

Investments and Management

Investing Perspective Investments and Markets

Investments

Investment Management

What Does *Investment Management* Mean?

A generic term that most commonly refers to the buying and selling of investments within a portfolio. Investment management can also include banking and budgeting duties, as well as taxes. But the term most often refers to portfolio management and the trading of securities to achieve a specific investment objective.

Investopedia explains *Investment Management*

Investment management can take many forms. It can be done either by the consumer or a professional and can be passive, active, aggressive or conservative. It can refer to sophisticated trading techniques involving derivatives and alternative investments or merely the rolling over of CDs.

<http://www.investopedia.com/terms/i/investment-management.asp>

Investment and Markets

- Terminal Objectives
 1. Identify the primary types of securities markets and describe the IPO process.
 2. Explain characteristics of various securities exchanges.
 3. Learn about the over-the-counter markets and alternative trading systems

Investment Markets and Transactions

- Learning Goals (cont'd)
 4. Review the importance of global securities markets, their performance, procedures and associated risks.
 5. Discuss trading hours and regulation of securities markets.
 6. Explain the motives, procedures and calculations in long purchases, margin transactions and short sales.

Types of Markets

- **Money Markets:** market where short-term securities are bought and sold
- **Primary Market:** the market in which new issues of securities are sold to the public
- **Secondary Market:** the market in which securities are traded after they have been issued
- **Capital Market:** market where long-term securities such as stocks and bonds are bought and sold

Primary Markets

- Initial Public Offerings (IPO)
 - The Initial public sale of a company's stock
 - Requires SEC Registration and approval
- 3 Ways to Market Securities in Primary Market
 - Public offerings
 - Rights offering
 - Private Placements

