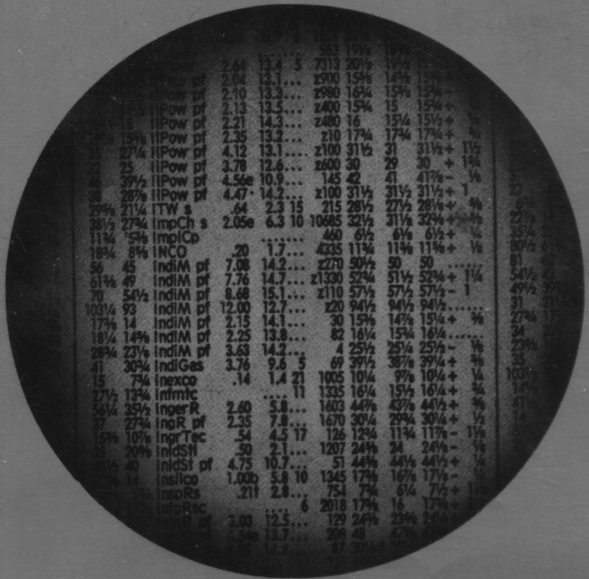
STOCKS AND BONDS PROFITS AND LOSSES:

A QUICK LOOK AT FINANCIAL MARKETS

BY ELAINE SCOTT



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Stocks and Bonds, Profits and Losses

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A Quick Look at Financial Markets

by Elaine Scott

Franklin Watts
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Contents

For Moya and Jerry, because friendship is the best investment of all.

Stocks and Bonds, Profits and Losses

1

Getting Down to Basics

Stocks and Bonds and What They Are

Nearly every person reading this book has probably, at one time or another, played the game of "Monopoly." At the beginning of the game each player is given $1,500 to invest in real estate, railroads, and utility companies, and the player who turns his $1,500 into the most money wins. Throughout the game, players try to increase the money they make, their profits (a *profit* is the money a business has left after its expenses are paid), by charging other players "rent" when they land on their property, or collecting payment for the "ride" should they land on their railroads, or charging them a varying fee if they land on the electric company or the water company and thus "use" those utilities. In addition to money they get from their properties, players can win, or lose, extra money from other sources, depending on the cards they draw from stacks called Chance and Community Chest. There is one card, among many others, in the Chance stack that says "Bank pays you dividend of $50.00," another from Community Chest that says "From sale of stock you get $45.00."

Throughout the years probably millions of games of "Monopoly" have been played by hundreds of thousands of people. Boys and girls, men and women, have collected $50 from the dividend card and $45 from the stock sale card over and over again. However, many young people who collect that money may not know what a dividend or a share of stock is. They may realize that dividends and stock sales can generate income—money—in the game of "Monopoly," and therefore are good things to have, but they may not realize that stocks and bonds and dividends all generate income in the game of real-life investing, too.

"Monopoly" is a game, with certain rules for playing it. Investing in the real world is different. Even though people often refer to "playing the market" (and it is true that investing can be fun), it is *not* a game. Still there are certain guidelines that investors can follow that will increase their chances of making money in the markets. Since statistics say that more than twenty million Americans under the age of twenty-one have investments in the stock market today, it makes sense to have a book that explains a bit about stocks, bonds, and financial markets that is written especially for young people, who might be considering investing.

Generally speaking, there are two kinds of businesses—privately owned companies and corporations. Years ago, in the 1950s, there was a small company in Fort Worth, Texas, called, after its owner, the Tandy Leather Goods Company. Mr. Tandy sold leather that could be tooled into belts, handbags, saddles, and billfolds. In the beginning Mr. Tandy was responsible for everything that went on at Tandy Leather Goods. The company grew, however, and eventually the Tandy Leather Goods Company went from being a privately owned company to a corporation that was publicly owned. It became the Tandy

Corporation. Tandy has come a long way from leather goods. Today, among other things, it owns all the Radio Shack stores in the United States. Mr. Tandy does not own those stores; the stockholders of Tandy Corporation do.

How many times have you seen the letters *Inc.* after a company's name? They are an abbreviation for the word *incorporated*, which means "to form into one body," and they appear after the names of giant international businesses such as Texaco, Inc., or Revlon, Inc., or PepsiCo, Inc. They often appear after the names of smaller businesses, and they can appear as well after the names of groups of professionals, perhaps doctors, who are providing their services together. The next time you visit your doctor or dentist, look at the name on the door of his office. It could say something like Memorial Family Practice Associates, Inc.

A corporation is formed when a group of people doing business together decide that they no longer want to own the company all by themselves; instead, they want to share the ownership with others. In order to do this, the corporation issues shares of *stock*, which it sells to people who are then called *stockholders* in the company. A share of stock is a share of ownership in a corporation. Therefore, if a corporation has 100 shares of stock to sell and you buy 50 of them, you become half-owner of the company and you share in half of the company's profits or losses. If you buy 10 shares of this company's stock, you own a tenth of the company, and likewise share in a tenth of the business's profits or losses. As a stockholder, you share in the profits and losses of the company in direct proportion to your investment in it. Shares of stock are often called *securities*, because the company that issues them has secured, or guaranteed, that the purchaser now owns a share of the company.

Businesses of all sizes include the abbreviation Inc. *in their names to show they are incorporated.*

You might be wondering why anyone who owned a successful business would want to share that ownership with anyone else by incorporating. Each business that incorporates has its own specific reasons for doing so, but there are a few general reasons that apply to all of them.

Suppose two people, Ferdinand and Isabella Rosencrantz, decide to go into business together making and selling widgets. They call their new company the Ferdis Widget Company. Business is good; in fact, it's great. *Everyone* wants a Ferdis widget, and Ferdinand and Isabella can barely keep up with the demand. They need to expand their widget operations to an international scale. But doing that takes money, a lot of it, probably more than Ferdinand and Isabella have between them or could even borrow at a bank. Few individuals are capable of providing the financial investment—the working capital, or money—that a business needs to expand. However, if Ferdis Widget Company incorporates, the income from the sale of its stock could generate the working capital Ferdinand and Isabella need to expand their business until Ferdis Widgets, Inc., becomes one of the biggest widget manufacturers in the world. The main reason, then, that companies incorporate and offer to sell shares of their stock to people like you and me, is to raise working capital so the business can expand.

If Ferdis's widgets become the most talked-about widgets in history and the business grows to an international scale, Ferdinand and Isabella probably will want to think that their company would continue to exist after their retirements, or even their deaths. By incorporating and offering to sell shares of the company's stock to the public, these two people provide a means for independent management of Ferdis Widgets, and for an orderly transfer of ownership, should that become necessary or desirable. Ferdinand and

Isabella will not live forever, but Ferdis Widgets, Inc., could. So another reason people incorporate their companies, then, is to give them unlimited life.

On the other hand, suppose Ferdinand and Isabella did not incorporate the Ferdis Widget Company. Suppose, too, that their business grew modestly, and they had managed to borrow some money from a bank in order to build a small widget plant on the outskirts of town. Suddenly, however, the demand for widgets falls off, and the Ferdis Widget Company stops making a profit. Without a profit, Ferdinand and Isabella cannot repay their loan at the bank. Now the bank can seize, or take, their personal assets—home, boat, furniture, car, jewelry, anything of value—to satisfy the debt. If they had incorporated, that would not happen. Remember, we have said that "to incorporate" means to form into one body. When a company becomes a corporation, the owners are no longer seen as individuals as far as the law is concerned and their personal property is protected from seizure. The bank, and any other people or businesses to whom Ferdis Widgets, Inc., owes money, can look only to the corporation itself to satisfy the debt. Therefore, the bank and any other creditors could force Ferdinand and Isabella to turn the deed to their manufacturing plant over, as well as all of the supplies necessary to manufacture widgets and any leftover widgets that were on hand, but they would have to leave Ferdinand, Isabella, and their stockholders' personal property alone. So protection from liability becomes another reason to incorporate a company.

Corporations often issue another kind of security besides stock: bonds. In fact, "stocks and bonds" rolls off people's tongues like "hamburger and fries," but like hamburgers and fries they are really very different things. Like stocks, companies and governments issue bonds in order to finance expansion. However,

when you buy a share of stock in a company, you are actually purchasing something—a share of ownership in the company. On the other hand, when you buy a bond, you are not really *buying* anything; instead, you are lending a company, or a government, something—the money you paid for the bond! When a corporation (a government can be a corporation) issues a bond, they are really issuing a kind of promise that they will redeem, or buy back, the bond at a specific time in the future, with interest. In the meantime, they will use the money you paid for it (bonds are usually sold in $1,000 amounts) for their own expansion. Owning a corporation's bonds makes you a *creditor*, not an owner, of the corporation. A creditor is a person to whom other people, or corporations, owe money.

Only corporations can sell stock or issue bonds, and you may be wondering how a corporation is formed. There are certain rules and regulations of both the state and the federal governments that must be met before those letters *Inc.* can be added to a company's name. One of the first things a company that is thinking of "going public"—that is, offering to sell its stock and bonds to the general public (that's you and me)—must do is file a registration statement with the Securities and Exchange Commission. The Securities and Exchange Commission—SEC for short—is a federal organization that regulates the securities industry. After the registration statement is filed with the SEC, the would-be corporation must prepare and print a *prospectus* and file it with the commission as well. The prospectus is usually anywhere from twenty-five to fifty pages long, and it contains more information than most people can digest about the new corporation. For example, it will include a history of the company up to the present time, complete with all the pertinent facts and figures, and it will include information about people like Ferdinand and Isabella and any

of their business associates who will be running the new corporation with them.

In addition to registering with the SEC and filing a prospectus with it, the new corporation must apply for *Articles of Incorporation* from the government of the state where it will have its headquarters. In the United States, the Articles of Incorporation have to meet the laws of the state where the company is headquartered, as well as the rules and regulations of the SEC. When both the state and the SEC are satisfied that all their regulations have been followed, the state government will issue a *charter* to the new corporation. The charter specifies the kinds of stock the company will sell, and it defines the rights and privileges that go with the ownership of each of the different kinds of stock. For example, a corporation always issues common stock, and the charter gives the owners of that common stock the right, and the responsibility, to elect the company's board of directors.

The board of directors is the most important group of people in a company. Members of the board are chosen by the company's owners, the stockholders, who trust them with the fate of their company. They are chosen to serve because they have expert knowledge of business, which the stockholders expect them to use to run their new corporation, Ferdis Widgets, Inc., profitably. It is the members of the board of directors, acting in unison, who ultimately decide how the company will be run, how its capital will be invested, and how its profits—if there are any!—will be divided.

The members of the board also have the responsibility of electing the new corporation's officers. In order to become a corporation, a company must have a president, one or more vice presidents, a treasurer, a secretary, and a legal representative. These officers

A company's board of directors meets regularly to oversee the operations of the business.

make the day-to-day decisions that go into the business, such as whether or not to sell widgets in China, whether they should be blue or red, how much they should cost, etc. If the board of directors does not agree with the decisions that the officers make, the board can overrule them, or even remove them from their jobs. After all, the board of directors must answer to the stockholders of Ferdis Widgets, Inc. They own the company.

2

The Bulls and the Bears

Why Do People Invest?

Why do most people work? To earn money, of course, because it takes money to buy food, and clothing, and shelter. It costs money to take a vacation, or go to school, or visit the doctor. Most people earn their money by working for someone else. It could be the neighborhood grocer or it could be Xerox Corporation, but the simple fact is, most of us will never have our own widget company or own any other kind of business. But we can still participate in many company's profits. How? By investing in corporations whose stock is sold to the public. We can also participate in many company's losses. How? By investing in corporations whose stock is sold to the public.

Back in 1670 a group of businessmen who lived in North America decided that they could make some money if they only could find the Northwest Passage to India. Everyone said it was over here in the New World somewhere! They approached King Charles II of England and asked him (there were no state governments!) to grant them a charter for their new corporation, which they were going to call Gentlemen Adven-

turers Trading into Hudson's Bay. King Charles granted the charter, the corporation sold stock to investors, and the new business started off looking for the fabled passage. They didn't find it, but they did do some fur trading along the way while they looked. Eventually, the company gave up its search for the passage and concentrated on merchandising and shipping the furs. Oh, and it changed its name, too, to one that was more manageable—Hudson's Bay Company. Today, over three hundred years later, its stock is still being traded on stock exchanges around the world, and the striped Hudson's Bay blanket is a familiar sight at outdoor sporting events in cold weather all across America.

The Hudson's Bay Company is a spectacular example of a company's longevity. However, even though we have said that one of the reasons people incorporate their businesses is to ensure that the company will continue to exist after they are no longer involved, it is important to remember that not all corporations will exist beyond the lifetime of their founders. It is a sad truth that, out of every five new corporations begun today, three will not be in existence in five years. For the investor, the secret is to know which ones will and which ones won't—and that is very hard to do! *Risk capital* is another name for the money that investors use to buy stocks and bonds and other securities. It's a good name, because any investment in the stock market is risky, and we will examine the reasons why. But before we do that, we need to look at the kinds of stocks that an investor can buy.

