under the cash basis of accounting, a firm recognizes revenues when it receives cash from customers and recognizes expenses when it pays cash to suppliers. Under the accrual basis of accounting, the firm recognizes revenues when the product is sold or the service is rendered, regardless of whether cash is received, as long as the receivable can be measured objectively and there is a high probability of collection. Expenses are matched with the associated revenues, regardless of when they are paid.

The accrual method of accounting, as promulgated by Generally Accepted Accounting Principles (GAAP), allows company managers sufficient leeway to accurately communicate the financial position and results of the company's operations. That same flexibility, however, also

allows managers to misrepresent and conceal information from investors and financial analysts. For example, companies estimate several financial statement items such as future warranty expenses, pension costs, uncollectable account receivables, and impairment value of assets. These estimates can be manipulated to show the company's financial position in the best possible light.

From a conceptual viewpoint, the accrual method of accounting, when employed correctly, should convey an accurate portrayal of a company's financial position. Unfortunately, GAAP has not kept pace with changes in the economy. GAAP was designed for the old brick-and-mortar type industrial company. The "new economy," as it is often referred to, comprises more service-type companies and involves the increased use of complex financial instruments. Additionally, certain rules and guidelines of GAAP have been modified, and in some instances new guidelines have been added, to meet the requirements of special interest groups. These changes have abridged, rather than enhanced, the level of transparency and disclosure.

The inappropriate use of partnerships, also known as special purpose entities (SPEs), exemplifies an egregious violation of the spirit of GAAP. Companies can create these SPEs and not consolidate the partnership's financials into its own account as long as it owns no more than 97 percent of the entity. So, if a company has poorly performing assets and a burdensome level of debt, it can siphon these into an SPE. Once unburdened, the company's financial statements take on a deceptively pristine quality. These and other forms of accounting chicanery, left unchecked, can seriously undermine the efficiency and ultimately the integrity and credibility of financial system.

It bears mention that a substantial portion of senior executive compensation is derived from the exercise of stock options. The higher the stock price the greater the value of the options. There seems to be a growing consensus that companies have used accounting gimmickry to create the illusion of rapid growth in an attempt to boost stock prices.

The American financial system is held in the highest esteem by investors around the world. These investors have voted with their pocketbooks by pouring billions of dollars into the American economy. A perception of decline in the integrity of the reporting system can have serious long-term consequences on the efficiency of capital markets and economic growth. It is, therefore, imperative that the level of transparency and disclosure is maximized and the influence of special interests that serves to undermine transparency is minimized.

There are potential red flags that the financial analyst or investor could look for to guard against an implosion in the value of an investment. The investor should:

- Observe the trend in net income and compare it to the trend in cash flow from operations (from the Statement of Cash Flows). Net income can be "managed" more than cash flow from operations. For example an improving trend in the former, concurrent with a declining trend in the latter could be due to an inordinate increase in accounts receivables. A company, attempting to inflate sales, might indulge in "channel stuffing," which usually means that it is oversupplying its distributors. By

transferring product to distributors, sales and accounts receivables would increase but cash flow would not change.

- Look for nonrecurring items in the income statement such as a gain from the sale of a business unit or gains from the company's investment portfolio. These gains could be used to offset an otherwise declining trend in income. The firm could change accounting principles that would appear to make the firm more profitable. These items should be removed from the income statement to determine true earnings power.
- Examine the trend in inventory relative to sales. A significant increase in the inventory-to-sales ratio could result from excessively high levels of inventory because it might include obsolete inventory. A company might keep obsolete inventory on its books because writing it off would reduce income.
- Determine if the primary source of earnings increase is sales growth or cost cutting. The latter, at best, is a temporary fix and is not a source of sustainable earnings growth.
- Determine if the primary source of sales increase is unit growth or price increases. Sales growth should be held suspect if it results predominantly from the latter. If a company builds a better "mousetrap," then units sold should increase on a sustainable basis. Price increases are not sustainable and can lead to an erosion of market share.
- Observe the trend in such discretionary expenditures as advertising and marketing, repairs and maintenance, and research and development. The notes to the financial statements should detail these expenses. A reduction in these expenses will increase near-term income at the risk of impeding income growth in the future.
- Be wary of companies that have grown substantially via the acquisition route. Casual empiricism has revealed that mergers and acquisitions increase the potential for earnings management, or income smoothing.
- Monitor the level of short interest in a stock. A stock with a reasonable valuation but high short interest might suggest that some investors are suspicious about the company's accounting practices. It would behoove the analyst to cast a skeptical eye toward published financial data.
- Ask questions when a company's financial data deviates from historical or industry norms. The investor should be especially cautious if these questions cannot be answered and explained in a credible manner by analysts covering the stock or the management of the company.