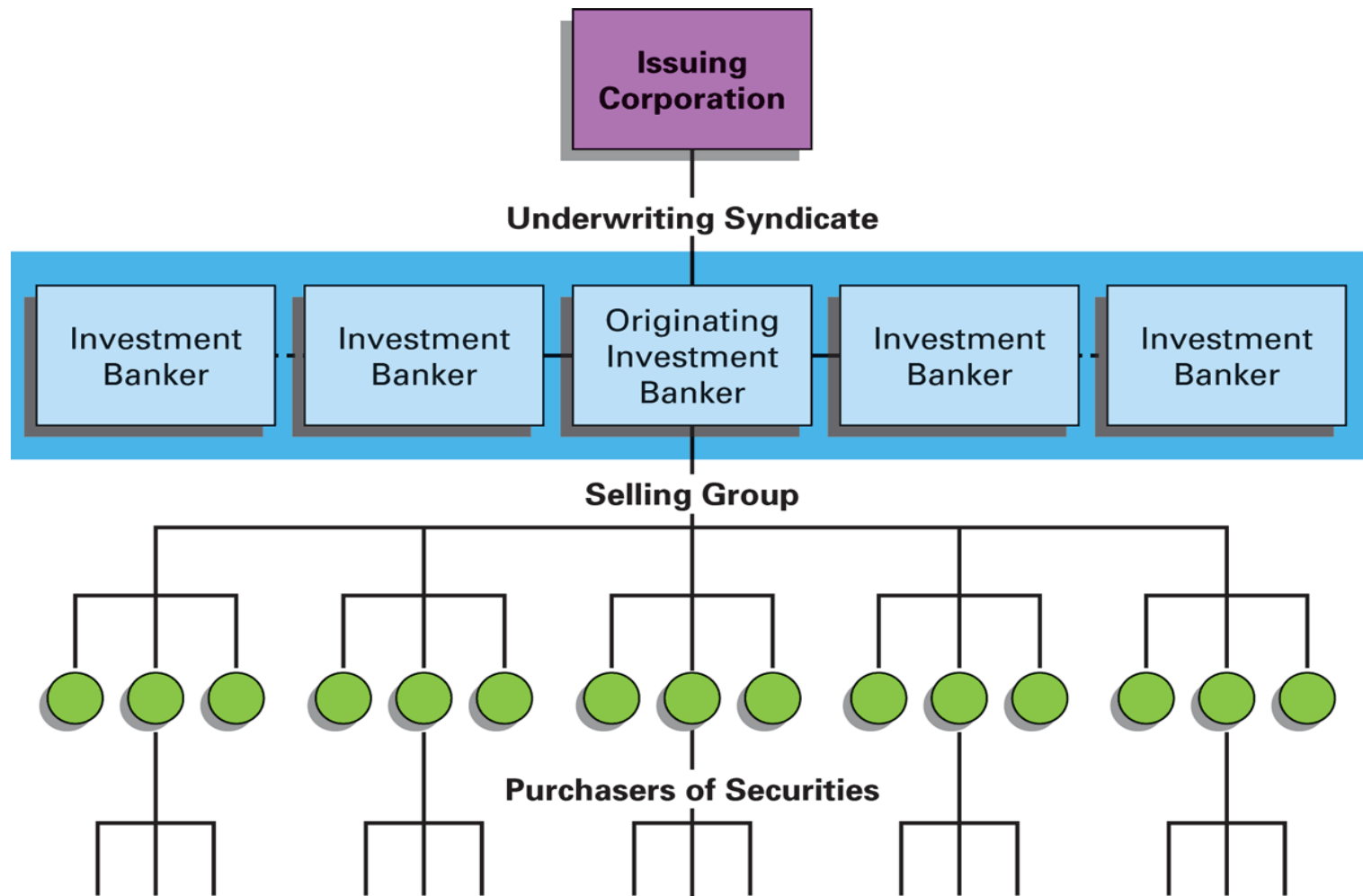
Going Public: The IPO Process

- **Underwriting of the offering:** The promoting the stock and facilitating the sale of company's shares
- **Prospectus:** The registration statement describing the issue and the issuer
- **Red Herring:** The preliminary prospectus available during the waiting period
- **The Quiet Period:** Time period after prospectus is filed when company must restrict what is said about the company
- **The Road Show:** series of presentations to potential investors

The Investment Banker's Role

- **Underwriting the issue:** purchases the security at agreed-on price and bears the risk of reselling it to the public
- **Underwriting syndicate:** group formed by investment banker to share the financial risk of underwriting
- **Selling Group:** other brokerage firms that help the underwriting syndicate sell issue to the public
- **Tombstone:** public announcement of issue and role of participants in underwriting process
- **Investment Banker Compensation:** typically in the form of a discount on the sale price of the securities

Figure 2.2 The Selling Process for a Large Security Issue



Secondary Markets

- **Secondary Market:** the market in which securities are traded after they have been issued
- Role of Secondary Markets
 - Provides liquidity to security purchasers
 - Provides continuous pricing mechanism
- **Organized Securities Exchanges:** centralized institutions in which transactions are made in already outstanding securities
- **Over-the-counter (OTC) Market:** widely scattered telecommunications network in which transactions are made in both initial public offerings and already outstanding securities

Securities Exchanges

- The New York Stock Exchange (NYSE)
 - Largest stock exchange—over 3,025 companies
 - Accounts for 90% of stocks traded on exchanges
 - Specialists make transactions in key stocks
 - Strictest listing policies
- The American Exchange (AMEX)
 - Second largest stock exchange—about 800 companies and 4% of stocks traded on exchanges
 - Major market for Exchange Traded Funds
 - Typically smaller and younger companies who cannot meet stricter listing requirements for NYSE

NASDAQ

- ***Nasdaq-NM* What Does *Nasdaq* Mean?**

A computerized system that facilitates trading and provides price quotations on more than 5,000 of the more actively traded over the counter stocks. Created in 1971, the Nasdaq was the world's first electronic stock market.

Organized Securities Exchanges (cont'd)

- Regional Stock Exchanges
 - Typically lists between 100–500 companies
 - Most listed stocks also listed on NYSE or AMEX
 - Best-known: Chicago, Pacific, Philadelphia, Boston, and Cincinnati
- Options Exchanges
 - Allows trading of options
 - Best-known: Chicago Board Options Exchange (CBOE)
- Futures Exchanges
 - Allows trading of financial futures (discussed in Chapter 15)
 - Best-known: Chicago Board of Trade (CBT)

Over-the-Counter (OTC) Market

- Nasdaq
 - Electronic network that connects OTC dealers with buyers and sellers
 - About 7,000 stocks trade on the Nasdaq
 - Both IPOs and secondary distributions are sold on OTC
- **Bid Price:** the highest price offered by market maker to purchase a given security
- **Ask Price:** the lowest price at which a market maker is willing to sell a given security
- LIMITS etc.. Day Only etc..