As we said in Chapter 1, all corporations sell common stock. Common stock is the bread-and-butter stock of the securities industry. Millions and millions of shares of it are traded on stock markets around the world every working day. A company's common stock rises in value if the general investing public (that's

you and me and the butcher, baker, and candlestick maker) thinks that the company will grow and expand.

The stock of companies that expand rapidly and profitably are called *growth stocks*. They are the glamour stocks of the securities industry, the ones that everyone wishes they had bought when the prospectus was first written, the ones people tell stories about over lunch. There is always going to be the anecdote about someone's Great-Uncle Thurber, who had the chance to invest $500 in a newfangled drink that a neighbor had concocted at his kitchen sink, but alas, although Uncle Thurber liked the taste of the drink, he decided not to take the risk. The drink turned out to be Coca-Cola. If all of those stories were true, Coca-Cola would have been brewed in kitchens all over America! Nevertheless, it once *was* a new product, and those who invested in the company early made a fortune.

Sometimes a company can have a product that is old, but a way of presenting it to the public that is new, and an entire new industry is born. Back in 1967 most people who wanted to eat a fried chicken dinner at home purchased a chicken at the grocery store, took it home, and fried it. Then someone got the idea that chicken, fried and ready to eat, could be sold at convenient neighborhood locations. The common stock of an enterprise called Kentucky Fried Chicken went on the market in April 1967, at $15 a share. That stock was worth $300 a share two years later.

These are two examples of growth stocks that earned fortunes for the investors who were willing and able to put money into products, or ideas, that were new and therefore risky at the time the companies began. You and I might make a small fortune (or at least a nice profit) if we were willing to invest in Ferdinand and Isabella's widgets. On the other hand,

if widgets don't catch on, you and I, and everyone else who took a chance on Ferdis Widgets, Inc., could lose everything we had invested in the corporation's common stock. No matter how carefully a new idea or product is researched before it is offered to the public, no one can be certain how well the product will be accepted. Remember, only two out of five new companies live until their fifth birthday, so for a stock to gain in value, the idea or the product must be accepted by the public.

There are other factors that influence whether or not the price of a share of common stock will rise or fall. Some people buy stocks not because they anticipate the value of a share will go from $15 to $300 but because they want the *dividends* the stock will pay. A dividend is a share of the company's earnings. In the United States there are laws that govern the payment of corporate dividends. One of the laws states that dividends can be paid only out of a company's surplus cash. When a corporation is able to pay its stockholders good dividends, and pay them consistently because it consistently makes a profit, the value of a share of its stock will usually increase.

The board of directors of a corporation makes the decision when—and if—dividends will be paid. Many factors influence the board when they make that decision, but the company's profits—or lack of them—carry the most influence of all. "No profit, no dividend" is a pretty good rule of thumb. And even if there is a profit, the board of directors may decide to use that money to buy more equipment and supplies, so the company can grow, and no dividend will be paid that year either. When a dividend is declared it is usually paid to the stockholder in cash, but it can take the form of additional shares of common stock.

So far, we have just discussed common stock. There is another kind of stock that corporations can

issue. It is called *preferred stock*, and although the name seems to imply that it is better stock than common stock, that is not necessarily so. The "preference" part of it has to do with, among other things, the payment of dividends. Have you ever heard the expression "I get first divs" on something? It has its origins in the stock market, and it refers to preferred stock. Preferred stock has a predetermined—you could almost say "guaranteed," except that there are no guarantees in the stock market!—dividend that must be paid to its owners before the owners of common stock can receive any dividends on their stock. Too, should a corporation be one of those that go out of business, or *liquidate*, the company's assets (its buildings, land, tools, the money in its treasury, etc.) will all be converted into cash. The cash, then, will be distributed among the stockholders of the company. However, preferred stockholders will share in the distribution first, before the common stockholders can receive their share. If the money runs out before the common stockholders receive theirs, well . . . that's another reason the stock is called "preferred."

The dividend that is paid to preferred stockholders is *not* based on the company's profits. It is a fixed amount that does not vary, even if Ferdis Widgets, Inc., takes off like a rocket and the common stock quadruples in value. Because the dividend is fixed, the price of preferred stock does not fluctuate, or change, with the stock market the way common stock does, and the chances of making a profit (or taking a loss) with it are not as great as they are with common stock.

The stock market changes every day. On days when investors are feeling confident in the American economy—in other words, when they feel that business is good and will get better—the value of an average share of stock will rise. Why? Because investors

This historic cartoon shows an alarmed investor caught between the stock market's bulls and bears.

are willing to buy stock in America's corporations, and when people want to invest in a company, the value of a share of its stock increases. On the other hand, there are times when investors are feeling pessimistic about the economy. They think that profits are falling and that in general companies will not be able to grow. During those times, the value of an average share of stock will fall. Why? Because people want to sell their stock, and when too many investors want to sell their shares of a given stock, the price of a share falls.

You have probably heard expressions like "We're bullish on America." Sometimes on the evening news you may hear a commentator say something like "The bears chased the bulls out of the stock market today." They are talking about bear and bull markets. A market where the price of stock generally is rising is called a *bull market*, and a market where stock is falling in value is called a *bear market*. Some people think the markets got those nicknames because of the way the two animals fight. When a bull is battling, he will swing up with his head and his horns. When a bear attacks, he slashes *down* with his paws.

The market swings between bears and bulls. Sometimes it is a bull market for a few days, sometimes for a few hours, and sometimes even for several weeks or months. The same is true for bear markets; they, too, can last for hours, days, weeks, or months. As long as we're comparing the market to bulls, we might as well use another ranching term. You could say that the stock market operates under the *herd instinct*. A herd of cattle will follow the lead steer wherever he goes—sometimes right off a cliff if someone doesn't stop them! In a way, investors in the stock market operate under the herd instinct, too. That is, they tend to follow what everyone else is doing. So if a few major investors begin to sell their stock, everyone rushes to sell *their* stock, too, before the price falls.

Similarly, when the prices of stock are low and major investors think they will rise and begin to buy, other investors tend to buy, too, so they can realize a profit when the value of the stock goes up. This kind of fluctuation goes on all the time, and most people (especially if they do not have any money invested in the stock market!) pay little attention. There was a time, however, when a bear market put its claws into everyone who lived in the United States, whether they ever owned stock or not.

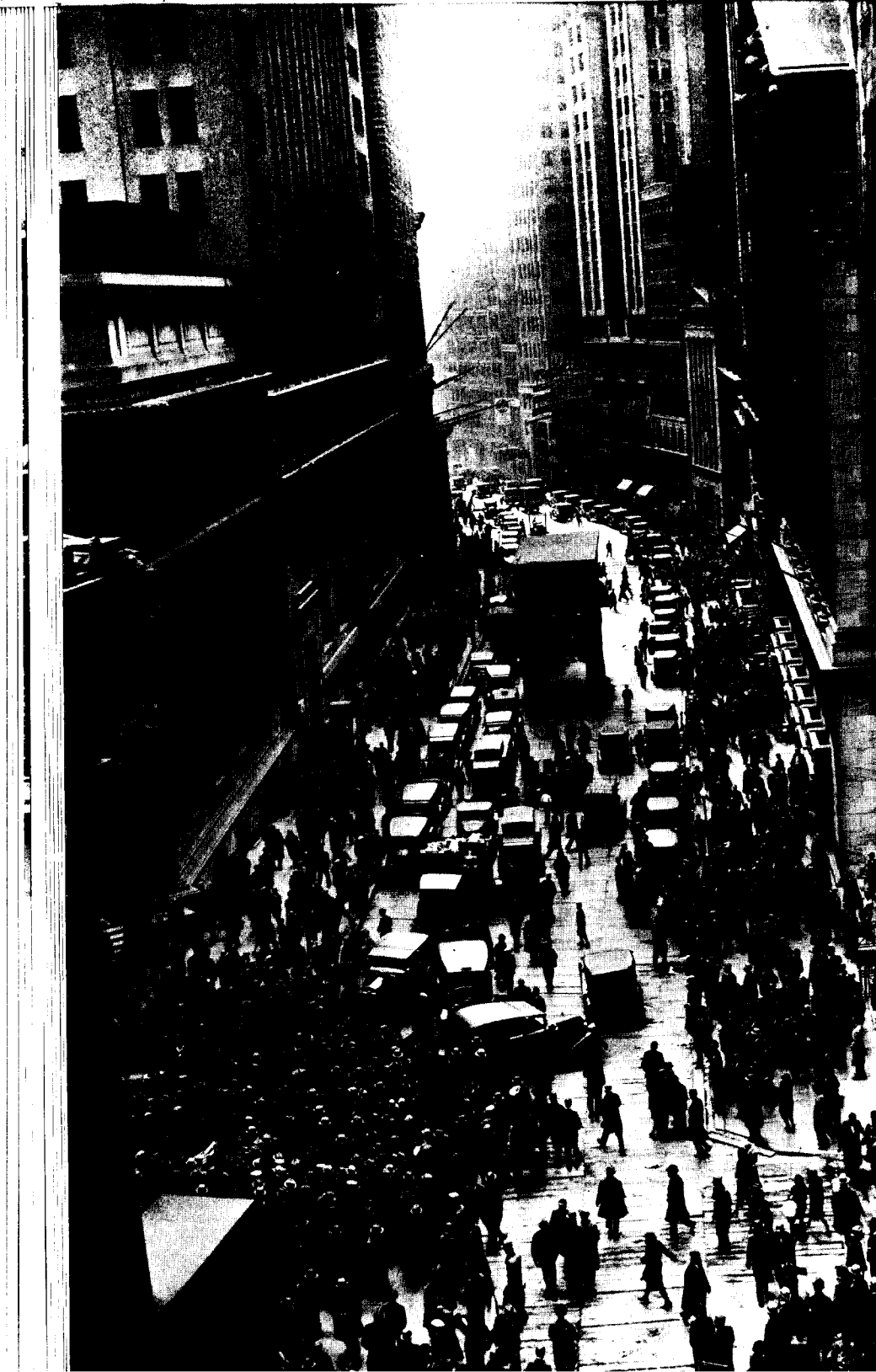
Perhaps you have heard your grandparents speak of "the Roaring Twenties." You certainly have seen television shows set during the 1920s. World War I was over, American women cut their hair and shortened their dresses, business was booming, and the only battles that were going on were between gangsters such as Al Capone and law enforcement agencies. Everyone in the country was optimistic about America's future, and that optimism caused many, many people to begin to invest in the stock market. It seemed to be an easy, quick way to make money, because during that period of time many stocks rose in value quickly. It was relatively easy to buy new stocks at a low price and sell them at a profit when the price went up. Soon people who could not afford to take the risk that goes with investment, people who did not have extra money to spare or money that they could afford to lose, were investing in the stock market. Some people even borrowed money to invest, because they were interested in the profits they thought they could make. Individuals were not the only ones who invested in the market. Businesses invested, and so did banks. They took the money that their depositers had placed with them, and invested it in the stock market, because banks, like any other kind of business, operate to make money. But some of the banks took nearly *all* of their deposits and put

them in the stock market, and that's how some of them got in trouble.

You have seen that the stock market goes up and down for many different reasons. When the market is bearish, the average price of a share of stock tends to go down. However, the market usually corrects itself, and in time investors who are bullish buy stock again, and the market goes up. It's a balancing act a bit like a seesaw, and as long as the bulls balance the bears, things are all right. But you know what happens when someone abruptly gets off a seesaw—it crashes. In 1929, many people got out of the stock market, and it got so out of balance that it, too, crashed.

The reasons for the Crash of 1929 are very complicated, and no one fully understands all of them—even to this day. In the fall of 1929, the market turned bearish. Investors suddenly decided that they wanted to sell their stocks in order to get their profits. As this profit taking increased, the prices of stocks fell. When other investors saw that the market was falling, they hurried to sell their stock, too, before it fell any more. With all of this money being taken out of the stock market, many businesses failed, and the people who worked for them lost their jobs. That complicated matters further because, without a job, people have no money to buy goods and services. When there are no customers to buy their goods, or use their services, still more businesses can fail.

To make matters worse, during this time people went to the banks to withdraw what money they had on deposit there in checking and savings accounts. Many of the banks could not give people their money, because the banks had invested it in the stock market and lost it! When depositers began to hear that the money in some banks was not safe, they became frantic. All over America, people raced to their banks, demanding their money. When most of a bank's



depositers want their money *right away*, the condition is called a "run" on the bank. Because of the runs, many banks failed; they had lost their customers' money and they, too, went out of business. The plunging stock market, combined with failing banks and companies going out of business, brought an abrupt end to the prosperity of the Roaring Twenties and replaced it with the poverty of the Great Depression. Hundreds of businesses failed. Thousands of Americans lost their jobs. Everyone in the country was affected by the crash of 1929, whether they had invested in the stock market or not.