Financial statement analysis is where the rubber hits the road for an investor. The use of sophisticated models or techniques will prove to be inconsequential, or worse, if the data inputs are suspect. Let's not forget the maxim – garbage in, garbage out.

The Financial Services Industry Cluster in the Tampa Bay Region

*Dennis Colie, Associate Director
Center for Economic Development Research*

In October 1998, the USF College of Business Administration's Center for Economic Development Research (CEDR) launched a comprehensive study of the financial services industry cluster in Tampa Bay. USF President, Dr. Judy Genshaft, announced the results of the study at a business breakfast at the Wydham Harbor Island Hotel in October 2000. The report, "Financial Services in Tampa Bay: Growth, Impacts, and Organization," is available for download from CEDR's website at <http://cedr.coba.usf.edu>.

The major findings of the study are:

- The Finance, Insurance, and Real Estate (FIRE) industry division does \$26 billion of sales annually in Tampa Bay. In 1998, there were 15,520 finance and finance-related business establishments employing 157,311 persons in Tampa Bay.
- The business activity of FIRE firms ripples throughout the Tampa Bay regional economy generating a total output valued at \$44 billion per year and 382,000 jobs.
- The average wage of FIRE workers, who were covered by state unemployment insurance, was \$39,052 in 1998.

The study concludes that Tampa Bay is positioned for continued leadership in financial services as high-tech applications in telecommunications and computing are changing the way financial services are delivered to the industry's customers. Tampa Bay is a cost-competitive area for an emerging cluster of finance and finance-related technical and administrative support centers for national and international financial services activities.

This article provides an update on the FIRE industry in Tampa Bay in the context of the overall structure of the Tampa Bay economy. We provide statistics that describe a decade of changes in wages, employment, and business establishments in Tampa Bay between April 1990 and April 2000.

Major employers in financial services include depository institutions, such as commercial banks and credit unions, as well as mortgage banks and brokers, securities dealers and brokers, insurance carriers and agents, and commercial and residential real estate brokers and agents.

Between April 1990 and April 2000, the weighted-average annual wage in Tampa Bay increased 47.71 percent to \$28,917 from \$19,577. In April 2000, the FIRE industry division enjoyed the highest average wage at \$38,881; the average wage in manufacturing was \$35,006, and the average wage in services was \$28,328.

Although gaining in average wage from April 1990 to April 2000, at the same time the FIRE industry division suffered a small decline in its percentage share of employment in Tampa Bay. FIRE's share of employment

was 6.58 percent in April 2000 down from 6.88 percent in April 1990. Between April 1990 and April 2000 only two industry divisions gained in percentage share of employment in Tampa Bay's economy. The public administration division experienced a slight increase to 5.44 percent from 5.35 percent. However, the largest shift in employment share was captured by services, which grew to 43.03 percent of the economy in April 2000 from a 35.31 percent share in April 1990.

Since April 1990 the number of business establishments in Tampa Bay has been steadily growing at a pace of 2.2 percent per year. There were 68,613 business establishments in Tampa Bay in April 1990; the number rose to 85,333 by April 2000. Service businesses continue to be the largest industry division within the structure of the Tampa Bay regional economy, comprising over 40 percent of all businesses. Over the 10-year span from April 1990 to April 2000 the region experienced a net gain of 98 manufacturing businesses, but manufacturing's percentage of the industry structure shrank to 4.36 percent from 5.27 percent.

