Smart Woman Securities

Understanding the Stock Market

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Tonight's Agenda

- Market Update – staying abreast of economic news
- Introduction to Stocks
- The Stock Market
- Stock Returns
- Risks of Investing in Stocks

Introduction to Stocks

What are Stocks?

- Share of ownership in a company
  - Proportionate claim to the earnings and assets of the company
  - Share of any dividends paid by the firm
  - As the value of the company increases, so does your stock's price
- "Public company" stocks are traded in the stock market for anyone to buy or sell
- Tickers
  - Abbreviated symbol for the firm
  - e.g. the ticker for Starbucks is (SBUX)

What are Stocks?

- Also known as “equities
  - Usually talking about “common stock”
  - Usually they represent an ownership claim
  - Contrast with a “bond” which is a loan that the investor has made to the firm
- Types of stock
  - Common stock - most prevalent; often sold to the public
    - Owners can vote to elect member of Board of Directors
  - Preferred
  - Treasury
- Market Capitalization = Number of shares outstanding x price of one share of stock
  - Changes every day
  - Large Cap: over $ 5 billion
  - Mid Cap: between $ 1 and $ 5 billion

StockClassifications

growth

- High growth potential due to market, product, segment, or company-specific situation.
- Hard to identify and usually risker
- Ex. pharmaceutical companies → specific drugs

value

- Stock that is undervalued
- Book value > current market price
- Typically sold off by investors for litigation, product issues, marketing etc.

income

- Companies with reliable track record of consistently paying dividends
- Popular with investors who want a steady inflow of income

Source: moneyinstructor.com

StockClassifications

cyclical

- Companies whose earnings tend to follow business cycle.
- Often more risky than stocks that are less subject to changes in the business cycle.
- Ex. Oil and natural resources, steel, and housing.

defensive

- Stocks that tend to remain stable or rise during periods of economic downturn.
- Show poorer results during economic upturn.
- Ex. food, beverages, and pharmaceuticals.

blue-chip

- Companies with a well established reputation and a long record of financial stability.
- Usually pays out dividends.
- “Blue-chip” designation is debatable

Source: moneyinstructor.com

The Stock Market

Financial Markets

- Publicly-traded versus Privately-held Corporations
  - Public company shares trade in a public stock market where any investor may buy or sell the shares.
  - Privately-held (a.k.a., closely-held) firms are organized as corporations and have equity, but their equity shares do not trade in a public market.
- Primary versus Secondary Market Transactions
  - Primary = firm sells securities to investors to raise capital.
  - Secondary = investors trade securities among themselves (the firm is not involved in these trades).

What is the Stock Market?

- The Stock Market or Equity Market is the total market for stocks/equities
  - All stocks available to publicly buy or sell
- The "Market" is Global
  - Total Global Market Capitalization is around $70 Trillion
  - Almost 60% of global Market Capitalization is outside the U.S.

What are StockExchanges?

- Stock Market vs. Stock Exchange
  - An "Exchange" is where you buy or sell stocks
  - The "Market" is ALL stocks traded on all exchanges
- U.S. and Global Stock Exchanges
  - Major U.S.
    - New York Stock Exchange (NYSE)
    - NASDAQ
  - Asia (Japan Exchange Group/Shanghai Stock Exchange/Hong Kong, etc.)
  - Europe (Euronext, London Stock Exchange, Deutsche Boerse, etc.)
- Stocks don't have to trade on an exchange. Lots of small companies are said to trade "Over the Counter" or (OTC).

Stock Index

- A **Stock Index** is a Group of stocks constructed to measure past performance and trends

- An index can be used as a proxy for how the “market” overall is performing

- A company’s stock can be, and often is, in multiple indices

U.S. Broad Stock Indices

- **Dow Jones Industrial Average (DJIA)**
  - The "Dow" is 30 "Blue Chip" stocks selected by the Wall Street Journal
  - Most widely quoted in the press but narrow representation of the broad market
  - Includes American Express (AXP), ExxonMobil (XOM), General Electric (GE), WalMart (WMT) and Verizon (VZ)
- **Standard & Poor's 500 (S&P 500)**
  - Primarily large cap U.S. stocks selected by Standard & Poors to give a broad representation of the U.S. stock market
  - The S&P500 is the Standard Institutional Benchmark and measure of stock market performance
  - Most mutual funds and other managers are ultimately compared the S&P500 for benchmarking

Stock Returns

Why Do Stock Prices Change?

