CHAPTER 7 LECTURE.

BACKGROUND . . .

WHY DO PEOPLE INVEST?...

<u>Individuals:</u>

- THE 25-YR-OLD "YUPPY" ? . . .
- THE 25-YR-OLD "DINC" COUPLE ? . . .
- THE 35-YR-OLD "YOUNG FAMILY" ? . . .
- THE 45-YR-OLD "MID-LIFE CRISIS" ? . . .
- THE 65-YR-OLD "RETIREE" ? . . .

➔ **DIFFERENT LIFE STYLES, LIFE CYCLES, PERSONAL GOALS, LEVELS OF WEALTH**

WHY DO PEOPLE INVEST?...

Institutions:

- LIFE INSURANCE COMPANIES
- PENSION FUNDS
- MUTUAL FUNDS
- BANKS
- FOUNDATIONS

➔**DIFFERENT CONSTITUENCIES, EXPERTISE, LIABILITIES, REGULATIONS, SIZES**

WHY DO PEOPLE INVEST?...

===> DIFFERENT TIME HORIZONS, RISK TOLERANCES, NEEDS FOR INCOME vs GROWTH

Therefore, . . . (implications for financial services industry)

TWO MAJOR INVESTMENT **OBJECTIVES**:

1) **GROWTH** (SAVINGS) - **RELATIVELY LONG-TERM HORIZON** (NO IMMEDIATE NEED);
2) **INCOME** (CURRENT CASH FLOW) -- **SHORT-TERM & ON-GOING NEED FOR CASH.**

MAJOR CONSTRAINTS & CONCERNS:

- RISK
- LIQUIDITY
- TIME HORIZON
- MANAGEMENT BURDEN, EXPERTISE
- AMOUNT OF FUNDS AVAILABLE FOR INVESTMENT (SIZE)
- CAPITAL CONSTRAINT

Therefore (again), . . . *What?*

Exhibit 7-1: UNDERLYING ASSETS vs INVESTMENT PRODUCTS, an Example from traditional corporate finance:

Underl. Asset:

ABC Widgets Corporation
(Collection of Physical, Human, & Legal Assets & Relationships)

Invest. Products:

ABC Common Stock
(Subordinated claims)
- Moderate Risk
- Moderate Total Return
- Low Cur.Yield

ABC Corporate Bonds
(Senior claims)
- Low Risk
- Low Total Return
- High Cur.Yield

Invest. Product:

Call Options
on ABC Stock
(Contingent claims)
- High Risk
- High Total Return
- Zero Cur.Yield

Invest. Products:

Various Mutual Funds
(owning various different types of claims on ABC & other assets)
- Various Risk, Return, & Cur.Yield Configurations

Exhibit 7-2: A REAL ESTATE EXAMPLE of the Investment System

Underl. Asset: (Priv.Traded)

"Bricks & Mortar" (e.g., Grump Family Shopping Centers)
(Rent-producing Real Properties)

Private Invest. Products:

e.g., Ltd Partnerships (or CREFs, Priv.REITs, etc)
Own equtiy in properties:
LP Shares (units) privately held
& privately traded if at all

Commercial Mortgages
Senior (debt) claims:
Privately held & traded
("whole loans")

Public Invest. Products:

REITs
“UPREIT” Owns
LP Units,
Issues publicly
traded shares.
(May also directly own
Underl.Asset, or Mortgs
& CMBS)

CMBS
publicly traded
securities based
on a pool of mortgs

Investors: **individual, institutional**

Small

&
Large

Large
Investors
(Wealthy Individuals, Developers, Institutions)

