

# Savings, Investments & the Stock Market



# What To Do With Income?

- **Pay taxes**
- **Spend it (consume today)**
- **Save it (delay consumption to future)**
- **Invest it**
  - **Using money you have saved to purchase a product that will create benefits in the future**
  - **Saving and investing involves trade-offs**

# Saving and Investment

## □ Saving

- Not consuming all current income
- Examples: Savings Account, Certificate of Deposit

## □ Business Investment

- Production and purchase of capital goods
- Examples: machines, buildings and equipment that can be used to produce more goods and services in the future

## □ Personal investment

- Purchasing financial securities
- Examples: stocks, bonds, real estate, mutual funds
- Pay a higher rate of return in the long run than the interest paid on savings accounts.

# Return, Risk and Liquidity

- **Rate of Return -Type of profit or loss you are getting on your investment (Interest on savings)**
- **Liquidity – ease of turning assets into money**
- Return and Risk (direct relationship)
  - Greater risk, higher returns (NASDAQ stocks)
  - Less risk, lower returns (CD)
- Return and Liquidity (inverse relationship)
  - Greater liquidity, lower return (CD)
  - Less liquidity, greater return (Bonds)

# How Liquid are the Following?

1. \$20 Traveler's Check
2. 30 Day Treasury Bill
3. Share of Microsoft Stock
4. \$5,000 Savings Account
5. Apartment Complex
6. \$1 (Dollar) Bill
7. Gold bullion
8. IBM 20-year Bond
9. Share in money-market mutual fund
10. Credit card with \$5,000 line of credit
11. Eurodollar savings account in a Swiss Bank
12. Your House
13. Oil painting by Monet

*Categorize as “very liquid,” “somewhat liquid” or “illiquid”*

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# Major Exchanges

- ▣ ***NYSE - New York Stock Exchange – “The Big Board”***
  - Founded in 1792, the oldest and most prestigious stock exchange in the U.S. – 3,000 mostly large-cap companies
- ▣ ***NASDAQ - National Association of Securities Dealers Automated Quotation System -***  
computerized national trading system that lists more than 5300 small-cap & technology companies
- ▣ ***AMEX - The American Stock Exchange*** founded in 1842 as the New York Curb Exchange – 700 companies

# Blue Chips

- Largest most consistently profitable companies that usually pay dividends
  - Coca-Cola
  - General Electric
  - McDonald's
  - Exxon-Mobile
  - Wal-Mart
  - Gillette





# Types of Stocks

## □ Common Stock

- The most basic form of ownership that a corporation issues.
- It designates that you own a fraction of the company.
- The value of a common stock is directly influenced by the successes and failures of the issuing company.
- It may or may not pay a dividend, which is the portion of the company's profits paid out to its shareholders.

## □ Preferred Stock

- They receive their dividends before common stock owners
- If the company goes out of business, preferred stockholders are paid back the money they invested before the common stockholders
- For these reasons, preferred stock is generally less risky than common stock
- The main drawback of preferred stock is that it cannot benefit as much from company profits because it only pays a fixed dividend

# Capital Gains and Dividends

## □ Capital Gains

- A profit made when selling stock at a higher price than they paid for it. Most people buy stock to make money from capital gains.
- For example, if you buy 100 shares of Company XYZ at \$100.00 a share (a total \$10,000 investment) and sold it for \$125.00 a share (\$12,500), you've realized a capital gain of \$25.00 a share, or \$2,500.00.

## □ Dividends

- Dividends are the distribution of profits from a company to the stockholders
- Investors buy stock for the dividend payments.
- For example, if Company XYZ declares an annual dividend of \$10.00 a share and you own 100 shares, you'll earn \$1000.00 a year, or, \$250.00 paid each quarter.

