

RESIDENTIAL SCHOOL ON SECURITY ANALYSIS

By A.O. Worthington Wilmer

(Mr. Worthington Wilmer, a member of the Queensland Branch of the Society, attended the Residential School on Security Analysis held at the University of New England over the period 5 to 12 February 1971.)

The Residential School on Security Analysis has been held at Armidale once a year for the past eight to ten years. It was originally organized by Peter Davies, at that time a lecturer at the University but who is now Economic Advisor to the Sydney Stock Exchange and mainly responsible for the new computerised statistical service called "Statex".

Now under the auspices of Ron Peterson, a former lecturer in the Department of Accounting in Queensland University, the course lasts a week and the students are limited in number. New Zealand was represented this year for the first time; of the 23 students two came from Auckland, four from Brisbane, three from Melbourne and the balance from Sydney. Their age varied from mid-forties to mid-twenties, with a predominant representation from the younger group, and the professions represented were Life Offices, Merchant Banks, Investment Houses, Stockbrokers and Accountants.

The programme was a full one with lectures, group projects and a day spent at the University's Computer Centre playing the business game. The lectures were all of an extremely high standard and contained a great deal of information in each session. Copious supporting notes were provided in the form of articles, mainly by well known American Security Analysts. The course was planned on extremely practical and logical lines, with each subject taking over from where the former left off.

The main security analysis subject commenced with the theory of "The Finance of the Firm", taking into particular account the theory of capital structure and the cost of capital. This led on to a treatise on cash flow analysis followed by sessions on corporate dividend policy, the theory of the financing of mergers and takeovers, and the various theories and methods evolved for valuing stocks. This last session covered half a day of fundamental analysis.

The next subject to be considered was technical analysis, a treatise and discussion on charting on which so much contrary opinion exists. The final series of analytical lectures were entitled "Portfolio Management", and were given by Mr. B.J. Phillips, Senior Lecturer and head of the Department of Economic Statistics. These lectures were approached from the mathematical theoretical viewpoint, trying to relate the movements of stock prices to a strict theoretical mathematical formula.. The whole basis of these lectures was to give us some mathematical theoretical thinking to share price movements and the variation and risk factors inherent in making up a portfolio. A very interesting but rather obtruse subject!

Interspersed with this programme of analytical lectures were three additional subjects, namely Statex, a Business Game and Economic Geology. Statex is the new computerised statistical service of the Sydney Stock Exchange and was explained in considerable detail by its author Peter Davies. The advantage of this system is that an enormous amount of information, both descriptive and analytical and including a large variety of ratios, is automatically computed and adjusted in many cases so that there is a basis of reliable accurate figures from which company situations may be deduced by the analyst.

The Business Game was played by the students divided into three groups representing three rival firms involved in a production and marketing

exercise. The groups started off on equal terms, and each made up a decision sheet which fed information into the computer on the basis of dividing available cash into various resources. The computer, through its set programme, then threw out the various results and came up with a profit or loss answer and the amount of cash left. This game was rather nerve racking, especially as each group was only allowed half an hour for each decision. If it taught me anything it was that a group playing this game has to be organised in a strictly disciplined manner into a Board of Directors structure, with each group member having a specific responsibility.

Economic Geology lectures were given by the Head of the Geology Department, Professor H.J. Harrington. These consisted of an explanation of the main geological features of Australia, together with a basic explanation on the different types of rocks and formations. In addition the Professor showed us how to estimate the size of ore bodies and make a rough calculation on theoretical values.

The course was designed to ask "Why" rather than "How". The lectures were of extremely high theoretical standard and one could not help being stimulated. The lecturers took the view that most students were practitioners in their own sphere and aimed to induce them to become far more critical over the various statements which are made by Boards of Directors, Geological Consultants etc.

The overall impression, rather a rueful one, is that the whole of the mechanical side of the securities industry including fundamental analysis can very easily be turned over to the computer, and therefore one can see the whole of the investment industry in the future comprising of a few people pressing buttons into computer data input apparatus. There is however quite obviously still enormous amount of room for the individual analyst's judgement on the figures which are produced and for this reason underlies the importance of a high standard of education on the subject and the detailed knowledge of an intricate mathematical theory behind the industry. In my opinion these courses cannot but be of extremely high value to those undertaking them, although I would add that a prior knowledge of the subject is essential for obtaining the best value from such courses.



QUOTATION ON INFLATION

"There are two schools of thought that have developed since the full employment concept was accepted generally by governments. One school was that you can only have high levels of employment with inflation; that there is a trade-off between unemployment and inflation. The other school of thought - to which I happen to belong, and, while they aren't here to defend themselves, I think that both Per Jacobsson and Lord Keynes would also be in that school - is that it is not possible to have high levels of employment on a semi-permanent basis with inflation. Inflation disrupts and undermines and dislocates in such a way that whatever employment is created by it is only temporary. Therefore, if we do not find means of resisting this inflation and keeping it under control, we are not ever going to attain the full employment goal that all of us are striving for. I state this as my conviction."

- William McChesney Martin, former member of New York Stock Exchange and until recently Chairman of Board of Governors of the Federal Reserve System, U.S.A., in introducing his paper "Toward a World Central Bank" to the Per Jacobsson Foundation, September 1970.