Small
&
Large
Investors

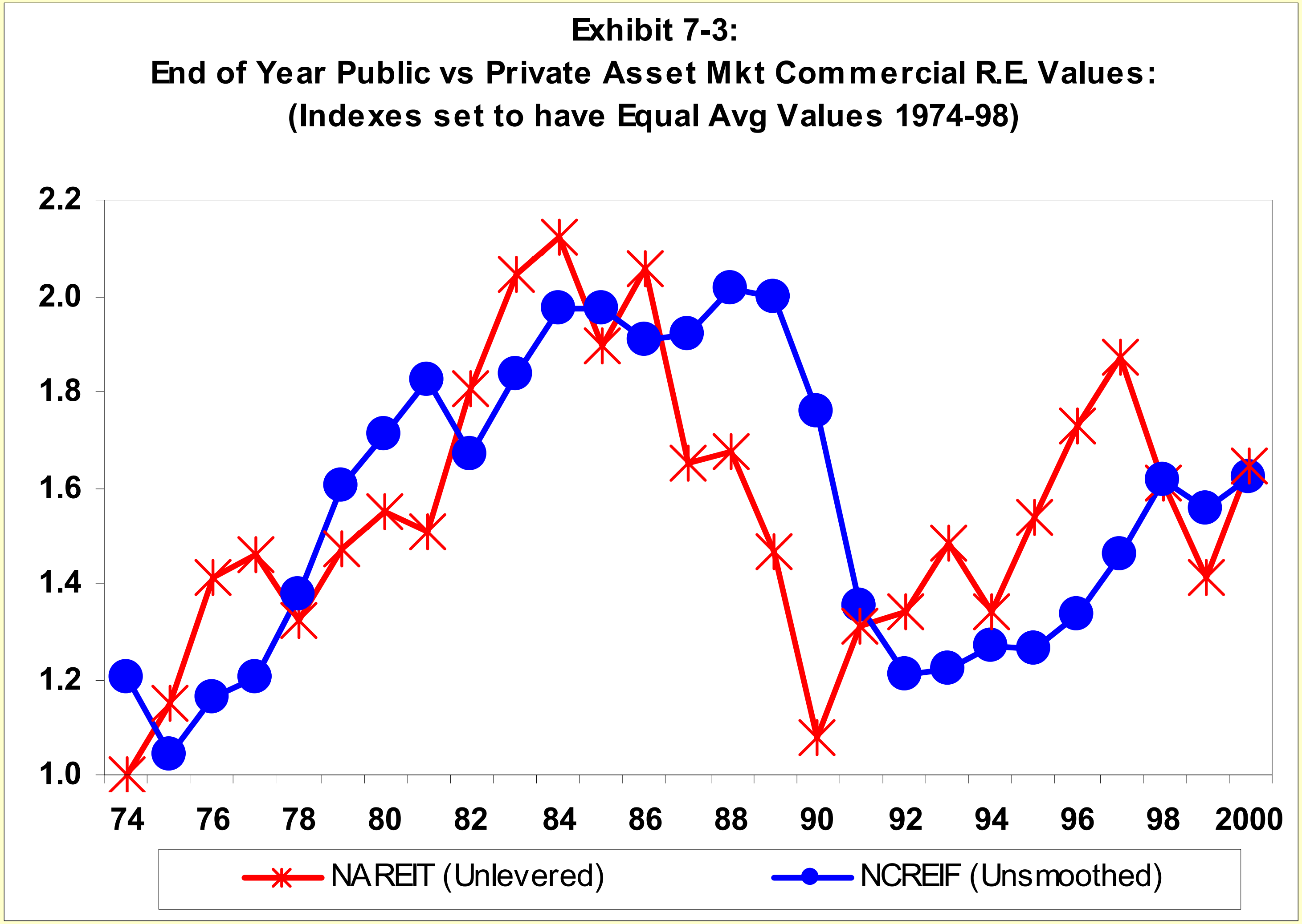


Exhibit 7-3:
End of Year Public vs Private Asset Mkt Commercial R.E. Values:
(Indexes set to have Equal Avg Values 1974-98)
2.2
2.0
1.8
1.6
1.4
1.2
1.0
74
76
78
80
82
84
86
88
90
92
94
96
98
2000
NAREIT (Unlevered)
NCREIF (Unsmoothed)

