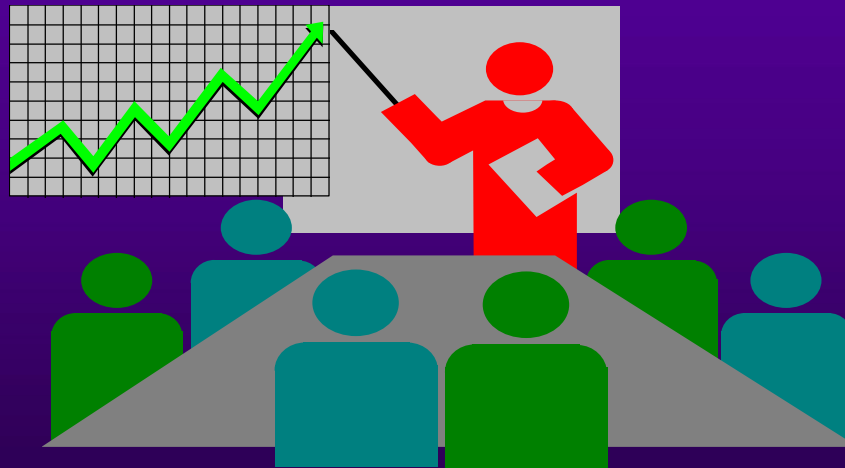


*An Understanding of the
Financial Markets
Guidelines of the Stock Market*





The Financial Pyramid

High Risk,
High Potential Return

Type of Financial Instrument

Commodities and
Stock Options

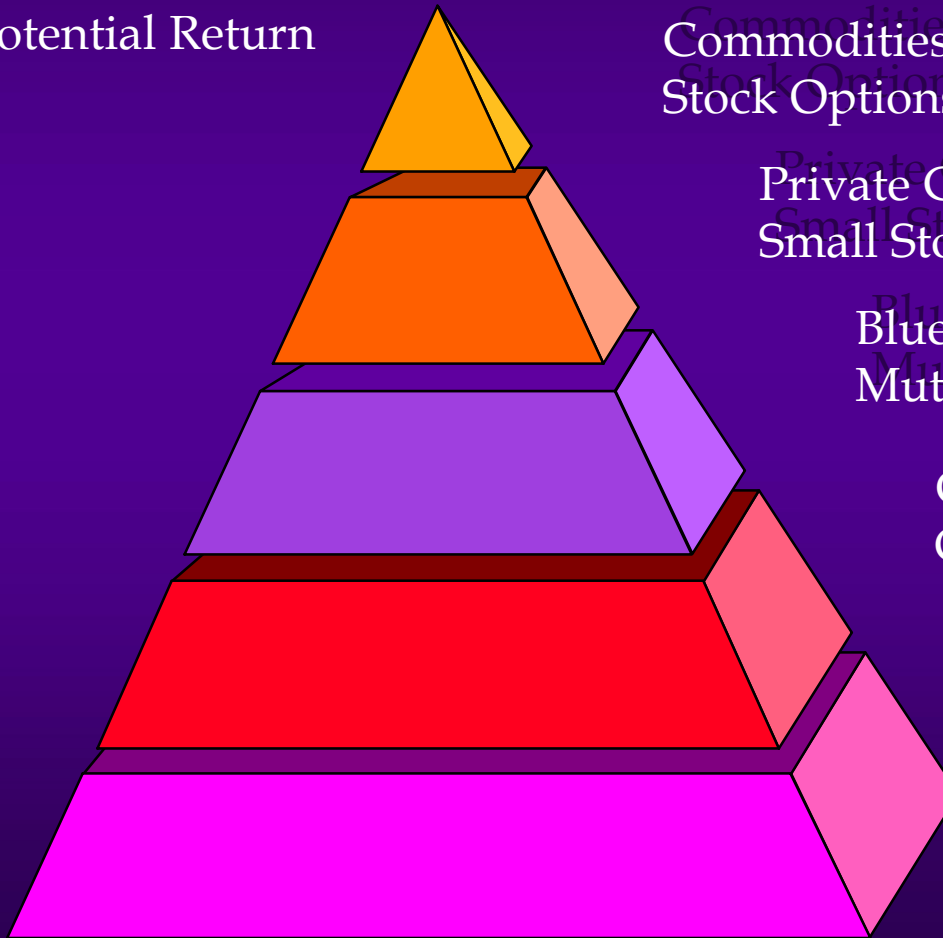
Private Companies
Small Stocks

Blue Chip Stocks
Mutual Funds

Corporate Bonds
Government Bonds

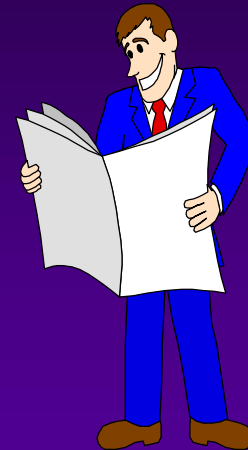
Real Estate
Certificates of Deposit
T-Bills
Bank Savings Account

Lower Risk,
Low Potential Return





Objective



- ◆ Gain an understanding of Stocks
 - ◆ What causes them to go up and down
 - ◆ Stock Market Terminology
 - ◆ Methods to valuing a specific Stock
 - ◆ What you need to know before buying any stock
- ◆ Learn the about other financial instruments:
Options, Mutual Funds, IRA's and 401K's



Overview of Stocks



- ◆ What is a Stock?
 - ◆ Stock is simply a representation of ownership within a company. If a company has 100 shares of stock outstanding and you own 10 shares you would own 10% of that company.
- ◆ When referring to the “Stock Market”, this is a reference to Publicly Held companies
 - ◆ A company that is not on the Stock Market is considered a Privately Held company.



Overview of Stocks, cont.

- ◆ Publicly held companies or Publicly traded stocks
 - ◆ The Stock Market allows easy partial ownership of a company and provides a easy method of buying and selling that ownership.
- ◆ Stocks go up and down due to the old adage of “Supply and Demand”
 - ◆ Simply put, a company that a lot of people want to own (high demand) will have a stock that goes up, and vice-versa, a stock that people are selling more heavily than buying, will go down.