- **Short-term:**
  - o Company Specific News
  - o Industry News
  - o Earnings Announcements
  - o Direct Competitor Makes an Announcement
  - o General Investor Confidence
- **Long-term:**
  - o The company becomes more valuable
  - o Company has increased earnings, which occurs when a company is increasing revenue (selling more), cutting costs, or a combination of both
  - o People believe the future looks better for a company (valuation)

  – Short term fluctuations are often hard to understand so market timing is tough

  – In SWS, we focus on long-term price changes as we can conduct research here to help us determine what will happen. We look at a minimum investment of one year.

Stock Returns

- **Returns** - What you "get" from your investment; 2 possible sources
  - **Dividends** - a cash payment that is made to stockholders
  - **Capital Gains** – change in price of your shares, net of commission fees
    - o Current Price minus Purchase Price
    - o Realized (what you earn if you sell)
    - o Unrealized (paper return if you don't sell, but continue to "hold" the stock)

- **Annual Pre-Tax Rate of Return**

$$R = \frac{Dividends}{Purchase\ Price} + \left(\frac{Current\ Price - Purchase\ \ Price - Commission\ Fees}{Purchase\ Price}\right)$$

$$R = \left(\frac{Current\ Price + Dividends - Commission\ Fees}{Purchase\ Price}\right) \ -1$$

For >1 year, $R = \left(\frac{Current\ Price + Dividends - Commission\ Fees}{Purchase\ Price}\right)^{\frac{1}{\#years}} -1$

Stock Returns

- **Annual Pre-Tax Rate of Return Formula**

$$R = \left(\frac{Current\ Price + Dividends - Commission\ Fees}{Purchase\ Price}\right)^{\frac{1}{\#years}} - 1$$

Example:

- January 1, 2007 – You buy 100 shares of Chipotle (CMG) for $55 per share or $5500.
- January 1, 2008 – The stock is $127 per share, you continue to hold and don't sell. You have an unrealized gain of $7200, (127-55)*100, which is an annualized rate of return of 131% = (12,700/5500) - 1
- January 1, 2009 – The stock is $53 per share, you continue to hold and don't sell. You have an unrealized loss of $200 (53-55)*100, which is an annualized rate of return of -2% = $(5300/5500)^{1/2}$ - 1.
- January 1, 2010 - The stock is $92, you decide to sell. You have a realized gain of $3700 (92-55)*100, which is an annualized rate of return of 19%.

  $(9200/5500)^{1/3} - 1 = 19\%$

Years	# of Shares	Purchase Price	Current Price	Gain/Loss	Return	Realized
1	100	55	127	7200	131%	No
2	100	55	53	-200	-2%	No
3	100	55	92	3700	19%	Yes