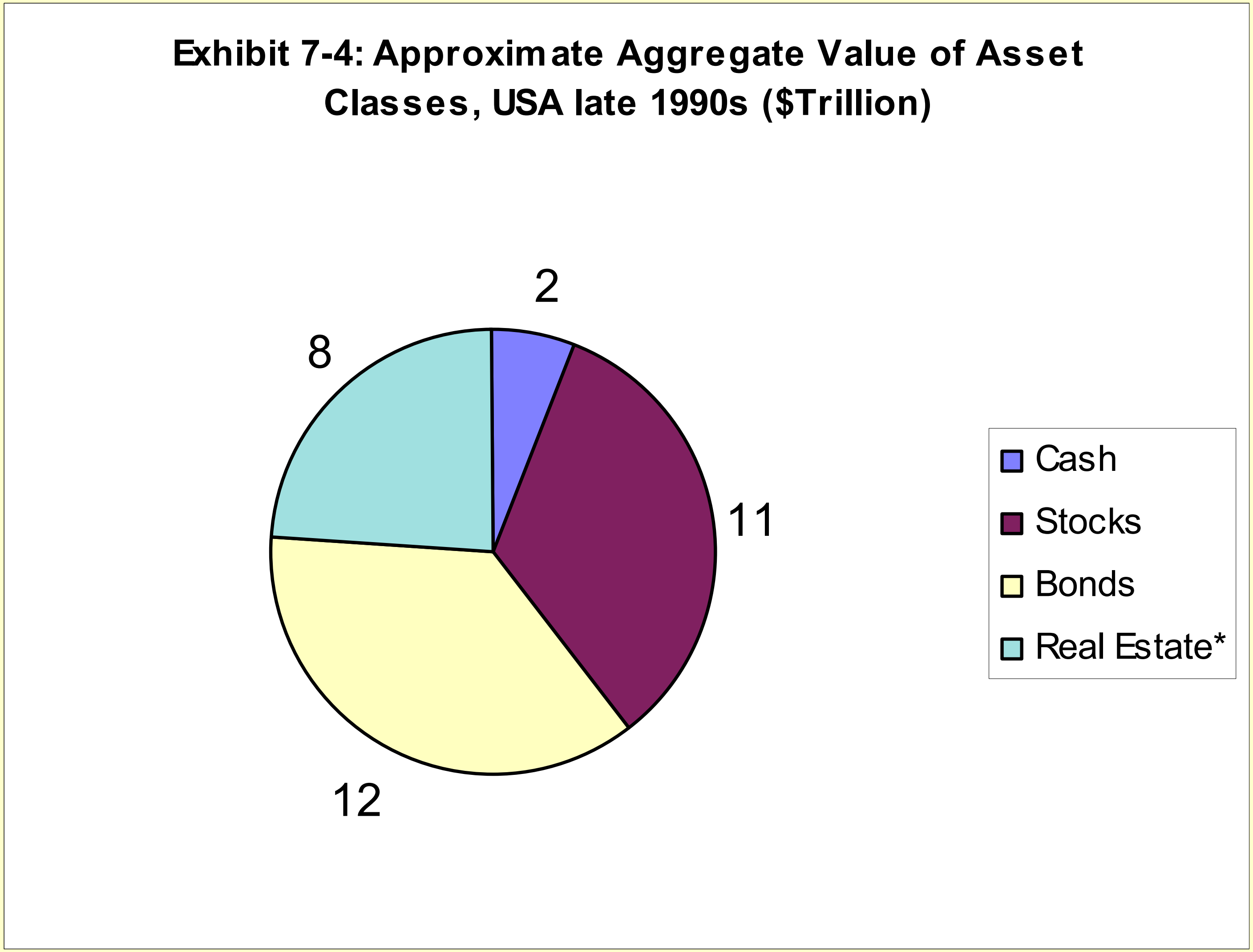


Exhibit 7-4: Approximate Aggregate Value of Asset Classes, USA late 1990s ($Trillion)
2
11
12
8
Cash
Stocks
Bonds
Real Estate*

Exhibit 7-5: Stereotypical characterization of major investment asset classes...

INVESTMENT CONCERN:	STOCKS	REAL ESTATE*	LONG TERM BONDS**	CASH (T-BILLS)
RISK	HIGH	MOD. to LOW***	MOD. to LOW***	LOWEST
TOTAL RETURN	HIGH	MODERATE	MODERATE	LOWEST
CURRENT YIELD	LOW	HIGH	HIGHEST	MODERATE
GROWTH	HIGH	LOW	NONE	NONE****
INFLATION PROTECTION	L.R. GOOD	GOOD	BAD	BEST (IF REINV)