Stock Market Terminology



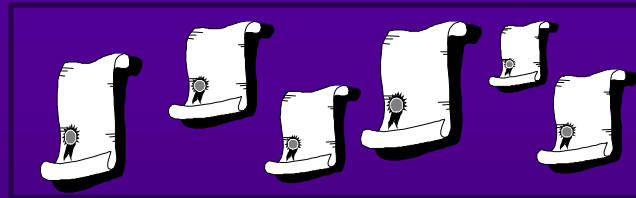
- ◆ “The Market was Up today”
 - ◆ When people say this what they really mean generally is that the Dow Jones Industrial average was traded up. The Dow Jones Industrial average is a composite of 30 major companies that are listed on the New York Stock Exchange. The average of these stocks is calculated constantly during the day to give an overall sense of direction of the Stock Market.
 - ◆ The S&P 500 is also a gauge of the market.



Stock Market Terminology

- ◆ Mutual Fund: A group of stocks that allows one person to buy into the fund and participate in ownership of a portion of all the stocks owned by the fund. Also a pooling of money to buy a group of stocks

- ◆ Fund



- ◆ Dividend: An amount paid by a company to shareholders out of profits earned, generally paid every quarter. I.e. \$.50 dividend per share per quarter on a \$40 stock would pay \$2 per share per year, or a 5% Yield.

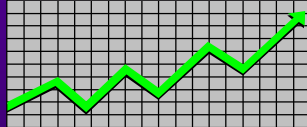
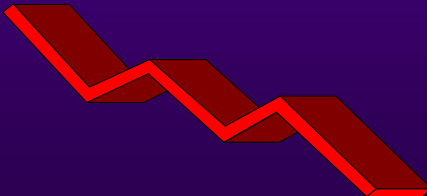


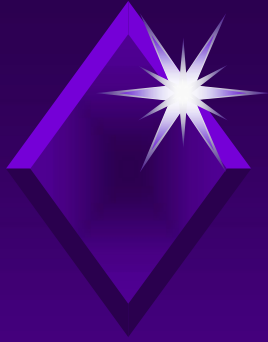
Stock Market Terminology

- ◆ Income Stock: One that provides a steady yield or high dividend.
- ◆ Growth Stock: One that does not typically provide a dividend but goes up consistently in value due to increase corporate earnings.
- ◆ Price Earnings Ratio: The relation of the Stock's current price divided by the earnings per share of the stock over the last 4 full quarters of business.
Example: A stock selling for \$40 that earned \$1.50 per share in the last year, would have a P/E Ratio of 26.6.
Calculated as $40/1.5 = 26.6$