The stock market crashed when Herbert Hoover was president of the United States, and the Great Depression continued for more than ten years. In 1933 Franklin Delano Roosevelt became president, and the first order of business for him was to try to do something about the nation's economy. He pushed a number of emergency bills through Congress. Some of these bills were designed to create jobs, so America would be working again. Roosevelt believed that at least part of the reason for the crash of the stock market lay in the fact that it was not regulated. In other words, there were no consistent rules and regulations that covered how stocks were issued in the first place, or how they would be bought and sold once they were issued. Although he did not want the government to interfere in the stock market directly, he did urge Congress to pass the Securities Act of 1933, and the Securities Exchange Act of 1934. The Securities Act of

Crowds fill the streets at the corner of Wall and Broad following the stock market crash in 1929.

1933 regulated how all brand-new stocks would be issued in the future, and the Securities Exchange Act regulated how they were to be traded. The Securities and Exchange Commission (SEC) is the agency that enforces these two acts. All stock exchanges in the United States must now register with the SEC. Although the market still goes up and down, it is much more balanced today than it was in 1929.

3

"Minds over Money"

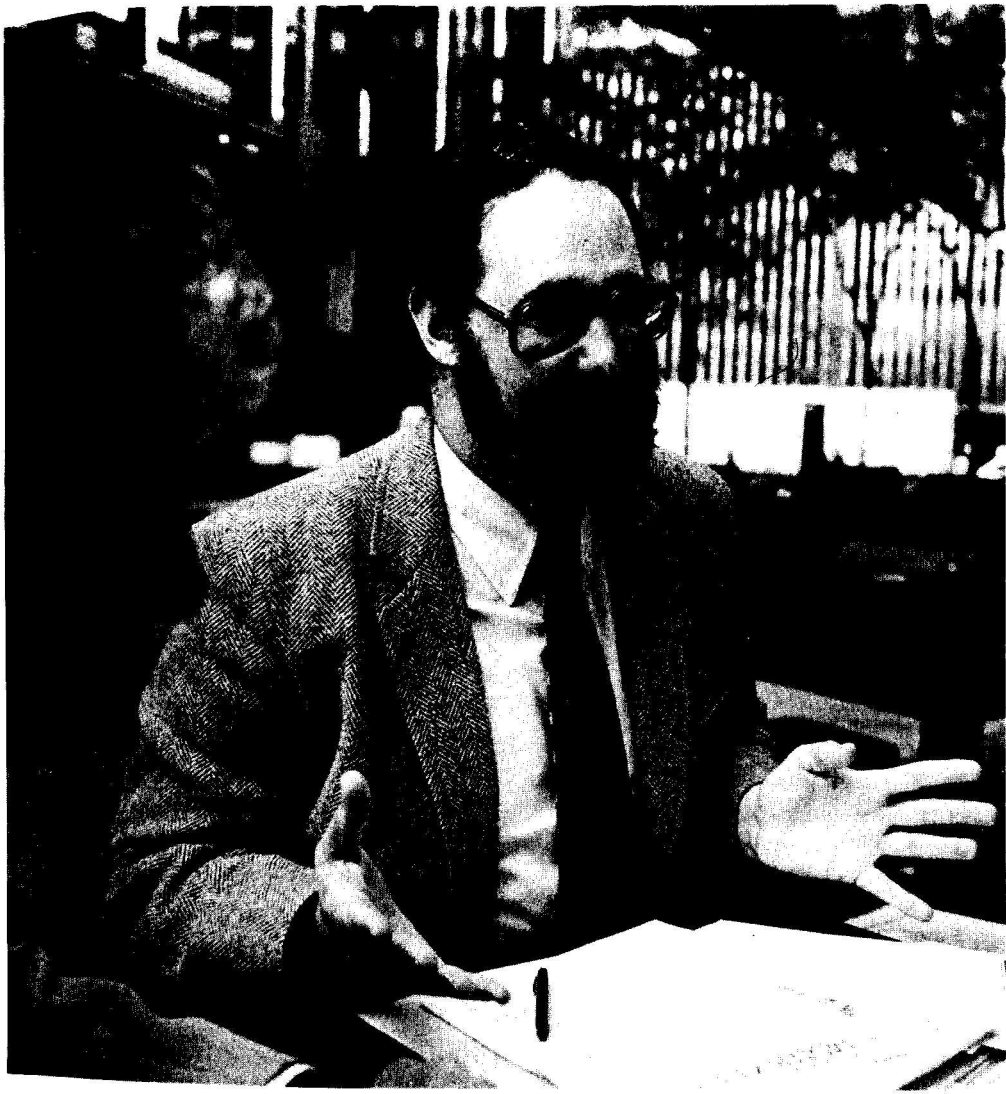
The Role of the Broker and His Tools of the Trade

Some of you who are reading this book have money invested in the stock market right now. Others of you will invest in the market in the future. Still others of you have no intention of ever investing in the stock market as an individual. However, even if you choose not to participate on your own, the chances are that some of your money will be invested in the market for you indirectly. When you go to work for a company you may be given the opportunity to participate in a pension plan or a profit-sharing plan. Although these kinds of plans vary from company to company, they usually involve the employee and his or her employer contributing a certain amount of money to the employee's account. The money that employees and their employers put into these kinds of retirement accounts comes to billions of dollars annually. Companies invest much of that money in the stock market. So you see, you could have a dollars and cents interest in the market whether you participate on your own or not.

As we have seen by the Crash of 1929 and the Great Depression that followed, everyone in a country is affected by that country's economy, and in the United States, the stock market is one thermometer that measures the nation's economic health. So, unless you plan to be a hermit living in a cave eating nuts and berries, you should care about what's happening in the market, whether you've invested in it or not.

If you decide to venture into the market, the first step you will need to take is opening an account with a stockbroker. A stockbroker is an *agent*—someone who acts for someone else, and he or she works at a brokerage firm. Many of these firms are quite large and advertise on national television. You have heard Shearson Lehman/American Express use their slogan "Minds over Money" to convince you to open an account with them. "Thank You, Paine Webber" is another slogan; so is Merrill Lynch's "We're Bullish on America." Stockbrokers who work for these firms and many other firms act for people who wish to buy and sell securities. Opening an account at a brokerage firm is as simple as opening an account at a department store—perhaps simpler, because it can be done over the telephone. However, since choosing a stockbroker is a serious step, it would probably be best to meet the man or woman you are considering in person, instead of just talking on the telephone.

One of the rules of the New York Stock Exchange is "know your customer," and all good stockbrokers do. In order to get to know you, however, he or she will have to ask you some questions that might appear almost nosey! At first, the broker will ask you for the basic information that you give when filling out a job application form—name, address, telephone number, social security number (if you have one), etc. Then, if you are earning a living, they will want to know about how much money you make in a year. They might ask



A stockbroker gets to know his clients in order to give them advice that suits their investment needs.

about any investments you have made in the past, and what investments you have now. Good brokers ask what their client's financial goals are. After all, you must set a goal if you want to reach it—but try to resist the temptation to say you want to be rich by 4:00 P.M. tomorrow! They probably will want to know how you feel about risk taking. Some people can lose $1,000 and grin and bear it; for others, the loss of a nickel ruins their day. And finally a broker will probably ask you, "How much money do you want to invest?" and equally important, "How much money can you afford to lose?" A person who cannot afford to lose any money is taking a terrific risk putting a dime into the stock market.

Once a broker has gathered this financial information about you, he or she will want to know something about your family, because the kind of family you live in could make a difference in the kinds of investments you should make. For example, some investors, especially young people with relatively few responsibilities, are willing (and able) to take more risks with their money than other investors. They might look for stocks with a higher-than-average growth rate. Remember the Kentucky Fried Chicken story. There are similar successes (and equally dramatic disasters) happening to new corporations every day. Growth stocks are an excellent way for an investor to increase his *net worth*. Net worth is measured by the amount of assets a person has left after all his liabilities (his debts and expenses) are subtracted. However, growth stocks are wise investments only if you are prepared financially and emotionally to take the risks that go along with them.

When a person gets married, responsibilities usually increase. Families with young children worry about the cost of a college education, or braces. They may also have to help support elderly parents.

Obviously these kinds of families are not in a position to put much of their investment capital in new, and therefore risky, ventures. A good stockbroker might recommend that they purchase *blue-chip* stocks. The term *blue chip* comes from the chips used in a poker game. The blue ones are the most valuable. Blue-chip stocks traditionally are stocks that have stability, which means they don't vary much in price because they have already increased in value. Blue-chip stocks also have a long record of paying dividends, because the company has been profitable for a very long time. Some examples of blue-chip stocks are Xerox, Kodak, IBM—corporations whose names are almost household words in America.

When a couple's children leave home, their investment needs could change again. People in that stage of life are looking toward retirement and are probably hoping to build a nest egg to help ease the financial burden when there is no longer a steady income from employment. People often try to protect their assets in this period of their lives, rather than trying to increase them, and because bonds are not as risky an investment as stocks, a broker might suggest that a couple add bonds to their *portfolio* at this time in their lives. ("Portfolio" is a term for all of the securities, such as stocks and bonds, that a person owns.) Bonds will be discussed in a later chapter.

Brokerage firms and the brokers who work in them are a bit like department stores. Some are full-service and some are discount. The price you pay for an item at a discount store is usually less than the price you would pay at a big department store. Sometimes that is fine, especially if you know exactly what it is you want to purchase and need no help or guidance. However, if you've never bought a vacuum cleaner before and you really don't know how one works, then you might want to buy it from a retail

department store that has a salesperson there who can answer your questions. The brokers in full-service firms charge more *commission* when they buy or sell your stock than do the brokers in a discount firm. A commission is the fee (usually a percent of the price) that a broker charges when he buys or sells securities for you. The commissions that brokers in full-service firms charge are higher because these firms have higher expenses. For example, they hire people who do nothing but research corporations whose stock is for sale. In fact, these researchers keep up to date with everything that is going on in the stock market. They pool their information and pass it along to the firm's brokers who, in turn, use it or pass it along to their customers. Discount brokerage firms do not employ staffs of researchers, and most of them do not advertise on television. Their expenses are not as high, and their commissions are less. If you, as an investor, have done all of the research yourself (and you *should* do research yourself!) and you know for a fact that you want to buy 100 shares of Ferdis Widgets, Inc., then a discount broker could save you money on commission fees.

Whether you research the stock market yourself or rely on a broker and his staff to do it for you, you should know something about the tools that are available to do that research. Although fears of a stock market crash like that of 1929 have largely gone away, most people who have invested in the market watch it

Stock analysts and researchers enable a full service broker to offer clients up-to-the minute information on the market and other investment opportunities.

carefully each day. They want to know if the general trend of the price of securities is going up—a bull market—or down—a bear market. On the evening news broadcasts invariably there will be an announcement something like this, "The closing Dow Jones Industrial Average was up (or down) 3 points in moderate trading." What in the world are they talking about? What is the Dow Jones Industrial Average and what does it have to do with the stock market?

In addition to being announced over radio and television, the Dow Jones Average is printed in the daily papers (except for the days the stock market is closed, which is weekends and certain federal holidays), so investors can follow it for themselves. The Average was developed in the last century by a man named Charles Dow. Mr. Dow was an editor of the *Wall Street Journal*, a leading financial newspaper. He became convinced that the stock market itself would give clues (if you knew which companies to look at) as to whether the market was going up or down. Mr. Dow chose twelve companies whose stock was listed on the New York Stock Exchange. He chose the companies carefully, because he wanted them to represent a good cross section of America's industries. He then totaled their share prices, and divided by twelve, coming up with the Dow Jones Average. The number of stocks used in the average has been increased from the original twelve, up to thirty, and some of the companies have been changed to reflect America's changing industries. Additionally, an average is taken of twenty transportation stocks such as railroads and airlines, and fifteen utility stocks such as electric companies

Charles Dow, the originator of the Dow Jones Average

and telephone companies. The Dow Jones Average has been figured daily since 1890. It is one vital statistic that persons who are interested in the stock market are always eager to know; however, there are other statistics such as Standard and Poor's Stock Prices Index and the New York Stock Exchange Price Index, which serve the same purpose.