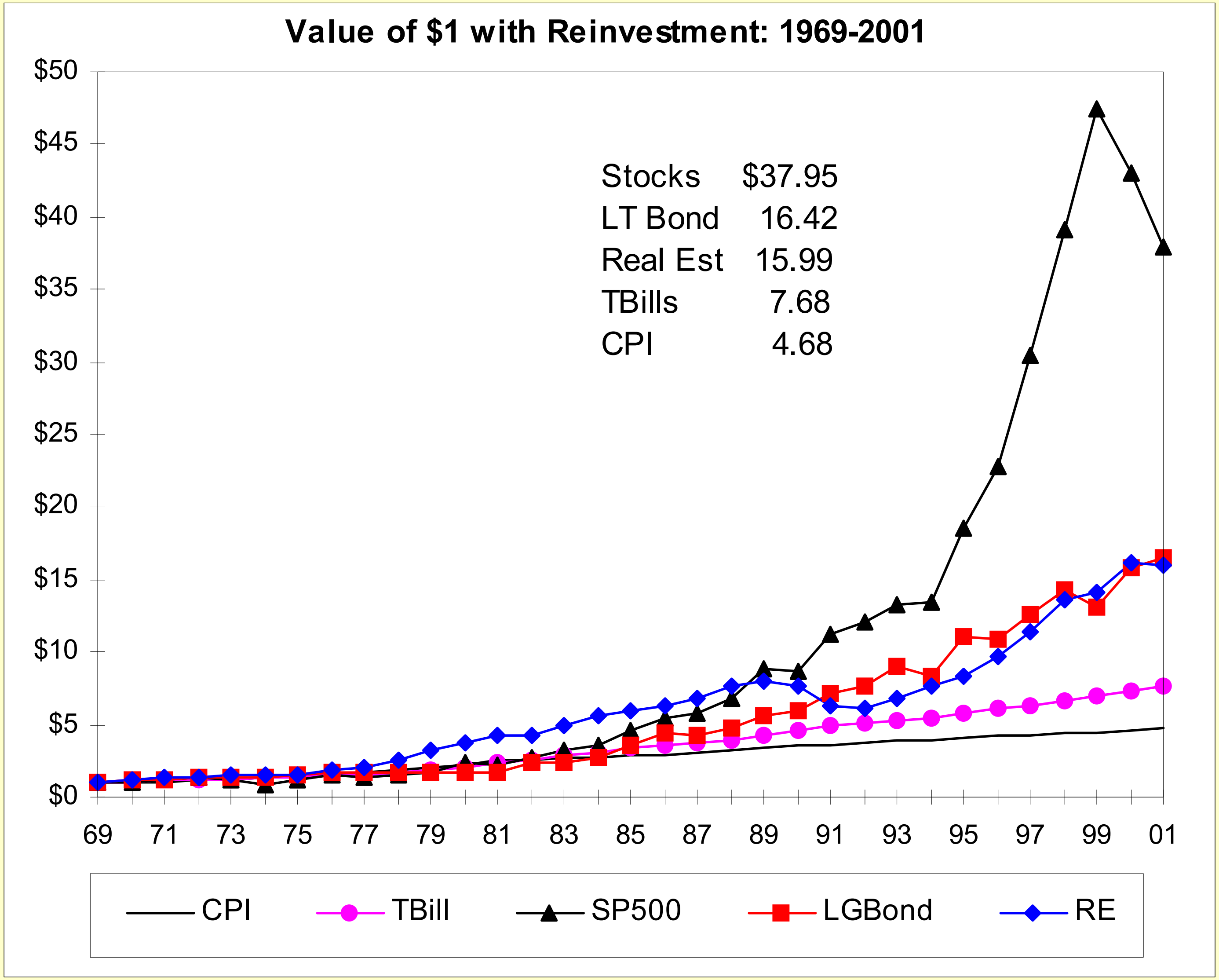
*Unlevered institutional quality commercial property (fully operational).

**Investment grade corporate or Government bonds.

***Low risk for investors with long-term horizons and deep pockets, so they can hold the assets to maturity or until prices are favorable. Moderate risk for investors fully exposed to asset market price volatility.