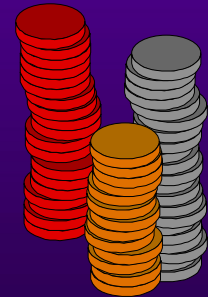
Stock Market Terminology

- ◆ Book Value: This is the 'net asset value' of the stock, represented on the balance sheet as 'Shareholders Equity'. $\text{Assets minus Liabilities} = \text{Shareholders Equity}$, this divided by the # of shares outstanding = Book Value per share
- ◆ Bull Market: A market that has a general trend upward.

- ◆ Bear Market: A market that has a general downtrend.




Stock Market Terminology

- ◆ Stock Split: A stock split is an increase in the # of outstanding shares, with a decrease in share price in equal ratio to the # of shares increased. The net asset value remains the same.
 - ◆ Example: Most common is a 2 for 1 stock split, this would mean the # of shares doubles and the price is cut in half.
 - ◆ Before the split you own, 100 shares at \$100
 - ◆ After the split you own, 200 shares at \$50
 - ◆ The Value in terms of Dollars does not change





Stock Market Terminology

- ◆ IRA: Individual Retirement Account, this account can hold individual stocks or share of a mutual fund.
- ◆ 401K: This is an account set up by employers for their employees that allows a person to invest money into it that is tax deferred until retirement and has a higher limit than IRA. Employers sometime match the employees contribution.



Determining a Stock's Value

- ◆ What is a Stock worth?
 - ◆ A Stock's value is based on many factors which can be viewed very differently by many people. But a stock is only worth or true value is "What someone else is willing to pay for that Stock".
- ◆ Brokers, Financial Analysts, and Fund Managers use various criteria to view a stock's value. The following are some of the common ways to value a companies stock, with most of them playing a factor. Rarely is one single method chosen.



Stock Valuation

- ◆ A stock can be calculated based on a company's projected earnings. This is generally done by taking the rate of growth or percentage and multiplying it by the earnings per share to come up with a reasonable valuation.
- ◆ A Stock's value can be based on the return on equity referred to as ROE. This is calculated simply by taking the Retained Earnings divided by the company's current equity.
- ◆ Book Value that was also mentioned is commonly used among banking stocks; however, less with high growth companies.
- ◆ Dividend Yield is commonly used when someone is looking for an income-producing investment.