The net increase in FIRE businesses in Tampa Bay between April 1990 and April 2000 was 1,953. FIRE establishments also gained slightly as a percentage of the industry structure, to 9.68 percent in April 2000 from 9.20 percent in April 1990. Over the decade, only businesses in the transportation, communication and utilities division of the industrial structure of Tampa Bay grew at a faster rate than FIRE. FIRE businesses have been increasing at an annual compound rate of 2.73 percent, while transportation, communications and utilities enjoyed a 3.57 percent rate. (services businesses multiplied at a 2.72 percent annual compound rate over the same 10-year period.)

Financial services is a growth industry in Tampa Bay, both in terms of employment and number of businesses. Average wages in the industry are among the highest in the region. New technology in telecommunications and computing reduces the importance of location for producing a wide variety of financial services. Proximity to customers becomes a function of the technology rather than a function of geography. This gives Tampa Bay a competitive advantage in the marketplace for delivery of financial services due to the region's low cost of living and relatively inexpensive labor and real estate costs. We can expect the financial services industry to continue to play an increasing role within the industrial structure of Tampa Bay's economy.

This newsletter is only as good as you, our alumni and business supporters, make it. Each issue presents informative articles and news. Please send us information on your recent career accomplishments, newsworthy items, and other information you would like to share with us and other supporters of the Department of Finance. Also, if you have an idea for an informative article that we can use in the newsletter, please let us know. Ideas and information can be sent to Murad Antia, Editor, via e-mail at mantia@coba.usf.edu or regular mail in care of the return address given on the back of this issue.

Retirement Planning and Social Security

Steve Fraser, Ph.D. Candidate
(with William W. Jennings, Assistant Professor, U.S.
Air Force Academy, and David King, Ph.D. Candidate,
Indiana University)

While the stock market returns over the past couple of years have many investors using caution in their approach to purchasing stocks, our study makes an argument that you may want to actually consider expanding your stock holdings. We show that when one considers the present value of Social Security benefits as part of the total portfolio, most individuals have far less of their wealth invested in the stock market than they desire.

The Role of Asset Allocation

One of the most important aspects of financial planning (after ensuring you have some type of plan) is determining where to put your money. Most of the time we simply worry about which mutual fund might be right for us, or whether we can afford to lock up money in some type of tax advantaged investment, such as an Individual Retirement Account (IRA). It may be surprising to many that it is not so much what specific vehicle we invest in but rather what class of assets we choose to invest in that determines our investment success. Studies have shown that more than 90 percent of an investor's total return is determined by the asset class (stocks, bonds, real estate, and so forth) and the overall proportional representation, while less than 10 percent of investment success is determined by the specific stocks or bonds an investor may choose.

So how much of your total portfolio is invested in stocks, bonds, or real estate? What about cash? We would all agree we need some amount of cash or very liquid assets to fund unexpected emergencies. We all practice some degree of asset allocation analysis each time we contribute to our favorite mutual fund. What we probably need to do more often, however, is to pay attention to how that investment decision impacts our total portfolio.

There are as many opinions on the proper asset allocation for an individual as there are investment advisors. Most of the opinions share the idea that the younger we are, the more risk we can assume. And the more risk we can assume, the more we should be invested in the stock market. Most agree that we should have some percentage in cash, stocks, bonds, and maybe real estate. (Also, it is assumed that as we get older we can afford to take less risk and, therefore, we transition portions of our portfolio from equities to bonds.) Burton Malkiel, author of *A Random Walk Down Wall Street*, proposes a life cycle guide where the asset allocations change over time. Malkiel's recommendations are illustrated in Table 1.