****Unless the investment is rolled over (reinvested), in which case there is no current yield.

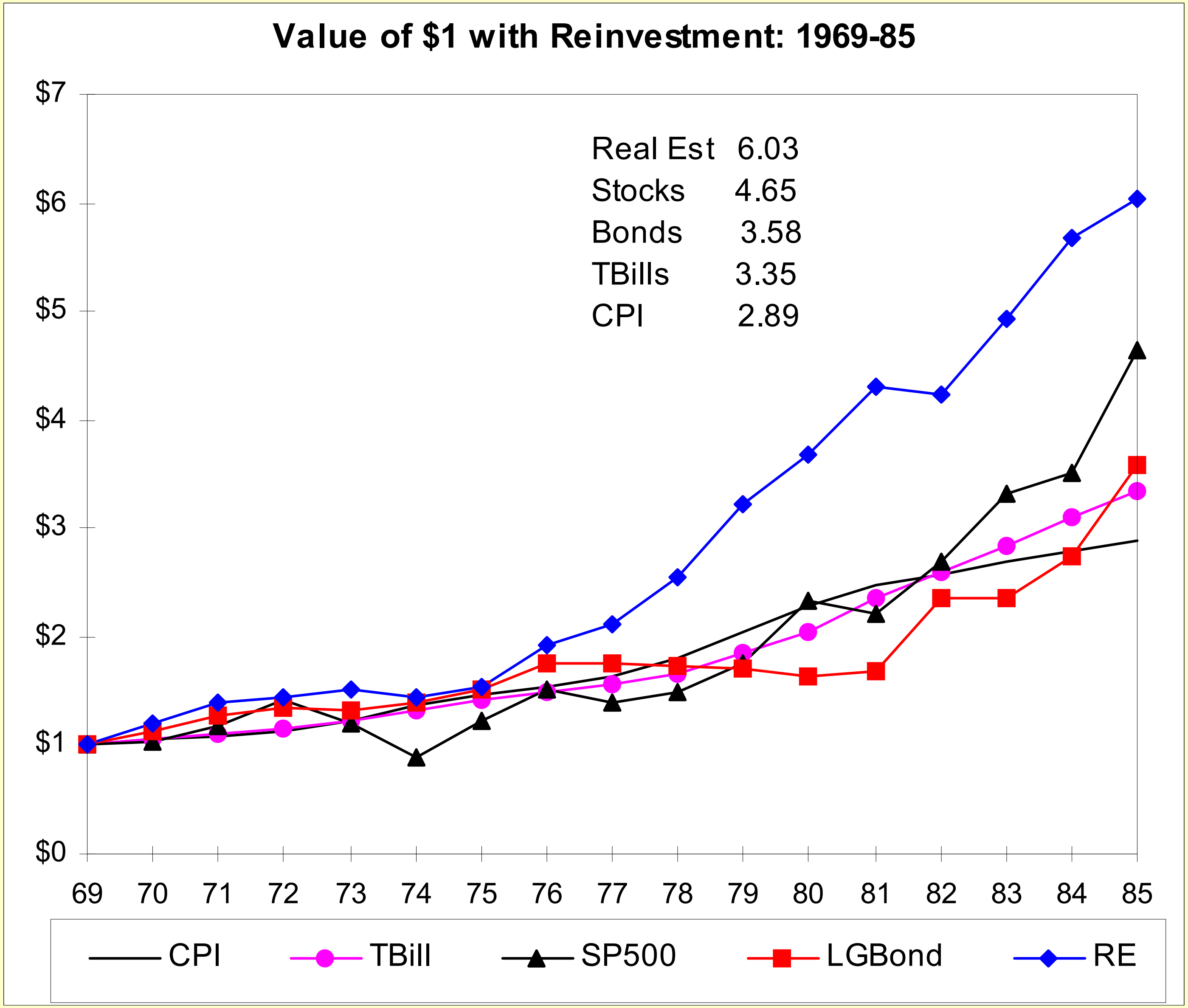
Exhibit 7-6: HISTORICAL PERFORMANCE OF MAJOR INVESTMENT ASSET CLASSES, COMPARED TO INFLATION (CPI), 1969-2001