Stock Options

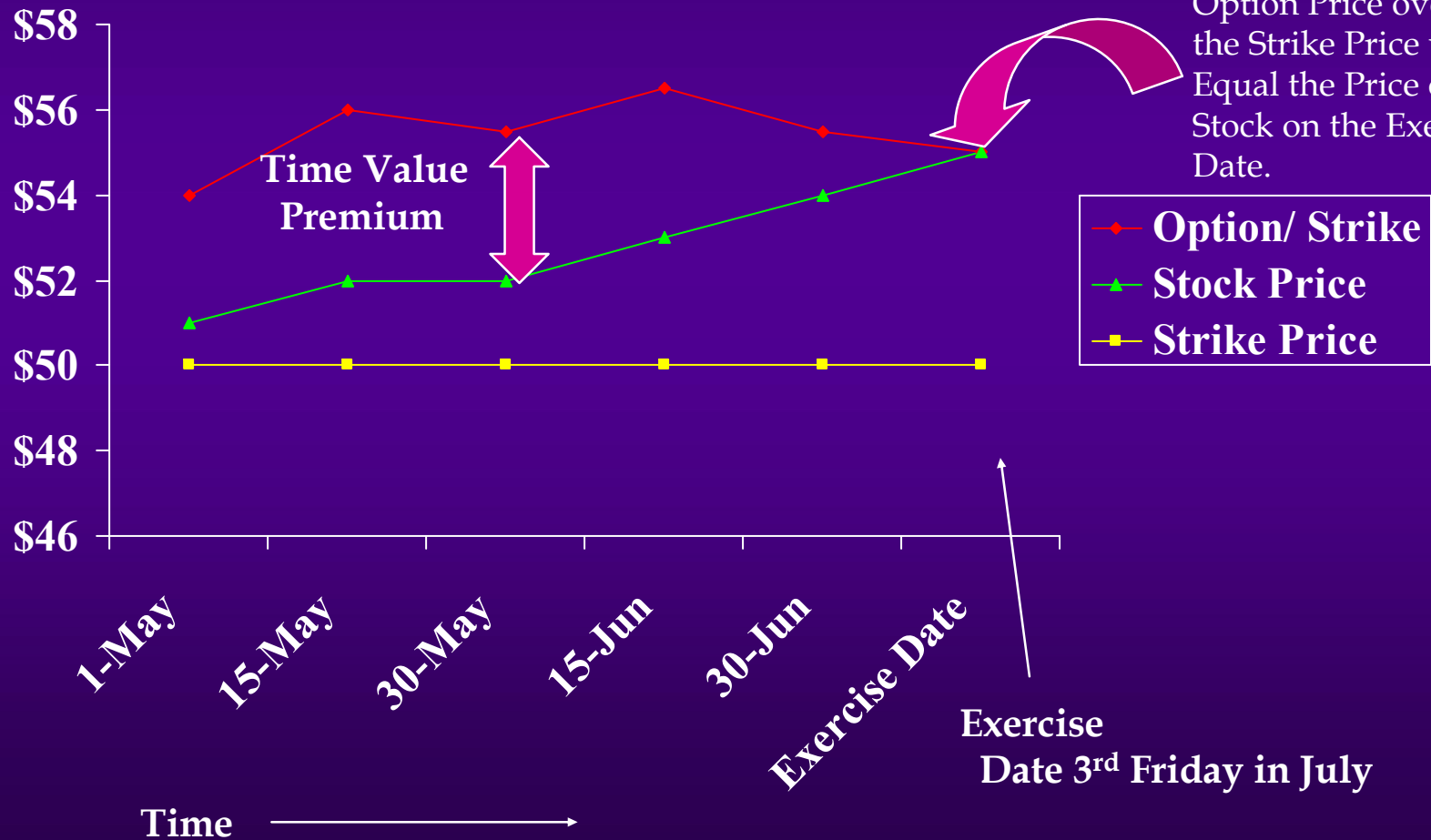
- ◆ A Stock Option is simply the “right but not the obligation” to purchase a set number of shares of a company at a preset price.
- ◆ The option price is based on the purchase price of the stock and the date in the future that one has the right to purchase the stock at the predetermined price.
- ◆ Options can be purchased on the open market or they are often granted by a company to an employee as an incentive to have them work for a company for a longer period.
- ◆ In the open market one can buy an ‘Option’ that allows them to buy a set number of shares on a set date but does not commit them to buy the shares on that date if the price is not attractive.



Stock Option Example #1

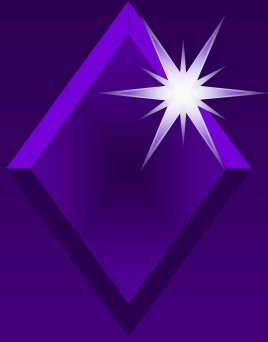
In the Money, \$1 Gain on Option

This Option Is a CALL
July 50 strike
Price on May
1st is \$400 per
Contract



The Value of the Option Price over the Strike Price will Equal the Price of the Stock on the Exercise Date.