The Dow Jones Average is just one of a number of tools that are used by professional market watchers, called *financial analysts*. All financial analysts are brokers, but not all brokers are financial analysts. Financial analysts evaluate the performance of stocks and bonds and the economic picture in general. They do this by studying the prospectuses of new companies and the annual reports of established companies. We have already discussed a company's prospectus. It is printed, as you know, at the time the company offers its stock for sale to the public for the first time, which is called the *primary offering*. After the corporation has been in business for a year, it publishes its *annual report*. Each year, in corporations all over America, many people labor long and hard hours to produce the annual report. The annual report is a corporation's official yearly statement to its stockholders of the company's assets and liabilities, as well as its philosophy ("We feel our corporation manufactures the finest widgets known to man, and we plan to keep up that standard"), achievements ("Every home in America has or wants a Ferdis widget"), and goals ("We plan to sell Ferdis widgets on the first space station"). As you can see, an annual report is not exactly unbiased. However, the figures in it must be accurate, and a careful study of those figures will give an investor an idea of how the company is doing. Annual reports are issued to all shareholders, but anyone else who is interested in the company can write the headquarters and request a copy.

In addition to reading annual reports, prospectuses, studying the Dow Jones Average, and tracking the stock's daily performance over a period of time, the analysts keep themselves informed about current events, because what happens around the world can affect the stock market here. For example, if there were a serious interruption in the supplies of oil coming from the Middle East, the stock of domestic oil companies would be affected, so keeping up with world events is important to anyone, from the analyst to the broker to the investor who is interested in the stock market.

Many analysts write books giving advice on how to make money in the stock market. (This is *not* one of those books!) Others write weekly newsletters which people subscribe to for a fee. Many of these books and newsletters contain sound advice, but they are not foolproof. An analyst has to combine the information he receives from all the sources we have discussed with his own intuition. Sometimes analysts are right, sometimes they are wrong; sometimes few people listen to them, and sometimes their pronouncements have major repercussions.

Joe Granville is a financial analyst who has over two thousand subscribers to his newsletter. In January, 1981, the stock market was bullish. The Dow Jones Industrial Average had climbed to over 1,000. Joe Granville analyzed the situation and decided that the Dow had peaked and the bears were getting ready to chase the bulls out of the market. In other words, he thought the market had risen as high as it was going to rise and was ready to go down. Granville contacted all his subscribers that day and told them to sell all of their holdings in the stock market. The herd instinct went into effect when the word spread that Granville's subscribers were selling, and there was a mass run on the market. The Dow Jones Average fell 20

points by the close of business the next day. Joe Granville says he knew the market would fall, which is why he told his customers to sell. Others say he *caused* it to fall by doing exactly that. Which theory is right? No one knows for certain, but, then, there is little that is certain in the stock market.

In 1983 there were approximately 150,000 stockbrokers in the United States, and the number is growing. Choosing the right broker for you is important. Look for one who knows you (or is willing to take the time to get to know you), and who knows the stock market (or has access to researchers and analysts who do). Then, together, you and your broker, using some of the guidelines we have discussed in this chapter, can select investments that are just right for you and you alone.

4

Under the Buttonwood Tree

A Look at the Exchanges

When people purchase something as an investment, whether it is a piece of jewelry, a racehorse, a painting, or shares of stock, they anticipate the day when they will sell it for a profit. If they do not anticipate selling it for a profit, it is not an investment; it is just a toy. Racehorses, jewelry, and paintings can be good investments, but there must be someone willing to buy when you want to sell. For many investors, the attraction of stocks and bonds is their *liquidity*, the ease with which they can be turned into cash.

Things are turned into cash in a market, which is a place where all kinds of goods are bought and sold. Stockbrokers do their buying and selling of stocks and bonds at a market called a *stock exchange*. In fact, it was a need for a marketplace that gave birth to the New York Stock Exchange around the time of the Revolutionary War. The secretary of the Treasury, Alexander Hamilton, had asked Congress to issue about $80 million worth of government bonds, in order to pay for the war. At that time, there were not too many stocks being marketed, but people were

buying bonds. About this time, too, banks began to spring up in America, and they had stock that they wanted to sell. (A bank can be a corporation, just like Ferdis Widgets, and sell its stock to investors.) Soon it seemed that there were some securities to be bought and sold in the new nation, but who had them and where to buy and sell them was a problem.

A group of men who had been selling securities on their own got together under a buttonwood tree on Wall Street in New York City and decided to form an association. They promised each other that they would not buy securities for anyone else, unless the buyer paid a quarter percent commission. It was 1792, and the New York Stock Exchange had been born. Today the New York Stock Exchange is often called by its nickname, "The Big Board."

In 1849, almost sixty years after the founding of the New York Stock Exchange, another group of men who sold securities gathered in New York. They were not members of the New York Stock Exchange, but they were eager to make their own marketplace by forming their own exchange. These men didn't choose a tree to meet under; instead, they first met on the curb of a street to sell their stocks and bonds. They called themselves and their marketplace the New York Curb Exchange. In 1953, that exchange took its present name, the American Stock Exchange, although it is still often referred to as "The Curb" or "AMEX."

These two stock exchanges are the largest in the United States and among the largest in the entire world. One of them, the New York Stock Exchange is so large and so important that many people use its address—Wall Street—as a synonym for all American stock exchanges. In addition to these two national marketplaces, there are twelve regional stock exchanges in the United States, and there are major stock exchanges in Great Britain, Europe, South Afri-

The famous buttonwood tree on Wall Street, where the New York Stock Exchange now stands

ca, Australia, Canada, Mexico, South America, and Japan as well.

Only members of a stock exchange may buy and sell stock on the exchange's floor, and memberships in those exchanges can be difficult to get. For one thing, the memberships, which are called *seats*, are limited in number. Only individuals may own a seat on an exchange, and they must meet the exchange's membership requirements. These requirements can be pretty tough. For example, prospective members must demonstrate through a test that they are knowledgeable about the securities field. And too, they must be willing to allow members of the exchange to look into their past business and financial records. In the stock market, a person's word is his or her bond. The exchanges require their members to have been—and continue to be—scrupulously honest in conducting business. Once a prospective member is admitted to the exchange, he must be able to purchase the seat, unless, of course, he or she has inherited it. That's right, *inherited* it. Seats on stock exchanges are considered property, just like a house or a car, and they can be left to someone in a will. If a prospective member does not inherit the seat, he or she must be prepared to purchase it. A seat on a national stock exchange can be quite expensive—sometimes several hundred thousand dollars—although the price does go up and down as the economy of the country goes up and down.

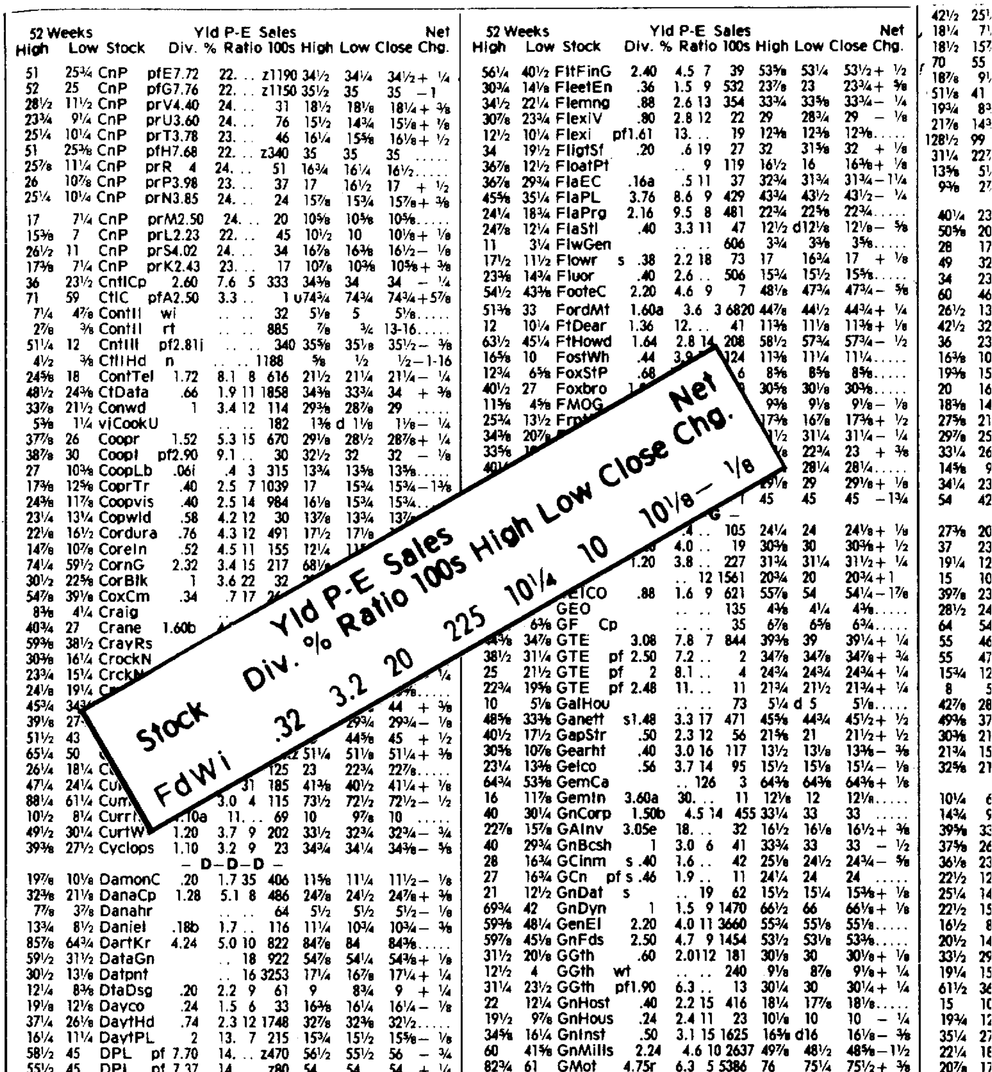
Members of a stock exchange are usually partners in a stockbrokerage house. Those firms are then called

The New York Stock Exchange today

member organizations or *member firms*. The member organizations can have offices all over the world, and can belong to more than one exchange. Your stockbroker will probably not own a seat on an exchange, but will instead work for one of these member firms.

Like any organization, the stock exchange has certain rules that its members must follow, such as the "know your customer" rule that we have already discussed. It also has rules and regulations about the kinds of stocks and bonds its members can sell. When a stock is sold on a certain exchange, it is said to be *listed* with that exchange. A corporation that wants to have its stock listed on a particular exchange, must apply to the exchange's board of governors. The board will look into the company's record, checking to be certain that it is doing lawful business, that the product or service of the company is one that would appeal across the nation, and that the company is in good financial condition. For example, the New York Stock Exchange requires a company to have issued at least 1 million shares of stock, that it have at least two thousand stockholders, that it earn over $2½ million a year! These figures tell you that a company listed on the exchange is not a brand-new company. Stock exchanges are often called the *secondary market* in order to indicate that the stocks sold there have already traded hands at least once.

Each day, in financial newspapers as well as your local daily paper, a listing of all the stocks that are sold on the major stock exchanges is printed. The newspaper listing will show the company's name, which is usually abbreviated, the highest amount of money that the stock sold for that day, the lowest amount it sold for, what it was selling for at 4:00 P.M., when the markets close, and how much, if any, change in price there had been that day. The listing will also show