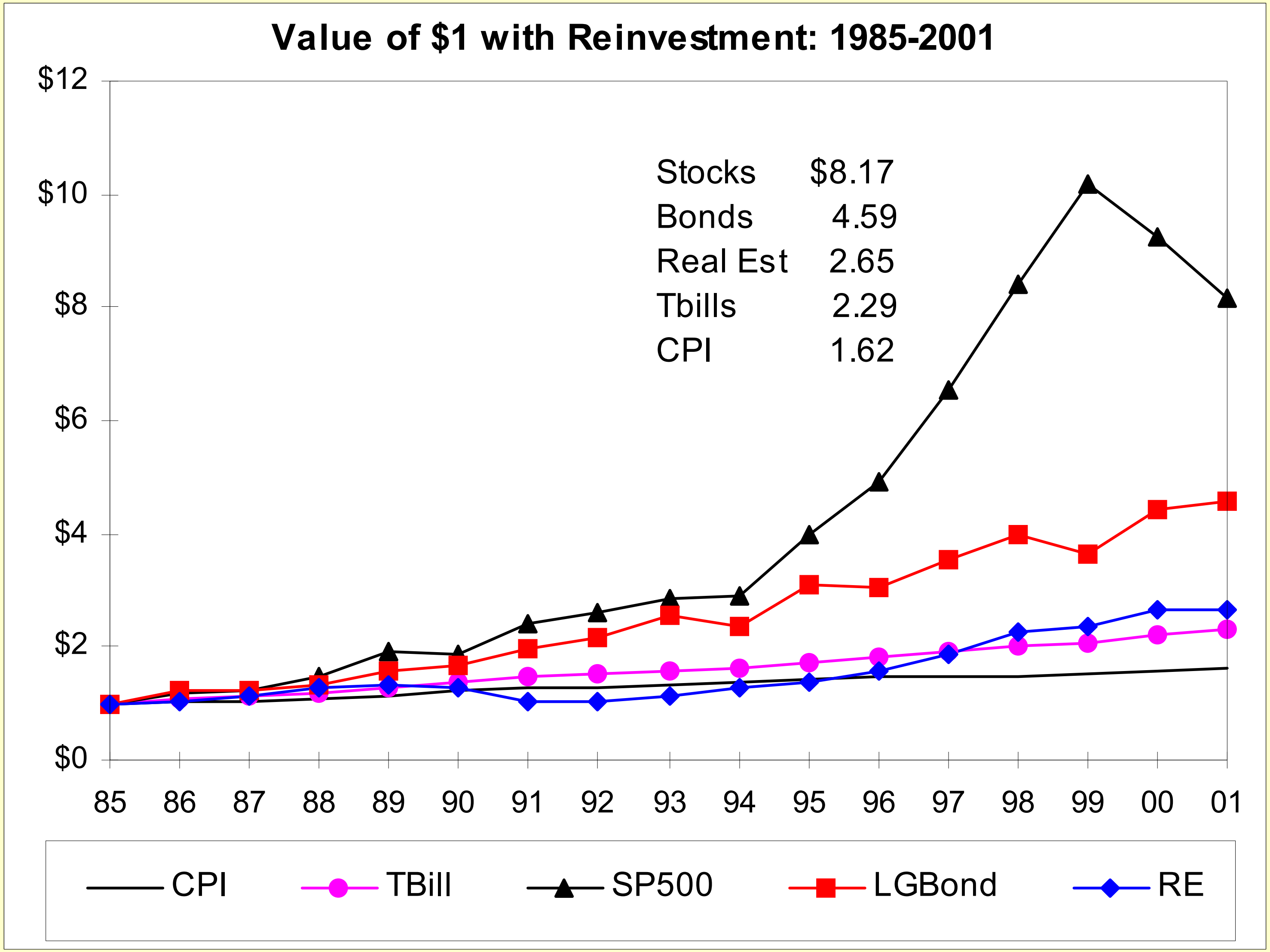
STATISTICS ON ANNUAL RETURNS (1970-2001):