Commissions, Dividends and Taxes

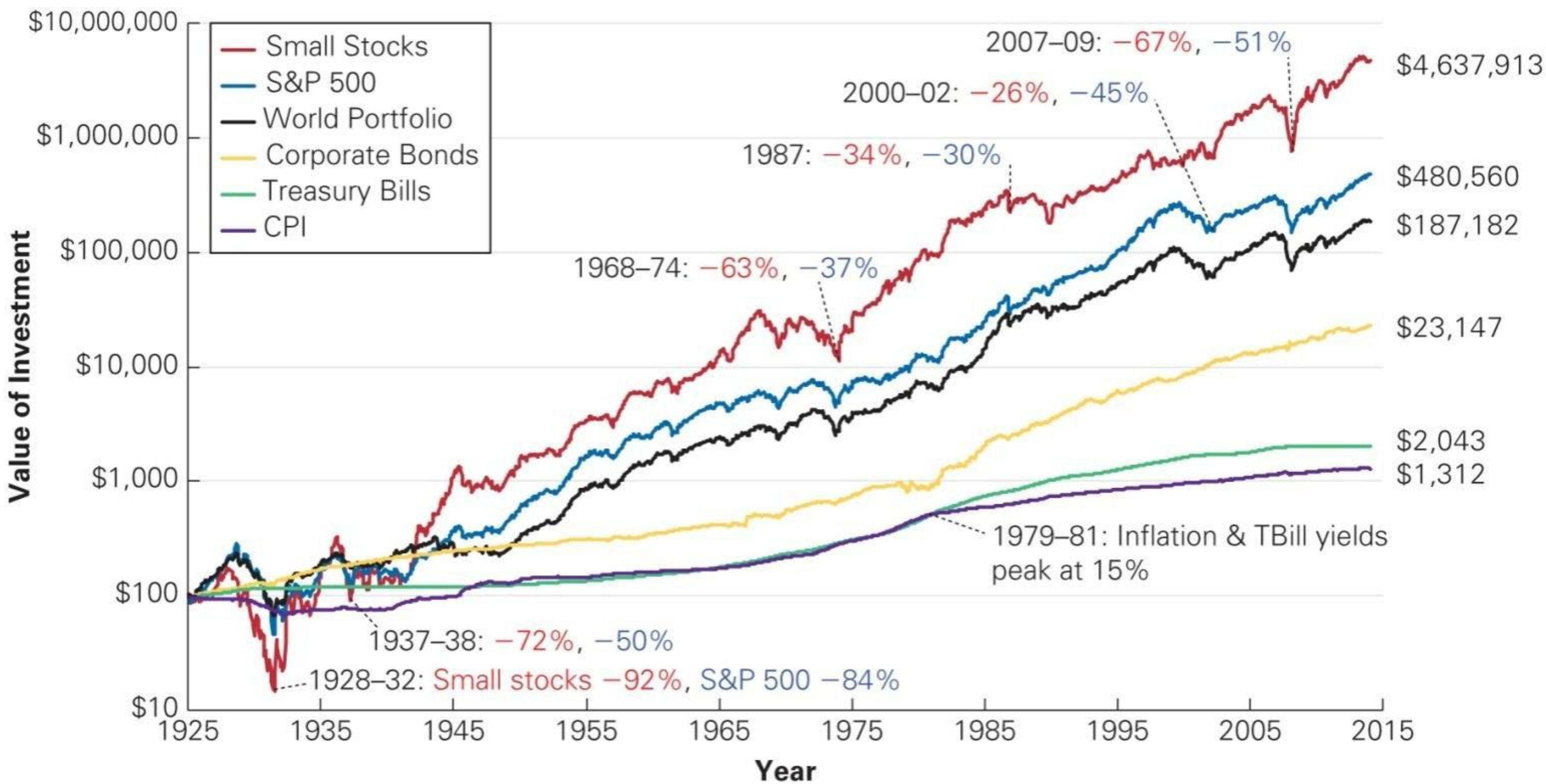
- **Commissions** - fees that a broker charges you to buy or sell a stock
  - Always pay attention to fees, especially if you are only buying a few shares. It may make sense to buy fewer stocks and more shares of each one.
- **Dividends** -a cash payment made to shareholders
  - Dividends will increase your return
  - Typically, larger, more mature companies issue dividends
- **Taxes-** You have to pay taxes on your dividends and realized investment gains.