Alternative Trade Systems

- 3rd Market
 - Large institutional investors go through market makers on the OTC market
 - Institutional investors such as (mutual funds, life insurance companies, pension funds) receive reduced trading costs due to large size of transactions
- 4th Market
 - Large institutional investors can deal directly with each other to bypass OTC market makers
 - Electronic Communications Networks (ECNs) allow direct trading
 - ECNs account for about a third of all Nasdaq transactions

General Market Conditions

- Bull Market
 - Investor/consumer optimism
 - Economic growth and recovery
 - Government stimulus
 - Favorable markets
 - Rising prices
 - Lower Interest Rates?
- Bear Market
 - Low Consumer Confidence
 - Unfavorable markets
 - Falling prices
 - Economic slowdown
 - Government restraint
 - Investor/consumer pessimism

Globalization of Securities Markets

- **Diversification:** the inclusion of a number of different investment vehicles in a portfolio to increase returns or reduce risks
- Use of international securities improves diversification
 - More industries and securities available
 - Securities denominated in different currencies
 - Opportunities in rapidly expanding economies
- International Investment Performance
 - Opportunities for high returns
 - Foreign securities markets do not necessarily move with the U.S. securities market
 - Foreign securities markets tend to be more risky than U.S. markets

Globalization of Securities Markets (cont'd)

- Direct Ways to Invest in Foreign Securities
 - Purchase securities on foreign stock exchanges
 - Buy securities of foreign companies that trade on U.S. stock exchanges
 - Buy American Depositary Receipts (ADRs): dollar denominated receipts for stocks of foreign companies held in vaults of banks
- Indirect Ways to Invest in Foreign Securities
 - Buy mutual funds that invest in foreign securities

Risks of International Investing

- Usual investment risks still apply
- Government policies risks
 - Sovereign Risk of foreign governments
 - Unique offshore laws in trade, labor or taxation
 - Unstable economic and political conditions
 - Less regulation of foreign securities markets
- Currency exchange rate risks
 - Value of various foreign investments may go up and down with exchange rate fluctuations
 - Value of foreign currencies fluctuate compared to U.S. dollar

Trading Hours of Securities Markets

- Regular trading session for U.S. Exchanges and Nasdaq
 - 9:30 A.M. to 4:00 P.M. Eastern time
- Extended-hours electronic-trading sessions
 - Nasdaq: 4:00 P.M. to 6:30 P.M. Eastern time
 - Orders only filled if matched with identical opposing orders
 - 24-hour market probably in near future
- “After-hours” trades
 - Brokerage firms allow after-hours trading to individuals

Securities Laws and Markets

- The Securities Act of 1933
 - Primary Markets - Required full disclosure of information by companies
- Securities Act of 1934
 - Secondary Markets - Established SEC as government regulatory body
- Maloney Act of 1938
 - Allowed self-regulation of securities industry through trade associations such as the National Association of Securities Dealers (NASD)
- Investment Company Act of 1940
 - Created & regulated mutual funds

Regulation of Securities Markets

- Investment Advisors Act of 1940
 - Required investment advisers to make full disclosure about their backgrounds and their investments, as well as register with the SEC
- Securities Acts Amendments of 1975
 - Abolished fixed-commissions and established an electronic communications network to make stock pricing more competitive
- Insider Trading and Fraud Act of 1988
 - Prohibited insider trading on nonpublic information
- Sarbanes-Oxley Act of 2002
 - Tightened accounting and audit guidelines to reduce corporate fraud <http://www.sec.gov/about/laws.shtml#sox2002>

Monetary Policy

- **Investopedia explains *Monetary Policy***

In the United States, the Federal Reserve is in charge of monetary policy. The monetary policy is one of the ways the government attempts to control the economy. If the money supply grows too fast inflation will be too high if it is too slow economic growth slows which affects the gross domestic product GDP. In general the US attempts to maintain a steady inflation of between 2% to 3%.