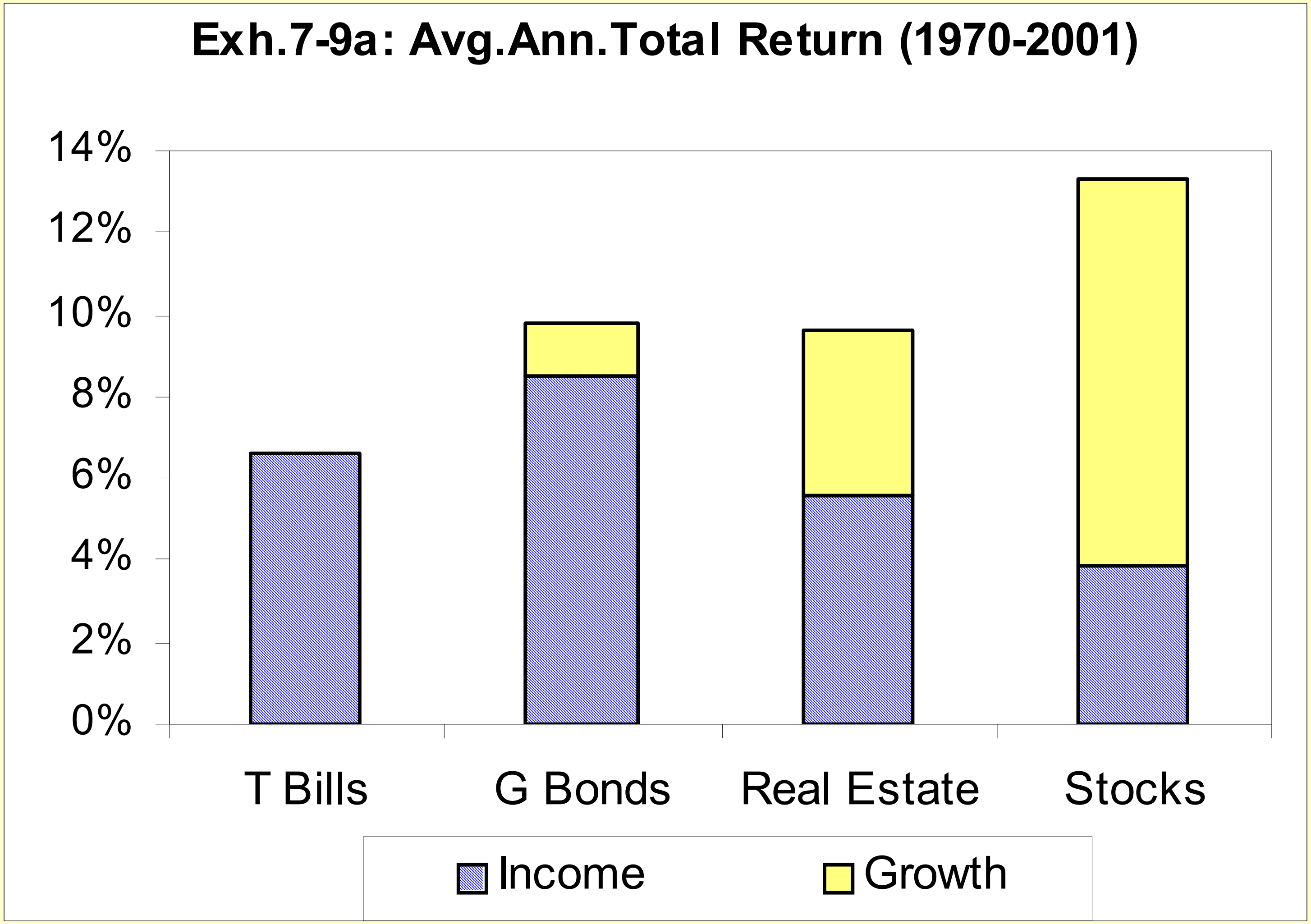
Asset Class	Average Tot.Return	Std.Dev		Average Inc.Return	Average Apprec.Ret
T Bills	6.61%	2.61%		6.61%	0.00%
G Bonds	9.75%	11.95%		8.54%	1.21%
Real Estate	9.65%	9.67%		5.57%	4.08%
Stocks	13.30%	16.67%		3.86%	9.45%
Inflation	4.99%	3.20%			

First half of the period…



Second half of the period…




Exh.7-9a: Avg.Ann.Total Return (1970-2001)
14%
12%
10%
8%
6%
4%
2%
0%
T Bills
G Bonds
Real Estate
Stocks
Income
Growth