52 Weeks High	Low	Stock	Div.	Yld %	P-E Ratio	Sales 100s	High	Low	Close	Net Chg.
51	25¾	CnP pfE	7.72	22.	..	z1190	34½	34¼	34½	+ ¼
52	25	CnP pfG	7.76	22.	..	z1150	35½	35	35	−1
28½	11½	CnP prV	4.40	24.	..	31	18½	18⅛	18¼	+ ⅜
23¾	9¼	CnP prU	3.60	24.	..	76	15½	14¾	15⅛	+ ⅛
25¼	10¼	CnP prT	3.78	23.	..	46	16¼	15⅝	16⅛	+ ½
51	25⅜	CnP pfH	7.68	22.	..	z340	35	35	35	.....
25⅞	11¼	CnP prR	4	24.	..	51	16¾	16¼	16½	.....
26	10⅞	CnP prP	3.98	23.	..	37	17	16½	17	+ ½
25¼	10¼	CnP prN	3.85	24.	..	24	15⅞	15¾	15⅞	+ ⅜
17	7¼	CnP prM	2.50	24.	..	20	10⅝	10⅝	10⅝	.....
15⅜	7	CnP prL	2.23	22.	..	45	10½	10	10⅛	+ ⅛
26½	11	CnP prS	4.02	24.	..	34	16⅞	16⅜	16½	− ⅛
17⅜	7¼	CnP prK	2.43	23.	..	17	10⅞	10⅜	10⅝	+ ⅜
36	23½	CntlCp	2.60	7.6	5	333	34⅜	34	34	− ¼
71	59	CtlC pfA	2.50	3.3	..	1	u74¾	74¾	74¾	+5⅞
7¼	4⅞	Contll wi		..	..	32	5⅛	5	5⅛	.....
2⅞	⅜	Contll rt		..	..	885	⅞	¾	13-16	.....
51¼	12	Cntlll pf	2.81j	..	..	340	35⅝	35⅛	35½	− ⅜
4½	⅜	CtllHd n		..	..	1188	⅝	½	½	−1-16
24⅝	18	ContTel	1.72	8.1	8	616	21½	21¼	21¼	− ¼
48½	24⅜	CtData	.66	1.9	11	1858	34⅜	33¾	34	+ ⅜
33⅞	21½	Conwd	1	3.4	12	114	29⅜	28⅞	29	.....
5⅜	1¼	viCookU		..	..	182	1⅜	d 1⅛	1⅛	− ¼
37⅞	26	Coopr	1.52	5.3	15	670	29⅛	28½	28⅞	+ ¼
38⅞	30	Coopl pf	2.90	9.1	..	30	32½	32	32	− ⅛
27	10⅜	CoopLb	.06i	.4	3	315	13¾	13⅝	13⅝	.....
17⅜	12⅝	CoprTr	.40	2.5	7	1039	17	15¾	15¾	−1⅜
24⅜	11⅞	Coopvis	.40	2.5	14	984	16⅛	15¾	15¾	
23¼	13¼	Copwld	.58	4.2	12	30	13⅞	13¾	13	
22⅛	16½	Cordura	.76	4.3	12	491	17½	17⅛		
14⅞	10⅞	Coreln	.52	4.5	11	155	12¼			
74¼	59½	CornG	2.32	3.4	15	217	68⅛			
30½	22⅝	CorBlk	1	3.6	22	32				
54⅞	39⅛	CoxCm	.34	.7	17					
8⅜	4¼	Craig								
40¾	27	Crane	1.60b							
59⅝	38½	CrayRs								
30⅜	16¼	CrockN								
23¾	15¼	CrckN								¼
24⅛	19¼	C							⅝	.....
45¾	34								44	+ ⅜
39⅛	27							29¾	29¾	− ⅛
51½	43							44⅝	45	+ ½
65¼	50						51¼	51⅛	51¼	+ ⅜
26¼	18¼	C				125	23	22¾	22⅞	.....
47¼	24¼	Cu			31	185	41⅜	40½	41¼	+ ⅛
88¼	61¼	Cum		3.0	4	115	73½	72½	72½	− ½
10½	8¼	Curr	.10a	11.	..	69	10	9⅞	10	.....
49½	30¼	CurtW	1.20	3.7	9	202	33½	32¾	32¾	− ¾
39⅜	27½	Cyclops	1.10	3.2	9	23	34¾	34¼	34⅜	− ⅝
		— D—D—D —								
19⅞	10⅛	DamonC	.20	1.7	35	406	11⅝	11¼	11½	− ⅛
32⅜	21⅛	DanaCp	1.28	5.1	8	486	24⅞	24½	24⅞	+ ⅜
7⅞	3⅞	Danahr		..	..	64	5½	5½	5½	− ⅛
13¾	8½	Daniel	.18b	1.7	..	116	11¼	10¾	10¾	− ⅜
85⅞	64¾	DartKr	4.24	5.0	10	822	84⅞	84	84⅜	.....
59½	31½	DataGn		..	18	922	54⅞	54¼	54⅜	+ ⅛
30½	13⅛	Datpnt		..	16	3253	17¼	16⅞	17¼	+ ¼
12¼	8⅜	DtaDsg	.20	2.2	9	61	9	8¾	9	+ ¼
19⅛	12⅛	Dayco	.24	1.5	6	33	16⅜	16¼	16¼	− ⅛
37¼	26⅛	DaytHd	.74	2.3	12	1748	32⅞	32⅜	32½	.....
16¼	11¼	DaytPL	2	13.	7	215	15¾	15½	15⅝	− ⅛
58½	45	DPL pf	7.70	14.	..	z470	56½	55½	56	− ¾
55½	45	DPL pf	7.37	14.	..	z80	54	54	54	+ ¼
29⅜	19¾	DeanF	s .48	1.8	15	67	27⅜	27	27	− ⅛
41	24⅝	Deere	1	[illegible]						

52 Weeks High	Low	Stock	Div.	Yld %	P-E Ratio	Sales 100s	High	Low	Close	Net Chg.
56¼	40½	FltFinG	2.40	4.5	7	39	53⅝	53¼	53½	+ ½
30¾	14⅛	FleetEn	.36	1.5	9	532	23⅞	23	23¾	+ ⅝
34½	22¼	Flemng	.88	2.6	13	354	33¾	33⅝	33¾	− ¼
30⅞	23¾	FlexiV	.80	2.8	12	22	29	28¾	29	− ⅛
12½	10¼	Flexi pf	1.61	13.	..	19	12⅜	12⅜	12⅜	.....
34	19½	FligtSf	.20	.6	19	27	32	31⅝	32	+ ⅛
36⅞	12½	FloatPt		..	9	119	16½	16	16⅜	+ ⅛
36⅞	29¾	FlaEC	.16a	.5	11	37	32¾	31¾	31¾	−1¼
45⅝	35¼	FlaPL	3.76	8.6	9	429	43¾	43½	43½	− ¼
24¼	18¾	FlaPrg	2.16	9.5	8	481	22¾	22⅝	22¾	.....
24⅞	12¼	FlaStl	.40	3.3	11	47	12½	d12⅛	12⅛	− ⅝
11	3¼	FlwGen		..	..	606	3¾	3⅜	3⅝	.....
17½	11½	Flowr	s .38	2.2	18	73	17	16¾	17	+ ⅛
23⅜	14¾	Fluor	.40	2.6	..	506	15¾	15½	15⅝	.....
54½	43⅜	FooteC	2.20	4.6	9	7	48⅛	47¾	47¾	− ⅝
51⅝	33	FordMt	1.60a	3.6	3	6820	44⅞	44½	44¾	+ ¼
12	10¼	FtDear	1.36	12.	..	41	11⅜	11⅛	11⅜	+ ⅛
63½	45¼	FtHowd	1.64	2.8	14	208	58½	57¾	57¾	− ½
16⅝	10	FostWh	.44	3.		124	11⅜	11¼	11¼	.....
12¾	6⅝	FoxStP	.68			6	8⅝	8⅝	8⅝	.....
40½	27	Foxbro					30⅝	30⅛	30⅜	.....
11⅝	4⅝	FMOG					9⅝	9⅛	9⅛	− ⅛
25¾	13½	Fr					17⅝	16⅞	17⅜	+ ½
34⅜	20⅞						1½	31¼	31¼	− ¼
33⅝								22¾	23	+ ⅜
40								28¼	28¼	.....
							29⅛	29	29⅛	+ ⅛
							45	45	45	−1¾
		G								
					..	105	24¼	24	24⅛	+ ⅛
				4.0	..	19	30⅜	30	30⅜	+ ½
			1.20	3.8	..	227	31¾	31¼	31½	+ ¼
				..	12	1561	20¾	20	20¾	+1
		GEICO	.88	1.6	9	621	55⅞	54	54¼	−1⅞
		GEO		..	..	135	4⅜	4¼	4⅜	.....
	6⅜	GF Cp		..	..	35	6⅞	6⅝	6¾	.....
4⅜	34⅞	GTE	3.08	7.8	7	844	39⅜	39	39¼	+ ¼
38½	31¼	GTE pf	2.50	7.2	..	2	34⅞	34⅞	34⅞	+ ¾
25	21½	GTE pf	2	8.1	..	4	24¾	24¾	24¾	+ ¼
22¾	19⅝	GTE pf	2.48	11.	..	11	21¾	21½	21¾	+ ¼
10	5⅛	GalHou		..	..	73	5¼	d 5	5⅛	.....
48⅝	33⅜	Ganett	s1.48	3.3	17	471	45⅝	44¾	45½	+ ½
40½	17½	GapStr	.50	2.3	12	56	21⅝	21	21½	+ ½
30⅝	10⅞	Gearht	.40	3.0	16	117	13½	13⅛	13⅜	− ⅜
23¼	13⅜	Geico	.56	3.7	14	95	15½	15⅛	15¼	− ⅛
64¾	53⅜	GemCa		..	126	3	64⅜	64⅜	64⅜	+ ⅛
16	11⅞	Gemln	3.60a	30.	..	11	12⅛	12	12⅛	.....
40	30¼	GnCorp	1.50b	4.5	14	455	33¼	33	33	.....
22⅞	15⅞	GAInv	3.05e	18.	..	32	16½	16⅛	16½	+ ⅜
40	29¾	GnBcsh	1	3.0	6	41	33¾	33	33	− ½
28	16¾	GCinm	s .40	1.6	..	42	25⅛	24½	24¾	− ⅝
27	16¾	GCn pf	s .46	1.9	..	11	24¼	24	24	.....
21	12½	GnDat	s	..	19	62	15½	15¼	15⅜	+ ⅛
69¾	42	GnDyn	1	1.5	9	1470	66½	66	66⅛	+ ⅛
59⅝	48¼	GenEl	2.20	4.0	11	3660	55¾	55⅛	55⅛	.....
59⅞	45⅛	GnFds	2.50	4.7	9	1454	53½	53⅛	53⅜	.....
31½	20⅛	GGth	.60	2.0	112	181	30⅛	30	30⅛	+ ⅛
12½	4	GGth wt		..	..	240	9⅛	8⅞	9⅛	+ ¼
31¼	23½	GGth pf	1.90	6.3	..	13	30¼	30	30¼	+ ¼
22	12¼	GnHost	.40	2.2	15	416	18¼	17⅞	18⅛	.....
19½	9⅞	GnHous	.24	2.4	11	23	10⅛	10	10	− ¼
34⅝	16¼	GnInst	.50	3.1	15	1625	16⅝	d16	16⅛	− ⅜
60	41⅝	GnMills	2.24	4.6	10	2637	49⅞	48½	48⅝	−1½
82¾	61	GMot	4.75r	6.3	5	5386	76	75¼	75½	+ ⅜
41	33	GM E wi		..	..	403	39¼	38⅝	38⅞	.....
39	32	GMot pf	3.75	10.	..	1	37⅜	37⅜	37⅜	+ ⅛

High	Low
42½	25
18¼	7
18½	15
70	55
18⅞	9
51⅛	41
19¾	8
21⅞	14
128½	99
31¼	22
13⅝	5
9⅜	2
40¼	23
50⅝	20
28	17
49	32
34	23
60	46
26½	13
42½	32
36	23
16⅜	10
19⅜	15
20	16
18⅜	14
27⅝	21
29⅞	25
33¼	26
14⅝	9
34¼	23
54	42
27⅜	20
37	23
19¼	12
15	10
39⅞	23
28½	24
64	54
55	46
55	47
15¾	12
8	5
42⅞	28
49⅝	37
30⅜	21
21¾	15
32⅝	21
10¼	6
14¾	9
39⅝	33
37⅝	26
36⅛	23
22½	12
25¼	14
22½	15
16½	14
20½	14
33½	29
19¼	15
61½	36
15	10
19¾	12
35¼	27
22¼	18
20⅞	17
33⅞	17
86	45

Stock listings in the daily newspaper give valuable information about all stocks listed on the major exchanges.

how many shares traded hands, whether or not a dividend was paid, and what the price-earnings ratio is.

Suppose Ferdis Widgets is listed on the Big Board. If you look at the New York Stock Exchange complete closing quotation in today's paper you might see Ferdis Widgets listed as Fd Wi. Right after Fd Wi you might see .32, which means that last year it paid a dividend of 32 cents on each share of stock. If that first column is empty, then the corporation did not pay a dividend.

The next column, headed Yld% (an abbreviation for yield) tells you what you earned on your investment that particular day. This figure, shown as a percentage, represents the amount of the annual dividend divided by the current price of the stock. In the illustration on page 49, you can see that Fd Wi's yield is 3.1 percent. The next figure you come across could be, say, 20. That is the price-earnings ratio, a figure that helps people judge whether a stock is priced too high or too low. Corporations arrive at that figure like this: They take the corporation's earnings for the year and divide them by the number of shares of stock they have issued. That gives the corporation a figure that they call "earnings per share." In order to arrive at the price-earnings ratio, the corporation then divides the earnings per share into the current price of the stock. So if Ferdis Widgets is selling for $10 a share and the company is earning 50 cents a share you divide 50 cents into $10. That gives you a figure of 20. The price-earnings ratio of Ferdis Widgets is said to be 20 to 1, and the number 20 will be listed in a column that says PE (for Price/Earnings, of course) above it.

The next column in a market listing tells how many shares of the stock were sold on that day. All stocks are listed as being sold in round lots of 100 shares each. So under the column marked "hds" you might see a figure of 7 or a figure of 255 or a figure of

1126. The abbreviation "hds" or 100s stands for hundreds. If you add two zeros to each of those figures, you will know how many shares of that particular stock sold in that day—700 or 25,500 or 112,600 shares or whatever. Next come the figures that everyone is interested in—the dollars and cents of what the stock sold for. The price is always quoted and listed in eighths of a dollar. So checking up on Ferdis, you could see in the column under "High" 10¼, under "Low" 10, under "Close" 10⅛, and under "Net Chg." −⅛. What that tells you is that on the particular day that is listed, Ferdis Widgets stock sold for as much as $10¼ a share, dropped to as little as $10 a share, and had risen to $10⅛ a share when the stock market closed and trading stopped at 4:00 P.M. EST. Ferdis Widgets, Inc., stock had a net loss that day ⅛ of a dollar, which is why the "Net Chg." figure is preceded by a minus sign.