Table 1

Age	Recommended Asset Allocation		
	Cash	Stocks	Bonds
Mid 20s	5%	70%	25%
Late 30s to Early 40s	5%	60%	35%
Mid 50s	5%	50%	45%
Late 60s +	10%	30%	60%

The Bond Question

No matter the model, it is readily apparent that you need some portion of your portfolio invested in stocks, and that percentage should probably decrease with age. Our study examines the impact of considering an expanded portfolio that adds the present value of future Social Security benefits. This viewpoint has dramatic effects on the investment allocation decision.

When you hear the term "bond," you probably think of traditional corporate or government bonds. An investor pays a certain amount to purchase the bond and receives periodic interest payments. Those interest payments represent a steady stream of constant payments, or an annuity, over the life of the bond. When the bond matures, the investor receives the face value of the bond. If the bond purchased is a government bond, then the stream of payments and return of the principle is guaranteed by the full faith and credit of the government. If we were to value a bond at any specific time, we simply discount, or find the present value of, the stream of payments and the original principal.

It is not too far of a reach to think of your Social Security benefits as a bond. Instead of investing an initial amount up front, however, you contribute to Social Security over your working life. Depending on the amount you work and how much you contribute over your lifetime, you are eligible for a stream of payments that are backed by the full faith and credit of the U.S. government. We can get a value for our expected Social Security benefits directly from the Social Security Administration (SSA). In fact, the SSA now mails out estimates to workers each year. The question now becomes determining what rate we should use to find the value of those benefit checks. An appropriate rate can be thought of as one appropriate for a similar investment in terms of risk and expected return. Because Social Security is indexed for inflation, our study uses the rates on Treasury Inflation Protection Securities, or "TIPS," which are treasury bonds that are indexed for inflation.

An Example

The impact of adding Social Security wealth to the total portfolio can best be seen through a simple example. While our study considers many different saving, retirement, and asset allocation frameworks, the following example highlights the general idea. Consider a 40-year old married worker who contributes the maximum to Social Security (a high wage earner), which has an estimated present value in 2002 of approximately \$120,000. This result comes simply from determining the present value of the estimated Social Security benefits that will be paid over the expected lifespan of the retiree based on the IRS actuary tables at the TIPS rate described above. Assume this same worker has saved a portion of his income such that he has \$105,000 in his

private retirement fund. If his *target* asset allocation is 60 percent stocks and 40 percent bonds, adding Social Security wealth to the allocation would yield a resultant portfolio of 28 percent stocks and 72 percent bonds.

Allocation without Social Security:

$$\text{Stocks} = \$105,000 \times 0.60 = \$63,000$$

$$\text{Bonds} = \$105,000 \times 0.40 = \$42,000$$

Allocation with Social Security:

$$\% \text{ Stocks} = \frac{\$63,000}{\$105,000 + \$120,000} = \frac{\$63,000}{\$225,000} = 0.28 = 28.0\%$$

$$\% \text{ Bonds} = 1 - 0.28 = 0.72 = 72.0\%$$

If the *target* asset allocation for the expanded portfolio, including the Social Security wealth, remained at the 60/40 percent level, a portfolio invested with 128 percent in stocks and -28 percent in bonds (borrowing) would be required. Essentially, the married wage-earning 40-year old who includes Social Security wealth in the portfolio and wants a target 60/40 percent asset allocation between stocks and bonds would have to actively buy stocks on margin. Additional scenarios are illustrated in Table 2 (*all examples assume the same saver described above*).

Table 2

Age/Status	Perceived Allocation		Resultant Allocation W/Social Security	
	Stocks	Bonds	Stocks	Bonds
30 Single	70%	30%	34%	66%
40 Single	60%	40%	36%	64%
40 Married	60%	40%	28%	72%
50 Married	50%	50%	23%	77%

Age/Status	Desired Allocation		Required Allocation W/Social Security	
	Stocks	Bonds	Stocks	Bonds
30 Single	70%	30%	142%	-42%
40 Single	60%	40%	100%	0%
40 Married	60%	40%	128%	-28%
50 Married	50%	50%	109%	-9%