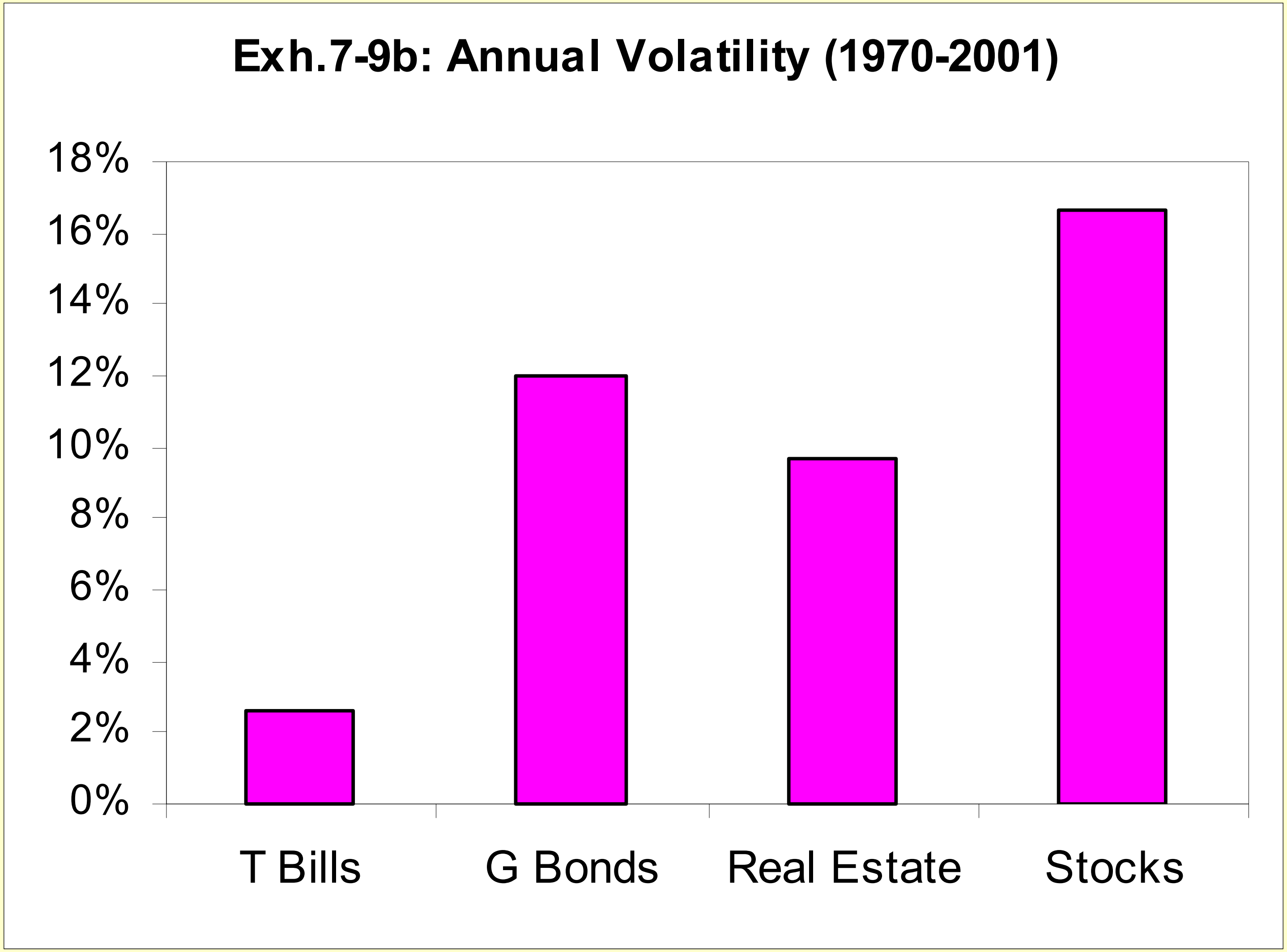

Exh.7-9b: Annual Volatility (1970-2001)
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
T Bills
G Bonds
Real Estate
Stocks

EXHIBIT 7-10: THE "ROLLER COASTER RIDE" IN COMMERCIAL PROPERTY PRICES OVER THE LAST ONE-THIRD-CENTURY . . .