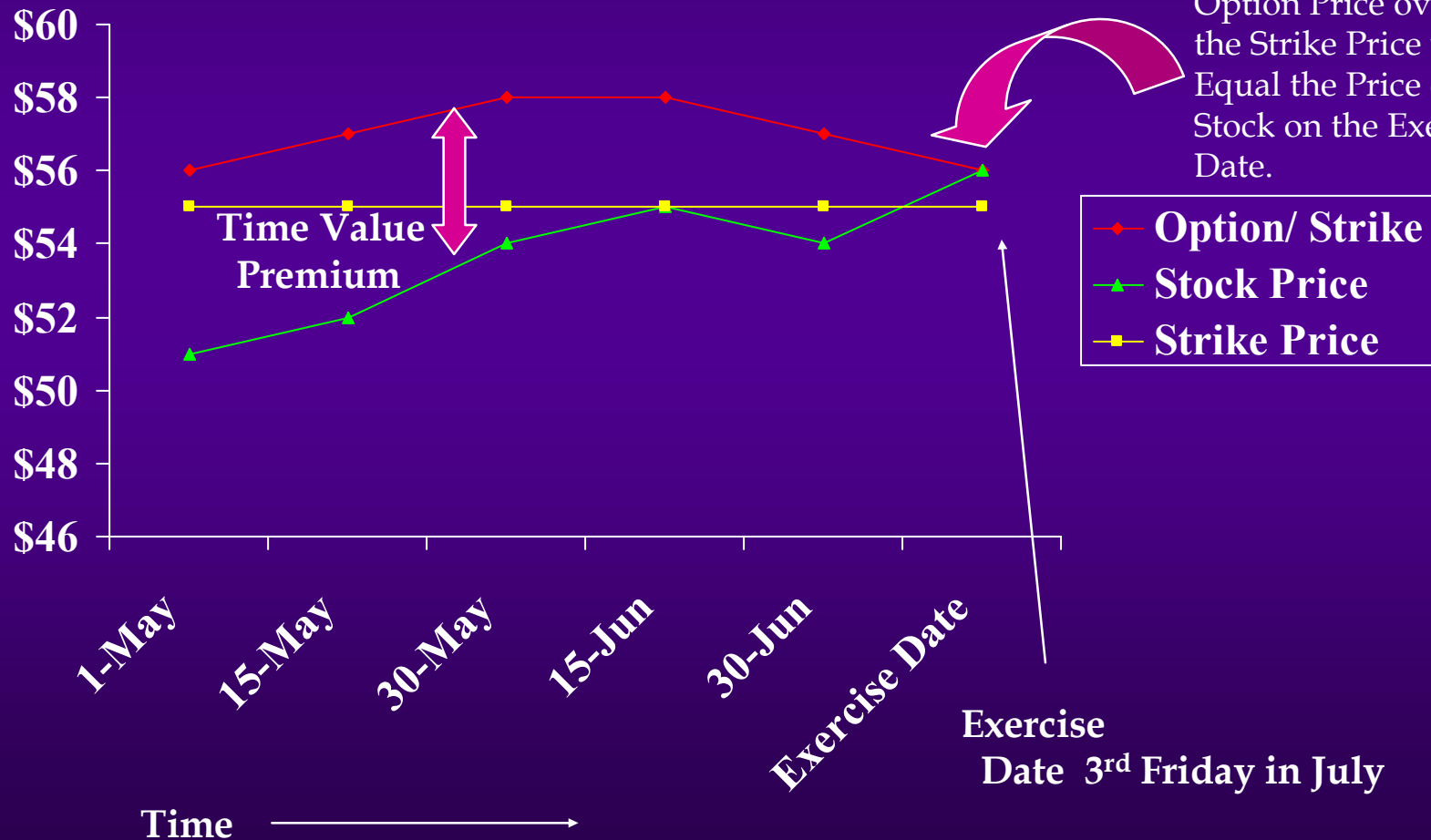
Exercise Date 3rd Friday in July



Stock Option Example #2

Out of the Money, Break Even

This Option
Is a CALL
July 55 strike
Price on May
1st is \$100 per
Contract



The Value of the
Option Price over
the Strike Price will
Equal the Price of the
Stock on the Exercise
Date.

- Option/ Strike
- Stock Price
- Strike Price

Exercise
Date 3rd Friday in July

Time →



Real World Example

- ◆ Understanding Purchasing and Selling
- ◆ Calls and Puts

Date 10/30/98

Current Stock Price \$89 $\frac{3}{16}$

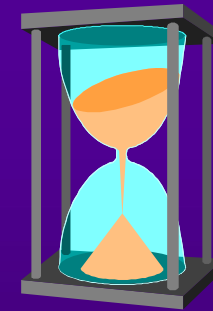
Intel Call Nov 90

Option at \$2 $\frac{3}{8}$

Breakeven: Stock at \$92 $\frac{3}{8}$

This is an out of the money Example

*Note: Paper trading is a great way to learn
Without incurring the risk of loss.



Time Premium of an Option is
the price of the option over the
stock price less the strike price of
the option.



Congratulations



Diploma

*You have
Completed a Basic
course on the
Financial Markets*