## □ Who Decides Dividends?

- A company's board of directors decides how large a dividend the company will pay, or whether it will pay one at all.
- Quarterly dividend payments are the most common; annual and semiannual payments are less common.
- Usually only large, established companies pay dividends.
- This is because smaller companies need to reinvest their profits to continue growing.

# IPO – Initial Public Offerings

- Taking a company through a public offering on the U.S. securities markets is a major undertaking
- It is a source of pride, an opportunity for business growth, and a serious legal responsibility.
- Great way to get growth money for expansion.
- Downside – give up control

# Why Invest in Stock?

- Earn regular income – dividend payments
- Buy low, sell high...hopefully 😊
  - Sell at higher price than you bought?
    - Capital gain
  - Sell at lower price than you bought?
    - Capital loss
  - When do you reap the benefits?

# Market Cycles

## □ Ups and Downs

- Throughout its history, the stock market has tended to move in cycles of activity.

□ The stock market is greatly affected by economics, social, and political factors.

□ While it's impossible to predict the market's future activity, one thing is certain: The stock market will continue to experience ups and downs.



# Bull and Bear Markets

- **Bull: attacks by thrusting horns up (positive)**
  - Optimistic outlook, investor confidence
  - Prices rising or expected to rise
  - Can apply to anything that is traded
- **Bear: attacks by swiping paw down (negative)**
  - Prices falling or expected to fall
  - Enter a downturn of 15-20% in multiple indexes
- **Psychological effects & speculation**

# Indexes

- Each exchange calculates an index, or benchmark, based on the activity of its member companies' stock prices.
- "The market's up" or "the market's down," refers to the Dow Jones Industrial Average. It is considered a reliable indicator of the strength - or weakness - of stocks in general. Composite of 30 companies.

# Market Indices & Averages

- A short list of the major U.S. indices:
  - Dow Jones Industrial Average (DJIA)
  - Dow Transports (DJTA)
  - Dow Utilities (DJUA)
  - DJ Wilshire 5000
  - NASDAQ Composite / NASDAQ 100
  - S&P 500 Index (S&P 500) / S&P 100
  - Russell 2000
  - NYSE and AMEX Composites

# Circuit Breakers

- **After the 1987 stock market crash, the NYSE instituted automatic thresholds to reduce market volatility caused by program trading.**
- **These thresholds, know as "circuit breakers," are updated quarterly and use the Dow Jones Industrial Average as their benchmark. The current thresholds are:**

# Three Thresholds

## ▣ *800 Point Drop*

- An 800-point drop will halt trading for one hour if it occurs before 2:00 pm; 30 minutes if between 2:00 pm and 2:30 pm; the drop will have no effect between 2:30 pm and 4:00 pm

## ▣ *1,600 Point Drop*

- A 1600-point drop will halt trading for two hours if it occurs between 1:00pm; one hour if it occurs between 1:00 and 2:00 pm; and halt trading for the day after 2:00 pm.

## ▣ *2,350 Point Drop*

- A 2350-point drop will halt trading for the remainder of the day, regardless of the time it occurs.

## Days with Greatest Percentage Lost

Rank	Date	Closed	Net Change	% Change
1	10/19/1987	1738.74	-508.00	-22.61
2	10/28/1929	260.64	-38.33	-12.82
3	10/29/1929	230.07	-30.57	-11.73
4	11/06/1929	232.13	-25.55	-9.92
5	12/18/1899	58.27	-5.57	-8.72
6	08/12/1932	63.11	-5.79	-8.40
7	03/14/1907	76.23	-6.89	-8.29
8	10/26/1987	1793.93	-156.83	-8.04
9	07/21/1933	88.71	-7.55	-7.84
10	10/15/2008	8577.91	-733.05	-8.54

# Mutual Funds

## □ What is a mutual fund?

- Diversification of portfolio in one fund
- Several businesses to spread risk
- Not a traditional bank deposit
- NOT insured by FDIC
- NOT guaranteed by banks
- Mutual funds carry risk, including the possible loss of principal.