Risks of Investing in Stocks

Stocks are risky in the short run, but

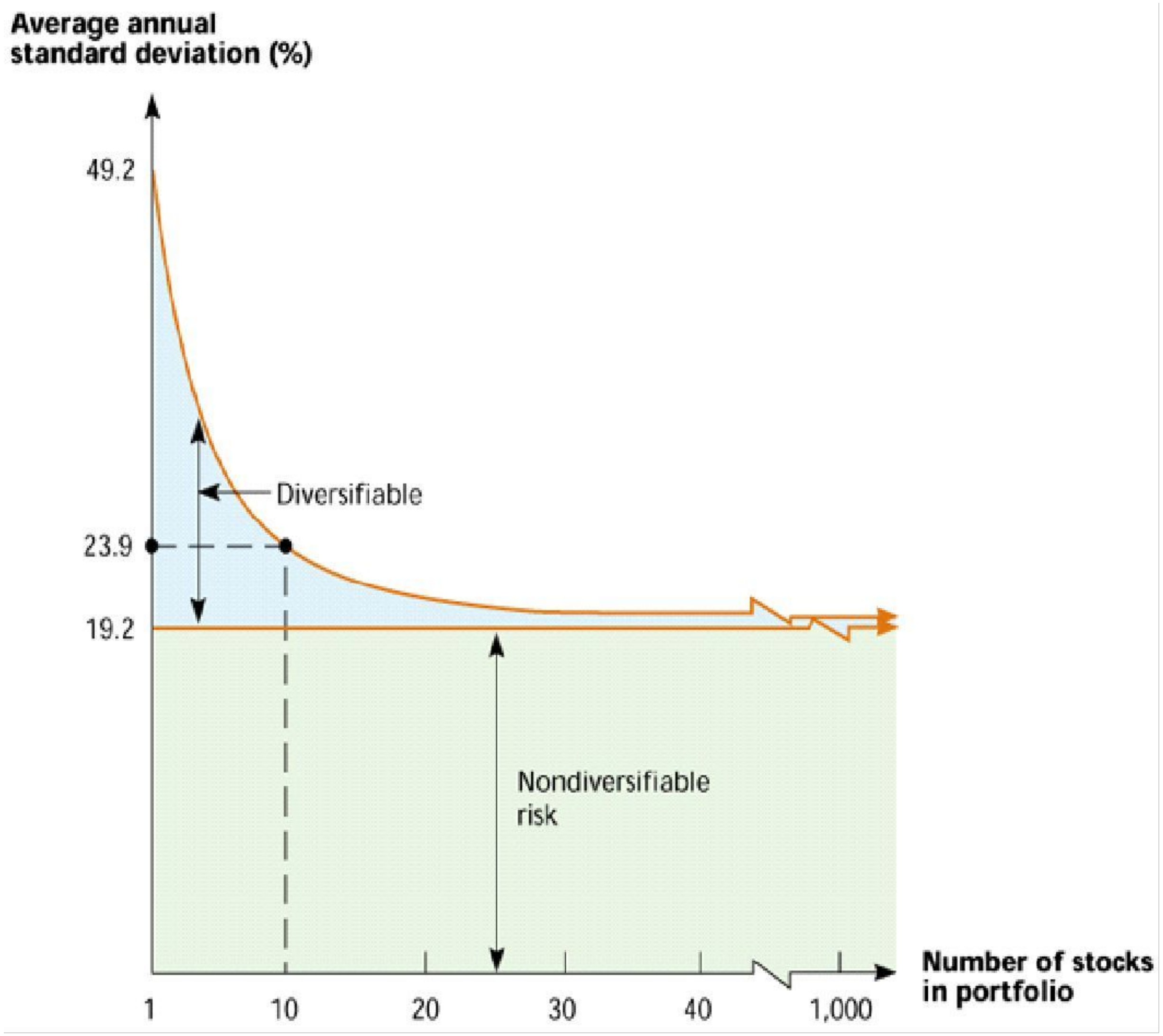
- **Consider your return based on the S&P 500 this year**
  - **December 31, 2018: 2506.85**
  - **Friday's close: 2992.07(up 19.4% on the year until Friday 9/20/19)**
  - **But, December 29, 2017: 2673.61 (down – 6.2% for 2018 year)**
- **Biggest single day losses in S&P 500:**
  - **October 19, 1987 -20.47%**
  - **October 15, 2008 -9.03%**
  - **December 1, 2008 -8.93%**
  - **September 29, 2008 -8.81%**
  - **October 26, 1987 -8.28%**
  - **October 9, 2008 -7.62%**
- **There have been 16 days with losses of more than 6% in a given day**

Provide good returns in the longrun



Source: Chicago Center for Research in Security Prices, Standard and Poor's, MSCI, and Global Financial Data.

And, diversification dramatically reduces the overall risk



Dangers of Market Timing

Annualized Returns for Hypothetical $10,000 Investment in the S&P 500 (10 Years Ending December 31, 2006)

	End Value	Return
Fully invested	$22,447	8.42%
Minus 10 best days	$13,985	3.41%
Minus 20 best days	$9,632	(0.37%)
Minus 30 best days	$6,909	(3.63%)

Investing Tips

- Means to an End – Not A Competition
  - No One Investment or Investment Style Fits All
  - Pick "Your" Way
- Have a Long-Term View
  - Avoid market timing strategies
- Diversify, Diversify, Diversify
  - Stocks, Bonds Cash
  - Large Cap, Small Cap, International
  - Balance of Growth and Value Styles
- Stay Emotionally Balanced
  - Understand Your Risk

Seminar Recap

- Many different types of companies and stocks, which change with time
- Must understand what meets your investment goals and invest in those types of stocks and investment vehicles
- Investors are not always rational, which leaves opportunities for you to invest
- Stocks are riskier than many other investments, but provide the best opportunities for return over the long run.