- [http://www.investopedia.com/terms/m/monetarypolicy.as](http://www.investopedia.com/terms/m/monetarypolicy.asp)

p I.E. Taxes and Interest Rates

Types of Securities Transactions

- Long Purchase
 - Investor buys and holds securities
 - “Buy and sell – long term holding”
 - Make money when prices go up

Basic Types of Securities Transactions (cont'd)

- Margin Trading
 - Uses borrowed funds to purchase securities
 - Currently owned securities used as collateral for margin loan from broker
 - Margin requirements set by Federal Reserve Board
 - Determines the minimum amount of equity required
 - On \$4,445 purchase with 50% margin requirement, investor puts up \$2,222.50 and broker will lend remaining \$2,222.50
 - Can be used for common stocks, preferred stocks, bonds, mutual funds, options, warrants and futures

Margin Trading

- Advantages
 - Allows use of financial leverage
 - Magnifies profits
 - As portfolio grows, so does buying power
- Disadvantages
 - Magnifies losses
 - Interest expense on margin loan
 - Margin calls

Margin Formulas

- Basic Margin Formula

$$\begin{aligned}\text{Margin} &= \frac{\text{Value of securities} - \text{Debit balance}}{\text{Value of securities}} \\ &= \frac{V - D}{V}\end{aligned}$$

- Example of Using Margin

$$\text{Margin} = \frac{V - D}{V} = \frac{\$6,500 - \$1,200}{\$6,500} = 0.815 = \underline{\underline{81.5\%}}$$

Basic Types of Securities Transactions

- Short Selling
 - Investor sells securities they don't own
 - Investor borrows securities from broker
 - Broker lends securities owned by other investors that are held in "street name"
 - "Sell high and buy low"
 - Investors make money when stock prices go down

Short Selling

- Advantages
 - Chance to profit when stock price declines
- Disadvantages
 - **Limited return opportunities:** stock price cannot go below \$0.00
 - **Unlimited risks:** stock price can go up an unlimited amount
 - If stock price goes up, short seller still needs to buy shares to pay back the “borrowed” shares to the broker
 - Short sellers may not earn dividends

Table 2.5

The Mechanics of a Short Sale

TABLE 2.5 The Mechanics of a Short Sale

Step 1—Short sale initiated:

100 shares of borrowed stock are *sold* at \$50/share:

Proceeds from sale to investor \$5,000

Step 2—Short sale covered:

Later, 100 shares of the stock are *purchased*
at \$30/share and returned to broker from
whom stock was borrowed:

Cost to investor 3,000

Net profit \$2,000

Review

- Review of Topics
 1. Identify the basic types of securities markets and describe the IPO process.
 2. Explain the characteristics of organized securities exchanges.
 3. Understand the over-the-counter markets and alternative trading systems, and the general conditions of securities markets.

Review (cont'd)

- Learning Goals (cont'd)
 4. Review the importance of global securities markets, their performance, procedures and associated risks.
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 6. Explain the motives, procedures and calculations in long purchases, margin transactions and short sales.

Banking and Markets

What Does *Investment Bank - IB* Mean?

A financial intermediary that performs a variety of services. This includes underwriting, acting as an intermediary between an issuer of securities and the investing public, facilitating mergers and other corporate reorganizations, and also acting as a broker for institutional clients.

<http://www.investopedia.com/terms/i/investmentbank.asp>

ETF

- **Investopedia explains *Exchange-Traded Fund - ETF***

Because it trades like a stock, an ETF does not have its net asset value (NAV) calculated every day like a [mutual fund](#) does.

By owning an ETF, you get the diversification of an index fund as well as the ability to sell short, buy on margin and [purchase](#) as little as one share. Another advantage is that the expense ratios for most ETFs are lower than those of the average mutual fund. When buying and selling ETFs, you have to pay the same commission to your broker that you'd pay on any regular order.

One of the most widely known ETFs is called the Spider (SPDR), which tracks the S&P 500 index and trades under the symbol SPY.