On the other hand, if Fd Wi showed a "High" of 10¼, a "Low" of 10, and a "Close" of 10¼, the "Net Chg." could read +¼, indicating that the stock rose in value. But wait a minute. Fd Wi could show a "High" of 10¼, a "Low" of 10, and a "Close" of 10¼ with an ellipsis (. . .) under "Net Chg."

Why is that? You note that the figures do not tell you the price at which the stocks *opened*—the price that it first sold for at the very beginning of the day. If Ferdis opened at 10 and closed at 10¼, then indeed it did rise in price that day. But if it opened at 10¼, changed a bit during the day and closed at 10¼, then the net change is . . . nothing.

The stock exchange listings in the paper also show the total volume of the market—that is, the total number of shares of stock that were sold on that market during that particular day. For example, the New York Stock Exchange could list a volume of 85.66 million shares and the American Stock Exchange, which

is smaller, a volume of 4.57 million shares. In addition to these figures, the markets often list the most active stocks that were traded each day—the ones that had the most shares trade hands—and many papers print the names of the stocks that reached new highs for the year and those that reached new lows. Another table will tell the investor which stocks have gone up the most in percentage of increase, and which have gone down the most.

Millions of shares, along with millions of dollars, change hands on the stock market each day, and a wise investor studies the financial pages of the newspaper carefully.

5

To Market, to Market, to Buy a Fat Pig

Buying and Selling on the Exchanges

By now you might be interested in buying some stock of your own, but you might be wondering exactly how it's done. Purchasing stock may seem forbidding to the first-time investor, but it really is a rather simple procedure. Perhaps you are interested in widgets, and you have noticed lately that the Ferdis Widgets company seems to be getting a lot of attention. Those widgets are almost as popular as the Cabbage Patch Kids were during Christmas of 1983! You decide, therefore, to take the $1,000 that Great-Aunt Hildegard left you and invest it in widgets. So you call your broker and place an order for a round lot of Ferdis Widgets stock, which you notice from reading the listings in the newspaper is selling for $10 a share. (Although all stocks are listed in multiples of 100 shares—a *round lot*—you are not obligated to buy 100 shares. You may choose to buy an *odd lot* amount—anything from 1 share to 99 shares. You will be charged a small additional fee in addition to your broker's commmission when you buy or sell odd lots of stock.) You tell your broker that you are willing to pay

the market price for the widget stock. Then your broker, whose firm is a member of one of the stock exchanges, will call his company's trader, who in turn gets in touch with the company's floor broker. The floor broker is the person who is actually right there on the floor of the stock exchange itself. The floor broker then begins the process of purchasing your 100 shares of Ferdis Widgets, Inc.

The trading floor of a stock exchange is a noisy, crowded, exciting place where everyone seems to be talking at once. And actually, they are. Stocks are sold at auction in a stock exchange and the term "bid" is part of the everyday jargon. There are several trading posts scattered on the floor of the stock exchange, and each post will sell around sixty-five different securities. You have said you are willing to pay the market price, so the floor broker walks (no running; it's against the rules) to the U-shaped trading post where Ferdis Widgets stock is sold. Brokers called *specialists* are stationed at the trading post, and they are responsible for perhaps twelve different stocks which they actually buy and sell. The floor broker will ask the specialist what the price of Ferdis Widgets is. The specialist may answer that it is *bid* at 10 and *asked* at 10½. What the specialist is saying is, "I will buy Ferdis Widgets for $10 a share if you have a customer who wants to sell his stock; I will sell Ferdis Widgets for $10.50 a share if you have a customer who wants to buy stock." The floor broker now knows he can buy your widget stock for $10.50 a share, but he will try to get the best possible price for you. He does this by shouting out your order. Other floor brokers from other brokerage firms who may be selling shares of Ferdis Widgets, shout out the amount their clients are willing to sell their stocks for. It sounds like a general free-for-all! Eventually however, in the midst of all this din, the buying and selling brokers agree on a price,

Trading is usually brisk on the floor of the New York Stock Exchange.

and the transaction is written down on a piece of paper. If your floor broker is unable to find anyone selling Ferdis Widgets for less than the specialist's asked price, then he will purchase the stock from him—or her. Once the sale is agreed upon, the necessary information is written down on a slip of paper and handed to a runner who sees to it that your transaction gets to the tape operator. The tape operator places the transaction on an electric device called a *ticker*, and the ticker tape flashes the news to brokerage firms across the country that 100 shares of Ferdis Widgets, Inc., have just been sold for $10.50 a share. The entire process has taken only a few minutes.

Even though you had anticipated purchasing widget stock for $10 a share when you called your broker, you are now obligated to go through with your purchase at $10.50 a share, because you agreed to buy it at the market price. Right now you may be thinking, "If I decide to purchase stock I'm going to be at the mercy of the floor brokers who are, after all, spending *my* money, not theirs!" That is really not the case. You can place a *limit order*. A limit order places a limit on the amount you are willing to spend for a particular stock, but you must state your limit at the time you place your order. Then, if you have said that you cannot spend more than $10.50 a share for Ferdis Widgets, and the price has already climbed to $11 a share when your buy order reaches the floor broker, no sale will take place. Instead, the floor broker will leave your buy order with the specialist who, in turn, will fill it when—or if—the price of Ferdis Widgets drops to $10.50. If you have just placed a *day order*, then it

Floor brokers place orders during a rally in trading.

will be void at the close of the business day if it has not been filled. However, if you placed an *open order*, then it is considered GTC—good till canceled—and the specialist will hold it until he can fill it at the price you specified.

Another kind of order is the *stop order*. It can be an order to either buy or sell at a specific price. For example, if you had reason to think that your Ferdis Widgets stock might be going down, you could place a *stop sell* order at, say, $9 a share. Then you could go about your business, secure in the knowledge that if your stock fell to that price, your broker would automatically sell it for you and you would be out of the market before it fell further. On the other hand, you might want to place a *stop buy* order. Perhaps you feel that a boom time for widgets is just around the corner, and if your widget stock hits $11 a share it will continue to climb up from there. If this happens, you may want to buy more widget stock. You can place a *stop buy* order with your broker, and he will fill it for you automatically if the stock rises to that price.

People usually buy stock in the anticipation that its price will rise, and they will make a profit when they eventually sell it. But it may surprise you to know that during a bear market, when the price of stock is falling, people also buy, and they anticipate reaping a profit from this kind of transaction, too. It is called *selling short*, and selling short can be a risky business. When a person sells short, he is actually selling something he does not own. It sounds illegal, but it isn't. If Ferdis Widgets is falling in price, an investor might be able to persuade his broker to lend him 100 shares from the broker's own account. The investor then sells these borrrowed shares on the market for, say, $9 a share. If everything works out according to the investor's selling-short strategy, the price will continue to drop. At some point, the investor will

have to return the borrowed shares to his broker, but if he can buy 100 shares of Ferdis Widgets at $5 a share, he's made a profit of $400, less the broker's commission. This kind of transaction is risky, of course, because the price of the stock could rise, and the investor would still have to purchase 100 shares of stock in order to return them to his broker. If he has to pay anything over $9 a share, instead of reaping a profit he would suffer a loss.

There is one other way that investors borrow money from their brokers to buy securities. It is called buying on *margin*, and it is strictly controlled by federal law and stock exchange rules. When an investor buys stock on margin, he is asked to deposit at least $2,000 in cash or securities in his brokerage account. Then, if he wishes to buy a stock on margin, he will be allowed to pay 50 percent of its purchase price—which becomes his margin—and the brokerage firm will pay the other 50 percent. Of course, he owes the brokerage firm for the other 50 percent, and the firm will charge the investor interest on that money. Federal Reserve Board policy stipulates the amount of margin that an investor must have in his stocks, and this percentage is changed from time to time as the economy changes. In addition to the federal requirement, the brokerage house has its own requirement about how much of a person's own money has to be invested in the stock. Most exchanges require at least 25 percent of the stock's value be in your money. So, if you buy 100 shares of Ferdis Widgets at $10 a share, you have $1,000 worth of stock. If you purchased it on margin, you would have $500 of your own money in the stock, and you would owe the broker for the other $500. (By the way, the broker will not expect to be paid this $500 until you sell the stock. The broker is making money on the interest you are being charged.) Let's imagine that suddenly the price of Ferdis stock

begins to fall. It's now worth only $6 a share, so you now have $600 worth of stock instead of $1,000—and you still owe the broker the original $500! So, actually, you only have $100 of your own money in this stock, and $100 is less than 25 percent of $600, which is what the stock is worth. Your broker will issue a *margin call*. That is, he will ask you to put up additional money to build your margin in the stock up to the proper level. If you do not have the money to answer this margin call, then the broker will sell the stock, take his $500, and return whatever—if anything—is left to you.

Margin purchases are regulated and watched very carefully because careless use of these kinds of accounts contributed to the stock market crash in 1929. In those days before the Securities and Exchange Act, people were buying stocks with as little as a 10 percent margin. The ease of purchasing stock when you had to pay only 10 cents for every dollar's worth, encouraged people to get into the market even when they did not have the necessary financial resources. When the prices began to fall, brokers issued margin calls and these people simply did not have the money to respond. The brokers lost money, the investors lost money, and the economy of the nation collapsed.

There is one other type of purchase that is popular with today's investors. It is called the *option*. An option gives the purchaser the right to buy or sell a specific security, at a specific time, and for a specific price in the future. It works like this: Perhaps you are convinced that a stock you are interested in and which is selling for $25 a share will soar to $50 a share in the next six months. You are not convinced enough, however, to spend $2,500 and buy 100 shares of it today. Maybe you simply do not have the money. You could, however, put a *call* option on that stock. If

your intuition is correct and the stock rises to $50 within the time period you have in your option, then you are free to exercise that option. Although the stock is selling on the market at $50, you can purchase it for $25. Of course there is a fee for this service. The broker charges you a percentage (usually between 10 percent and 15 percent of the stock's value) when you buy the option, so this particular option could have cost you $250 to $375, but that's a small price to pay for doubling your money. And what if you were wrong and the stock never made it to $50 a share? You simply let your option expire. True, you've lost what it cost you, but that's better than having invested $2,500 and watched it disappear. The situation works in reverse as well. An option to sell stock at a specific price and time is called a *put* option, and people buy those to give themselves insurance that they will always be able to sell their stock for at least a minimum price, usually what they have paid for it. If the stock rises above that price, they can let their put option expire.

6

Lending Your Money

A Look at Bonds

There are two ways you, or any investor, can make your money increase. You can spend it by buying stock, or you can lend it by buying bonds. Of course, your money can *decrease* by doing either of those two things also! You may think, "Well, I won't spend it, and I won't lend it, either. I'll just keep it." At first glance, keeping your money may appear to be the safest thing to do with it, but depending on *where* you keep it, you could actually lose it—it could be slipping away from you even as you look at it, touch it, count it, and congratulate yourself for being clever enough to keep it. Why is that so? Because money that is neither spent nor lent—in other words, money that is not invested—can deteriorate in value due to something called *inflation*.

During periods of inflation, a plentiful supply of money is in circulation in the economy. In other words, people are spending more, often borrowing money from banks and other lending institutions to do so. As a general rule, it is safe to say that the more of something there is, the less valuable the item becomes. After all, if diamonds were as plentiful as

pebbles, diamonds would be far less valuable than they are. The same is true of the value of a dollar. The more money there is in circulation, the less valuable each dollar becomes. During inflation, then, because there is more money in circulation, the value of a dollar decreases. Therefore, it takes more dollars to buy an item today, than it would have to purchase the same item last year. An economy's rate of inflation is something that always influences investors and always affects the securities industry. Why? Because, depending on the times, investors are trying to decide whether to spend or lend their risk capital.

In order to protect the value of their dollars during inflationary times, most people want to invest them in something whose price will rise, right along with the cost of everything else. As a general rule, investment in the stock market is attractive to these people, because as we have seen, the price of stock tends to rise as prices for other goods and services rise also.

Recession is a period in the economy that is the opposite of inflation. During a recession, the economy is not growing; in fact, it is moving backward. Prices may fall, or at the very least they will remain the same, because there is not as much money in circulation as there has been in the past. People and investors are "tightening their belts." Part of the reason people are reluctant to spend is because the interest rates are high, but it is these high interest rates that make buying bonds attractive to some investors. They are not willing to spend their money, but to lend it to a corporation by purchasing its bonds.