The Lesson

The idea here is not to recommend you immediately invest everything you have in the stock market. Our study simply aims to raise financial awareness and offer a different perspective on retirement planning. It is also important to note a few cautions from the earlier example. First, while one may consider Social Security wealth an asset, those benefits are not liquid. You cannot sell or trade your Social Security wealth. Probably more important, however, is the notion that the only important stakeholder in any asset allocation decision is you. Where you put your money should depend on your ability to assume various levels of risk—and that will be different for each individual. Many of us have children and mortgages, while others are single with little or no outstanding liabilities. Decisions about asset allocation are part of an ongoing process—not something you decide one time and move on. Over time, your ability and willingness to assume risk will undoubtedly change.

Sometimes we think it is too risky to be in the stock market. If you consider the perspective offered in our study, there may be risk in *not* being in the stock market.

The preceding discussion is based on an article published in the *Financial Services Review* (volume 9, 2000, pages 295-326) entitled “Strategic Asset Allocation for Individual Investors: The Impact of the Present Value of Social Security Benefits.”

Finance majors often seek internships to apply what they have learned in the classroom and to gain valuable work experience. If your company is looking for an intern with a good understanding of finance, please let us know. We will be happy to recommend students that have the appropriate qualifications. Contact Scott Besley via e-mail at sbesley@coba.usf.edu.

USF Student Finance Association

The Student Finance Association (SFA) is an organization that is primarily for finance majors and other business-oriented students. SFA provides exposure to the many facets and opportunities in the field of finance. Although the emphasis of the organization lies in finance, all majors are welcome.

The purpose of the SFA is to:

- Provide students a collective group of speakers that will creatively expand their understanding of finance. Students have an option to request specific speakers.
- To familiarize students with the various types of career opportunities related to the field of finance.
- To assist students in academic pursuits.
- To promote professionalism and integrity among its members.

The SFA is always looking for speakers who work in finance-related areas. We welcome USF alumni who have “real-world” experience to speak at meetings. The meetings generally are held every Monday at 4:45 p.m. in the College of Business Administration.

The current officers of the association are:

- Tuomas Niemi, President
- Jennifer Murray, Vice President
- Christine Gierman, Secretary and Public Relations
- Sandra Palamar, Treasurer
- Chris Sapio, Director of Marketing

If you have any questions or wish to communicate with the SFA organization, please e-mail the association at usfsfatampa@hotmail.com.

If you are an alumnus of USF who majored in finance as an undergraduate, remember to complete and return the enclosed Alumni Survey. A small amount of your time will help us a great deal. Thank you for your help.

Profiles of Graduates

Paul and Penny Anderson

Paul and Penny Anderson graduated with MBAs from USF in 1986 and 1987, respectively. Paul graduated with a GPA of 3.9, only to be topped by Penny, who graduated with a 4.0 GPA. They moved to Florida in 1979 from Madison, Wisconsin, where they both did undergraduate work at the University of Wisconsin, and Penny earned her Ph.D. in the sciences. Paul has also earned the Chartered Financial Analyst (CFA) designation.

The Andersons opened a small business in Clearwater after moving to Florida, so the night program at USF met their needs. They ran the business during the day, and attended courses in the evening. Paul concentrated in the area of finance and Penny in management information systems and accounting.

Penny is now employed in the accounting field by AutoNation and spends time with their 15 year-old daughter, who is attending Clearwater High School and is active in high school sports. "I needed flexibility in my job schedule," says Penny. "AutoNation has been great to work for, since they understand the needs of working mothers."

Paul started his post-MBA career as a research analyst in the trust department of First Florida Banks. Soon after First Florida Banks was acquired by Barnett Banks, Paul relinquished his research role and became a portfolio manager for retail trust accounts. Now a senior vice president and senior portfolio manager in the Private Bank Division of Bank of America, Paul manages assets for high net worth individuals and foundations. During the past 16 years, he has played a variety of roles in the investments field, including equity research and stock selection, equity fund management, and portfolio management.

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