Mutual Funds

- **What Does *Mutual Fund* Mean?**

An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

<http://www.investopedia.com/terms/m/mutualfund.asp>

- Loads, Open, Closed etc..

Options

- An option is a contract that gives the buyer the right, but not the obligation, to buy or sell an underlying asset at a specific price on or before a certain date. An option, just like a stock or bond, is a security. It is also a binding contract with strictly defined terms and properties.

- **Calls and Puts** - The two types of options are calls and puts:

A call gives the holder the right to buy an asset at a certain price within a specific period of time. Calls are similar to having a long position on a stock. Buyers of calls hope that the stock will increase substantially before the option expires.

A put gives the holder the right to sell an asset at a certain price within a specific period of time. Puts are very similar to having a short position on a stock. Buyers of puts hope that the price of the stock will fall before the option expires. <http://www.investopedia.com/university/options/option.asp>

Options

- **The Lingo**

To trade options, you'll have to know the terminology associated with the options market.

The price at which an underlying stock can be purchased or sold is called the strike price. This is the price a stock price must go above (for calls) or go below (for puts) before a position can be exercised for a profit. All of this must occur before the expiration date.

An option that is traded on a national options exchange such as the Chicago Board Options Exchange (CBOE) is known as a listed option. These have fixed strike prices and expiration dates. Each listed option represents 100 shares of company stock (known as a contract).

For call options, the option is said to be in-the-money if the share price is above the strike price. A put option is in-the-money when the share price is below the strike price. The amount by which an option is in-the-money is referred to as intrinsic value.

The total cost (the price) of an option is called the premium. This price is determined by factors including the stock price, strike price, time remaining until expiration (time value) and volatility. Because of all these factors, determining the premium of an option is complicated and beyond the scope of this tutorial

<http://www.investopedia.com/university/options/option.asp>

So Many Investment Types

- **21 Investments** 1) [20 Investments: Introduction](#) 2) [20 Investments: American Depository Receipt \(ADR\)](#) 3) [20 Investments: Annuity](#) 4) [20 Investments: Closed-End Investment Fund](#) 5) [20 Investments: Collectibles](#) 6) [20 Investments: Common Stock](#) 7) [20 Investments: Convertible Security](#) 8) [20 Investments: Corporate Bond](#) 9) [20 Investments: Futures Contract](#) 10) [20 Investments: Life Insurance](#) 11) [20 Investments: The Money Market](#) 12) [20 Investments: Mortgage-Backed Securities](#) 13) [20 Investments: Municipal Bonds](#) 14) [20 Investments: Mutual Funds](#) 15) [20 Investments: Options \(Stocks\)](#) 16) [20 Investments: Preferred Stock](#) 17) [20 Investments: Real Estate & Property](#) 18) [20 Investments: Real Estate Investment Trusts \(REITs\)](#) 19) [20 Investments: Treasuries](#) 20) [20 Investments: Unit Investment Trusts \(UITs\)](#) 21) [20 Investments: Zero-Coupon Securities](#)

Diagnosis of Assets.....

- Assets, Cash, Stock, Bond, Fund Investments
- Home, Real Estates
- Partnerships, LLCs, C-Corporations
- Children, Grandchildren, Parents and related assets
- Cash Flow, Burn Rate, College, Retirement
- Tax Deferred Vehicles 401K or other
- Insurance Policies and Beneficiaries
- Estate Planning Issues and Probate Issues
- Taxation issues on income or other
- Gaining confidence to produce a report.....

Tax Policy, Global and Debate

- In our recent courses, former and current IRS agents say that the agency is ramping up.
- Offshore investments will be more closely scrutinized.
- The UBS EFFECT is huge. Expected 1000 and got over 10,000 in amnesty?
- Philosophical Debate over what tax is too much for the hardest working i.e. Economic Slavery.

Defy the Market

- About 20 percent of stocks defy the markets
- Some are defensive
- When economy is bad, Wal-Mart does well...
- What sector is positioned to lead
- What is a market leader in that sector.
- Where are interest rates? If low, good for growth companies.
- What is regulation doing to the stocks you like?

Global Exposure?