If you buy a $1,000 Ferdis Widgets bond, you give Ferdis Widgets your money and receive, in turn, a bond from the corporation promising to pay you a guaranteed rate of interest on your money while the widget company uses it, and the promise that the company will *redeem* (buy back) the bond when it

matures. Bonds are issued for a specific period of time, usually several years; when the time is up, investors say the bond has *matured*. It can then be redeemed for its face value. When you purchase your bond, you do not pay $1,000 for it. That amount is the *face value* or *par value* of the bond. It is the amount of money you will receive when the bond matures. Instead, you pay a percentage of the face value of the bond. Stock prices are always quoted in 1/8 of a dollar; bond prices are always quoted in 1/8 of a percent.

In Chapter 1 we talked briefly about bonds and stated that owning them makes the investor a creditor of the corporation, not an owner. When people lend other people, or corporations, money, they want some kind of assurance that they will get their money back. Some creditors will accept a *mortgage* on property as a guarantee, or pledge, that the debt will be paid. A mortgage gives the creditor—the person lending the money— a claim on property that the borrower has. In other words, if you borrow money from a bank to buy a car, the bank becomes your creditor and it may hold a $5,000 mortgage on that car until the debt is paid. You will also have to pay the bank interest on that money until the debt is paid. Some bonds are issued in a similar manner.

Just like any other creditor, the bondholder is interested in protecting his money while it is in a bond. Some bonds are protected just like the bank protects its car loans—the creditor holds a mortgage on property. In this case, the mortgage could be on the buildings and equipment that belong to Ferdis Widgets. If Ferdis Widgets went out of business before its bonds matured, the holders of those bonds could possibly claim a percentage of the value of Ferdis's assets. But what if a company doesn't have the kind of assets that are tangible, that you can touch? How can you hold a mortgage, for example, on the assets of a city?

Who owns the streets? the fire department? the park? Well, of course, the answer is the citizens of the city. They paid the taxes that provided those things, even though the city may have issued bonds to come up with additional money to improve them. The fact is, there are some bonds (and various government bonds are good examples of some of them) that simply cannot be secured by a mortgage. If that is the case, the bond is properly called a *debenture*. In the case of debentures, the only guarantee an investor has is the credit of the corporation that issues it.

Bonds are given ratings by companies like Moody's Investors and Standard & Poor's Corporation. Moody's and Standard and Poor's charge companies a fee to rate their bonds, and the companies happily pay it, because they know investors will not buy their bonds if they are not rated—it would be too risky for the investor. A rating is a judgment of the company and its performance, much like your report card is a judgment of you and your performance. The ratings range from AAA down to B—no F's in this case! The AAA bond is the safest bond an investor can buy. The issuing corporation's credit rating is excellent, and the investor can be almost certain of receiving the bond's face value at maturity, and collecting the semiannual interest payments during the life of the bond. From AAA, the ratings drop to AA, then A, then BBB, BB, and B. There are subcategories of bonds under each of these ratings, too! As the ratings drop, the risk for the investor increases and the bonds become more speculative. When investors *speculate* in either the stock market or the bond market, they buy securities that are risky in the hope of making a large profit. A bond rated B would be considered speculative, that is, risky, because the payment of interest might not be assured under difficult economic conditions. Investors who wish to know more about a corporation's

bonds can discuss them with their broker, or look them up in publications such as Moody's and Standard and Poor's.

The interest rate that corporations are willing to pay on their bonds depends on the economy at the time the bonds are issued. If interest rates are high, as they usually are at the beginning of periods of recession, corporations issuing bonds must offer to pay those high interest rates in order to get investors to buy their bonds. Once the interest rate on a bond is set, it cannot be changed. As the recession continues interest rates can come down, but the corporation cannot renegotiate the interest it is paying on its bonds. It *must* continue to pay the investors the higher interest rate. So you can see that bonds can be an attractive investment during periods of high interest rates, especially if investors think the rates will fall in the future. By buying bonds, they can be sure their money will earn the higher interest rate, at least for the life of the bond.

But then, interest rates generally drift *upward*, not downward, and that presents a problem for bond holders. If you purchased bonds that paid you 10 percent interest and matured in twenty years, what happens if five years down the road bonds are being issued that pay 12 percent interest? What are you going to do to make up that 2 percent interest you are losing? Not much. Oh, you can sell your bond. They are traded just like stock. But who will buy a bond from you that pays only 10 percent interest when they can buy a new one that pays 12 percent? If you simply *have* to get some of your money you can sell the bond at a discounted rate. That is, you can sell it for less than its face value—it's sort of like selling a dollar for 75 cents. Someone might not mind getting 2 percent less than the going rate on interest, if he could buy a bond for $750 that would pay $1,000 on maturity.

Even though bonds are generally considered to be less speculative an investment than stocks, you can see that they do have their drawbacks, too.

Although a AAA bond is guaranteed (as much as any security can be said to be "guaranteed") to return the investor's principal when the bond matures, and they are guaranteed to continue to pay the interest at which they were issued, they are not guaranteed to increase in value beyond that, even if the issuing corporation's profits soared and the value of their common stock went up like a rocket. So you can see that an investment in a corporation's stock allows the investor to spend his money in order to participate in the company's growth; an investment in a corporation's bonds allows the investor to lend his money with a pretty good guarantee that it will be returned to him with interest.

When an investor wants to buy a bond, his stockbroker will do it for him or her. Like stocks, they have their "bid" and "asked" price, but unlike stocks, they are not bought and sold each day. In fact, many bonds will not change hands for as many as fifteen days in a row! The "bid" and "asked" prices of bonds that are sold on the New York Stock Exchange are kept in a cabinet in a special section on the floor of the exchange. When a trader wants to check on the price of a *cabinet bond* (that's what these bonds are called), he looks at the quote in the cabinet. There's no yelling out prices in bond sales.

The bonds that sell on the New York Stock Exchange are quoted in the newspaper, just like the stock market listings. However, the information given on a bond quote is different, because bonds are different from stocks. Like stocks, we see that bonds are listed alphabetically with the corporation's name abbreviated. In the illustration, look at ATT7s01. What in the world does that tell you? ATT stands for

New York Exchange Bonds

Tuesday, December 4, 1984

Total Volume $28,350,000

	Domestic Tue.	Domestic Mon.	All Issues Tue.	All Issues Mon.
Issues traded	974	918	980	922
Advances	400	302	403	302
Declines	360	425	361	427
Unchanged	214	191	216	193
New highs	67	58	68	58
New lows	12	16	12	16

SALES SINCE JANUARY 1

1984	1983	1982
$6,413,521,000	$7,055,999,000	$6,507,151,000

Dow Jones Bond Averages

1982 High	1982 Low	1983 High	1983 Low	1984 High	1984 Low		Tuesday	1984	1983	1982
71.52	55.67	77.84	69.35	72.86	64.81	20 Bonds	72.38 – .21	70.32 – .19	70.96 + .45	
72.71	53.80	78.88	65.76	70.31	59.43	10 Utilities	69.11 – .31	67.32 – .43	71.30 + .68	
71.23	57.36	77.13	71.51	75.77	69.61	10 Industrial	75.66 – .09	73.33 + .06	70.62 + .22	

CORPORATION BONDS
Volume, $28,220,000

Bonds	Cur Yld	Vol	High	Low	Close	Net Chg.
10¾97	15.	6	74	72¾	74	+1¼
4⅝s96	cv	26	69⅜	69⅜	69⅜	– ⅞
9s08	cv	14	73½	73½	73½	+ ½
8½s07	12.	1	70	70	70	.....
9s2000	12.	24	76	75½	76	+ ⅜
8½s01	12.	5	71⅛	71⅛	71⅛	+ ⅛
8⅞s03	12.	23	72⅜	72¼	72⅜	– ⅞
8¼s03	12.	10	68⅛	68⅛	68⅛	.....
9¾s04	12.	5	78¾	78¾	78¾	+ ½
10⅞s05	13.	3	85⅜	85⅜	85⅜	– 2⅛
8⅝s87	9.3	17	93	93	93	+ ⅜
9⅝s08	12.	10	77⅜	77⅛	77⅛	– 1¾
12⅜10	13.	2	97	97	97	– 1½
15¼10	15.	125	104½	102½	103	– 3⅜
14¾91	14.	5	108⅜	108¼	108¼	+ ½
17⅜11	15.	32	114½	112¾	114½	+2
18¼89	17.	50	110½	110½	110½	+ ⅜
9s03	cv	2	98½	98½	98½	.....
16¼99	15.	5	111	111	111	– 1
17¾91	16.	8	113	112⅛	112⅛	– 2⅞
18¾01	17.	79	111	110½	110¾	– ¼
10.4s02	15.	2	71¼	71¼	71¼	.....
zr87	..	3	74¼	74¼	74¼	+ ½
zr92	..	11	40¾	40	40	– ⅞
zr96s	..	53	26⅞	25	25	– 1
zr98s	..	40	20⅜	20⅜	20⅜	– ⅛
zr2000s	..	2	17¼	16¾	17¼	+ ¾
d6s90	8.2	2	73⅜	73⅜	73⅜	.....
9½07	cv	135	137½	136½	137½	+1
8¾09	cv	1	110	110	110	– ½
10.35s99	16.	1	65⅝	65⅝	65⅝	– 2
16s91	16.	30	97¼	97	97	– 2¼
7⅞87	8.5	10	93¾	92¾	92¾	– ¾
9s95	11.	3	83	83	83	+ ¾
9½95	11.	4	82⅞	82⅞	82⅞	+ ⅝
93s00	14.	15	68	68	68	– 2
14¼90	14.	10	101	101	101	+1
5s30	12.	50	41	41	41	+1
5s30r	13.	20	40	40	40	.....
5¼98	11.	5	48	48	48	.....
8⅛85	8.2	10	99⅝	99⅝	99⅝	.....
13¼93	13.	16	104	104	104	+1¾
6¾91	cv	10	68	68	68	.....
11¼00	12.	30	92½	91¼	91¼	– 1⅜
11s07	cv	40	140	139	139	+1
11s08	cv	36	140	139	139	+ ½
9½01	cv	72	105½	104⅞	105¼	+ ¼
8¼08	cv	11	85¼	84½	85¼	– ¾
13s01	cv	10	130	130	130	– 6
6s88	cv	6	78½	78½	78½	.....
9⅞90	9.9	7	100	100	100	– ⅛
4⅜s85	4.5	166	98½	98 5-16	98 5-16	
2⅝s86	2.9	80	90⅜	90¼	90¼	
2⅞s87	3.3	25	87	87	87	
3⅞s90	5.2	145	74	73¾	74	+
8¾00	11.	285	77¼	77	77⅛	–
7s01	11.	313	65⅛	64⅞	64⅞	+ ⅛
7⅛s03	11.	108	64⅜	64	64	– ⅛
8.80s05	12.	139	75½	75¼	75¼	– ⅜
8⅜s07	12.	97	74	73⅝	73⅝	– ⅜
10¾90	11.	194	96¼	96	96	+ ⅛
13¼91	13.	181	104½	104⅛	104⅛	– ⅛
8½09	cv	53	102¼	101	101	– 1¼
13⅞02f	cv	7	48¼	47½	47½	– ¾
8.55s08	12.	5	69	69	69	– 1⅜
9.9s86	9.9	12	100½	98⅜	100½	+ 2½
11s87	11.	10	100	100	100	.....
9½89	10.	2	92	92	92	– 2⅞
7.45s02	12.	8	60½	60½	60½	+ ⅜

Bonds	Cur Yld	Vol	High	Low	Close	Net Chg.
Bevrly 7⅜03	cv	10	93	93	93	+1
BigT 8½06	cv	20	77¾	77¾	77¾	.....
Boeing 8⅞06	cv	49	132¼	132¼	132¼	+1
BrkUn 9½95	11.	8	82½	82½	82½	– ½
BwnSh 9¼05	cv	4	75	75	75	.....
BrnGp 9⅞00	12.	5	84	84	84	+5½
BurlInd 9s95	12.	5	77⅝	77⅝	77⅝	– 1⅛
BurlInd 8¾08	cv	52	75	75	75	.....
Butte 10¼97	17.	48	59⅜	59	59	– ⅜
CIT 9s91	11.	7	83⅝	83⅝	83⅝	.....
CIT 9⅝09	12.	5	77¾	77¾	77¾	– ⅞
CNA 8½95	11.	5	75	75	75	– 1¾
Caesr 11¼97	13.	7	84	84	84	+2
CPc4s perp	12.	12	34¾	34¾	34¾	
CapHd 12¾06	13.	36	99¾	99¼		
CarPL 7¾02	12.	20	65⅝			
CaroT 8.1s03	12.	2			91½	– ⅛
Carr 8⅛s96	12.				94	–1
CasNG 10¼						
CastIC						
C			53	75	65	– 2
		14.	9	105	105	105	.....
	11½00O	15.	36	75	73⅝	75	.....
	11½00N	15.	9	75	73⅝	75	.....
Celanse 4s90	cv	6	84⅝	84⅝	84⅝	+ ⅛
Celanse 9¾06	cv	30	116	115	116	+ ½
CtrlTel 8s96	11.	14	74	74	74	.....
Cessna 8s08	cv	1	83	83	83	+1
CATS zr91	..	7	47	47	47	+ ¾
CATS zr92	..	6	44	43½	43½	– 1⅜
CATS zr95	..	7	32½	32½	32½	.....
CATS zr97	..	25	25⅜	25½	25½	+ ⅞
CATS zr02	..	11	17½	17½	17½	+ ⅛
CATS zr03	..	12	15½	15½	15½	– ¼
vjChtCo 10⅝98f	..	37	22¼	21⅜	22⅛	+ ⅛
vjChtC d14¾02f	..	46	24	23⅝	23⅝	– ⅜
ChsBk 8¾86	9.0	31	96¾	96⅜	96¾	+ ⅜

Bonds	Cur Yld	Vol	High	Low	Close	Net Chg.
CmwE 8¼07	12.	2	67¼	67¼	67¼	.....
CmwE 9⅛08	13.	6	73	73	73	+ ⅞
CmwE 12½86	12.	43	102	101½	101½	– ¼
CmwE 14⅞87	14.	10	106	106	106	.....
CmwE 14s91	13.	5	104⅞	104⅞	104⅞	+ ⅝
CmwE 16¼89	15.	1	106½		107⅜	+ ⅝
CmwE 16s90	15.	5	11			
CmwE 16¾11	14.					+ 2¼
CmwE 12⅛						
CmpSci					73¼	– ¾
Con					103⅜	104¾	+3
					93⅝	93⅝	93⅝	.....
			2.7	10	92⅜	92⅜	92⅜	.....
	5s87		4.7	8	90½	90½	90½	+1
	4s88		5.0	19	86⅛	85¾	85¾	+ ⅛
ConEd	4s88		5.8	20	86⅛	85¾	85¾	+ ⅛
ConEd	5s90		6.9	10	80	80	80	+ ⅜
ConEd	4⅝91		6.8	10	72⅝	72½	72⅝	.....
ConEd	4⅝91r		6.8	10	68⅜	68⅜	68⅜	– ½
ConEd	4¾92V		6.8	10	67⅝	67⅝	67⅝	.....
ConEd	4¾92V		6.7	7	65	65	65	+ ¾
ConEd	4¾92W		6.8	25	64	64	64	+2
ConEd	4⅝93		7.3	27	63⅛	62¼	63⅛	+ ⅞
ConEd	9¾00		12.	45	80	79⅛	80	– ¾
ConEd	7.9s01		11.	21	69⅜	69⅜	69⅜	.....
ConEd	7.9s02		11.	18	69	68⅞	68⅞	– ⅛
ConEd	7¾03		11.	1	68	68	68	– 1½
ConEd	8.4s03		12.	20	72⅛	71⅞	71⅞	– ⅛
ConEd	9⅛04		12.	74	77¾	77⅛	77½	+ ½
CnNGS	8¾96		11.	10	79⅜	79⅜	79⅜	+ ¾
CnPw	4½88		6.6	5	68⅛	68⅛	68⅛	– ⅞
CnPw	5⅞96		13.	25	48	47	47	+1
CnPw	6⅞98		14.	4	48⅜	48⅜	48⅜	– ⅝
CnPw	6⅝98		14.	25	49	47½	47½	+ ¾
CnPw	7⅜99		15.	10	52	52	52	+1
CnPw	8⅜00		15.	15	56⅜	56⅜	56⅜	+ ⅛
CnPw	8⅛01		15.	65	53½	53¼	53¼	.....
CnPw	7½02J		15.	50	49½	48¾	49¼	– ¾
CnPw	7½02O		15.	35	50	49	50	+ ⅜

ATT 7s01 11. 313 65⅛ 64⅞ 64⅞ + ⅛

Bond listings appear daily in the newspaper.

American Telephone and Telegraph, Inc. You've heard of *them*, haven't you? The listing in the paper tells you that the AT&T bonds that pay 7 percent a year (that's the 7s) will mature in the year 2001 (that's the 01). The next figure—in the column headed Yld, for yield—is a percentage that tells you how much you are earning on your investment in the bond. In this case, the yield, or return is 11 percent. The yield is higher than the interest on the bond because the bond is currently selling at a lower price than the one at which it was issued. The next column tells you how many $1,000 bonds were sold. In this case, 313. For how much? Well, the listing tells us that the high bid was 65 1/8 percent, the low bid was 64 7/8 percent, and they closed at 64 7/8. The "last change" column shows that these bonds were up by 1/8 percent, so we can figure that the last time they were sold, they must have gone for 64 3/4 percent of face value, or 64 3/4 percent of $1,000. As you can see, there are several listings for AT&T bonds. Companies can issue more than one set.

Even though the listing for New York bonds looks vast, only about 5 percent of the total bonds traded are bought and sold on the stock exchange. Most bonds—the other 95 percent—are bought and sold at a different kind of marketplace, called the over-the-counter market, or OTC for short. Bonds are not the only securities sold over the counter. At least fifty thousand companies sell their stock over the counter, too. For comparison purposes, only six thousand companies have their stock listed on stock exchanges. Stocks which are sold on the OTC market are said to be *unlisted* stocks. The OTC provides a marketplace for those thousands of companies whose size or product makes it impossible for them to be listed on a stock exchange. Nearly all new issues of stock are first sold OTC.

7

Pork Bellies and Profits

A Look at Other Investments

Have you ever heard a financial news commentator discussing the price of pork bellies or May wheat (and it's December!)? He is probably giving the latest quotes from the Chicago Board of Trade, which is the largest commodity market in the world. The commodities, or futures, market is a very active financial market that draws thousands of investors each day. It is different, however, from the secondary and third markets and the OTC market, which we have discussed before.

A share of stock or a bond is an intangible thing. After all, you can hardly reach out and touch it (unless you want to count the piece of paper such as the stock certificate or bond itself). A commodity, however, is tangible. It is a product, and you can touch it. Most commodities bought and sold in the United States are grains, such as wheat and barley and corn. However, pork bellies, coffee, eggs, sugar, gold, silver, tin, and copper, are all traded as well. These items change hands at boards of trade or commodity exchanges.

A commodity exchange is similar to a stock exchange in that all trading is done on the floor of the exchange by members of the exchange. Like the stock market, the commodity market is monitored by an agency of the federal government, the Commodity Futures Trading Commission.

There are two kinds of trading done in a commodity market—cash trading and futures. Cash trading is rather simple and straightforward. The farmers (most of the cash market is in grains) sell their grain for cash to processing plants that will turn it into flour, or to exporters who want to sell it for a profit abroad. The purchasers in a cash market can ask for immediate delivery, or request delivery at a future date. For those who want immediate delivery, there are usually samples of the grain that is for sale right there on the floor of the commodity exchange. Cash trading is a pretty straightforward exchange.

The other type of trading that is done in commodities—futures—is more complicated to explain. The futures market does not deal in an actual product. Instead, contracts to buy or to sell that product at a specific time in the future are traded in an auction which is held in the *pit*, a circle on the floor of the commodity exchange. An example of futures trading might go something like this: In June, a trader buys a futures contract for 2,000 bushels (70,500 liters) of wheat at $3.75 a bushel (35.2 liters). The wheat is to be delivered in September and now will be known as

At the Kansas City Board of Trade, a commodity broker inspects samples of corn, that are ready for trading.

"September wheat." In July, the price of wheat goes up, and now September wheat is selling for $3.85 a bushel. Our trader could sell his contract for September wheat and make a tidy profit of 10 cents a bushel, or $200. When an investor, or trader, purchases something like wheat in the anticipation that the price will rise and the contract can be sold for a profit in the future, the investor is said to be selling from a *long* position, and he is investing during a bull, or rising, commodity market.

However, investors in commodities can also sell short, just as they do in the stock market. In order to sell short, traders sell futures contracts that they do not actually own, banking on a bear market and the hope that the price of wheat will fall before the due date on the contract. If it does fall, the trader will buy a contract at the lower price and all will be well. If the price of wheat goes up, the trader could be in trouble. This kind of futures trading is called speculative trading, and it is risky indeed.

If futures trading is perhaps the riskiest kind of investment, then investments such as a passbook savings account have to be the safest. Many of you reading this book probably already have savings accounts at a bank or a savings and loan institution—an account may be opened for as little as $5. These accounts are a form of investment, for you are actually lending your money to the institution which, in turn, will pay you interest on it while they use it. The interest, which usually ranges from 4½ to 5½ percent, is earned daily. That is, it is earned from the day you deposit your money until the day you withdraw it. A passbook savings account is considered a "demand" deposit; that is, you are free to withdraw, or demand, your money at any time, and the institution must be willing (and able) to give it to you. If, for any reason, the bank cannot come up with your money when you

Traders in action at the grain pit of the Chicago Board of Trade, the largest grain futures exchange in the world

want it, you will get it anyway, which is why these accounts are so safe. Agencies of the federal government insure these accounts against loss for up to $100,000. That means if the bank or savings and loan institution fails and has to close its doors, the government's insurance agency will pay you your money, up to a maximum of $100,000. The Federal Deposit Insurance Corporation, or FDIC, insures bank accounts and the Federal Savings and Loan Insurance Corporation, the FSLIC, insures accounts that are placed in savings and loan institutions.

Look for a seal with those letters on it the next time you go to your bank or savings and loan institution. If you don't see it, ask if the institution is insured. If the manager says it is not, withdraw your money immediately and put it in an institution that has this insurance!

Certificates of deposit, sometimes called "CD's" for short, are another kind of investment in which you loan your money to someone else. They pay higher interest rates than a savings account does; however you must have more money to purchase them, and you must be willing to give up the use of that money for time periods that can range from thirty days to several years. Most CD's are issued in amounts that range from $1,000 to $5,000. The institution that issues your certificate of deposit will promise to pay you a relatively high interest rate compared to the rate paid on savings accounts—perhaps around 10 percent. During 1980 when interest rates skyrocketed, CD's were paying investors a whopping 15 percent. In exchange for this relatively high interest rate, you must give up some of your *liquidity*. If you recall, we said that one of the attractions of the stock market for investors was the fact that their investment was so liquid—that is, could be converted into cash quickly if they needed it. A CD is a different story. With a CD, you promise the

institution you have lent your money to that you will not withdraw it before the time limit is up—whether it is thirty days or eight years. If you do try to withdraw it, the company can make you pay a penalty—or they can actually refuse to let you take your money out until your CD reaches its maturity date. CD's are insured up to the $100,000 limit by the FDIC and the FSLIC.

You've probably heard the expression "Don't put all your eggs in one basket." Well, if possible, you should not put all your investment capital in one security either. To minimize your risk, you should *diversify*, that is, spread your investment dollars among several different kinds of investments similar to the ones we have just mentioned. However, for most people, there is a problem with this kind of plan. Most investors simply don't have the risk capital—the money to spare—to invest in more than one or two areas. Only wealthy investors can afford to diversify and often only they have the time to supervise their investments once they have made them. (Most of the rest of us are too busy going to school or working!) There *is* a way, however, to be diversified in your investments and spend a relatively small amount of money. You can buy shares in something called a *mutual fund*. One of the definitions of mutual is "shared together," as in "We have mutual friends." I may have only $100 to invest. That amount certainly will not allow me to diversify my investments. However, if you have $100, and Sam, Bill, and Hortense have $100, and five other friends each have $100, by pooling your money together you will have $1,000 to invest. Now you're talking. And if you each had $1,000 to invest and pooled it, why, you'd have $10,000 to invest. And if you each had $10,000 to invest you could pool it and have $100,000! You get the picture. Mutual funds allow smaller investors to

diversify their investment dollar in the same way that wealthy individuals and corporations diversify their investments.

Mutual funds are operated by professional money managers who select the securities the funds will buy and then supervise those investments after they are purchased. The profits from these diversified investments are then shared on a percentage basis with the persons like you and me, and Hortense, Sam, and Bill, and anyone else who has contributed to the mutual fund.

As you can see by now, there are many, many ways to invest your money—stocks, bonds, futures, savings accounts, CD's, mutual funds—are just a few; the list can go on and on. People speak of "playing the stock market" as if it were a game like "Monopoly." In some ways, it is like a game. You win and lose in the stock market, just as you win and lose in "Monopoly." Some success comes through sheer good luck, like landing on Boardwalk and being able to buy it. Some disasters come through plain bad luck, like drawing "Go to jail. Go directly to jail. Do not pass go. Do not collect $200." Fortunately, success in the stock market is not dependent on a roll of the dice. As you have seen, there are many resources that careful investors can use to see that their profits exceed their losses. Pork bellies, anyone?

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