- Over the last 20 years, global regional growth has been wild and made millionaires ..
- Brazil, Latin America, Russia, China, Taiwan, Africa, Korea and more.
- Many of these stocks trade on the American Exchange.
- Many of the companies have huge cost savings in labor, benefits, and materials.
- Technology to invest in other countries via funds or ETFs etc.

Who is Next?

- Will Internet have a 2nd Boom
- INDIA
- Indonesia Malaysia
- New China Stocks and New India Stocks that are listed on the USA exchange
- Parts of Africa who have the best legal systems and tax systems.
- USA? With new wave of technology?

What's Hot

- PDAs cell phones... IPOD
- IPAD
- Search Engines
- Software
- Education
- Health Care
- Travel, Job hunting, and more
- EBAY USA and EBAY in other languages
- Commodities – Gold, Silver, Copper etc.

The Jobs of the Future

Occupations with the largest percentage growth expected through 2018:

- Biomedical Engineers 72%
 - Network Systems Analysts 53%
 - Home Health Aides 50%
 - Personal, Home-Care Aides 46%
 - Financial Examiners 41%
 - Medical Scientists 40%
 - Physician Assistants 39%
 - Skin-Care Specialists 38%
 - Biochemists, Biophysicists 37%
 - Athletic Trainers 37%
- Source: Labor Department 'Occupational Outlook Handbook'

Back to the Future?

- Taxes are set to revert back to the Clinton Years.
- Politics is poised to mirror what happened in 1994
- Interest Rates are Low
- Legal and Financial Products of the 1990's may become very popular again: Insurance Trusts and Long Term Holding of Investments
- Global Confidence? Up Down for USA?
- Will business go offshore and will the cash stay offshore?

Laws that Apply – Of Course

- Confidentiality and Privacy
<http://www.ftc.gov/bcp/edu/pubs/business/idtheft/bus53.shtm>
- No Self Dealing – Shadow and Front
<http://www.investopedia.com/terms/f/frontrunning.asp>
- Conflicts of Interest <http://www.sec.gov/news/speech/spch051205css.htm>
- Suitability, Risk Tolerance, Objectives.. <http://www.sec.gov/answers/suitability.htm>
- Limitations on stocks and investments applying to account.
- Can't do anything without authority & permission.
- Protect Joint Accounts 401ks etc.
- Securities laws
- Investment Advisor Laws <http://www.sec.gov/investor/pubs/invadvisers.htm>
- Margin Rules and Laws <http://www.sec.gov/investor/pubs/margin.htm>
- Accredited Investors <http://www.sec.gov/answers/accred.htm>
- High Risk Investments, Options etc. <http://www.sec.gov/answers/options.htm>
- Binding Arbitration <http://www.sec.gov/answers/arbproc.htm>

Conclusion

- Taxes are secondary to earning and growing and protecting your assets and money.
- Buy assets and Create appreciation and worry about taxes later.
- If you don't like taxes, move to a state with no income tax to mitigate ongoing state taxes, but buy a small home or rent.
- Fed taxes do not apply to long term holdings until you SELL.
- Invest each month and each year into IRAs, 401Ks, self directed accounts, annuities.
- Or, just invest your after tax savings.

References

- 24 Essential Lessons for Investment Success by William O’Neil and CANSLIM
- **Beginners' Guide to Investing: Online Publications at the SEC -**
<http://www.sec.gov/investor/pubs/begininvest.htm>
- **Get the Facts: The SEC's Roadmap to Saving and Investing -**
<http://www.sec.gov/investor/pubs/roadmap.htm>
- <http://www.sec.gov/investor/pubs/takingstock.htm>
- **Beginners' Guide to Financial Statements.** This brochure will help you gain a basic understanding of how to read financial statements.
<http://www.sec.gov/investor/pubs/begfinstmtguide.htm>
- **View More Information on Different Types of Investments:**
<http://www.sec.gov/investor/pubs/investop.htm>
- [A Guide to Understanding Mutual Funds](#) – A publication from the ICI that explains mutual funds, describes how to establish realistic goals, and suggests questions to ask before you invest. (Provided in [PDF](#) format.)
- **Exchange-Traded Funds (ETFs) -**
<http://www.sec.gov/answers/etf.htm>