

**PART 4:**  
**MANAGING YOUR INVESTMENTS**

## **Chapter 12**

### **Securities Markets**





# Learning Objectives

- Identify and describe the primary and secondary securities markets.
- Trade securities using a broker.
- Locate and use several different sources of investment information to trade securities.



# Securities Markets

- A place where you buy and sell securities.
- Includes stocks and bonds.
- Securities are issued by corporations to raise money.
- After the initial issue, securities are traded among investors.



# Primary Markets

- Place where new securities are traded.
- 2 types of primary market offerings:
  - Initial public offering (IPO) - the first time a company's stock is traded publicly.
  - Seasoned new issues - stock offerings by companies that already have stock trading in the marketplace.



# Primary Markets

- Primary market activities require the help of an investment banker to serve as the underwriter.
  - The underwriter is a middleman who buys the entire issue from the company, then resells it to the public.
- The managing investment banker will form a syndicate of other investment banking companies to underwrite the security.



# Primary Markets

- Tombstone ads are placed in newspapers to announce the offering and provide details.
- A prospectus describes the issue and the issuing company's financial prospects.



# Secondary Markets - Stocks

- Previously-issued securities trade in the secondary markets.
- Secondary markets can be either:
  - Organized exchange – a physical location where stocks trade.
  - Over-the-counter market – transactions conducted over phone or computer.



# Secondary Markets - Stocks

- There are 9 organized exchanges in the U.S.

## National Exchanges:

- New York Stock Exchange (NYSE)
- American Stock Exchange (AMEX)

## Regional Exchanges:

- Pacific Stock Exchange
- Chicago Stock Exchange
- Philadelphia Stock Exchange
- Cincinnati Stock Exchange
- Intermountain Stock Exchange
- Spokane Stock Exchange
- Boston Stock Exchange



# Secondary Markets - Stocks

- New York Stock Exchange (NYSE) – also known as the “Big Board”
  - The oldest of the U.S. exchanges.
  - In 1792, 24 traders signed the “Buttonwood Agreement,” giving preference to each other when trading securities.



# Secondary Markets - Stocks

- Members of the NYSE occupy “seats” with the number fixed at 1366.
- On December 1, 2005, a seat sold for a record \$4 million.
- 2800 companies are listed on the NYSE.



# Secondary Markets - Stocks

- The American Stock Exchange (AMEX) is the second largest organized U.S. exchange, in terms of the number of listed companies.
- 1000 companies are listed on the AMEX.
- It has 660 “seats” and operates like the NYSE.
- The daily dollar value of trading is less than some regional exchanges.



# Secondary Markets - Stocks

- The Regional Stock Exchanges trade securities of local and regional firms.
- Have more relaxed listing requirements.
- Many regional exchanges also list stocks found on the NYSE and AMEX.



# Secondary Markets - Stocks

- The over-the-counter (OTC) market links dealers, has no listing requirements.
- The OTC is highly automated, providing quotes on 35,000 securities.
- Information on infrequently-traded stocks is disseminated daily through “pink sheets” mailed to dealers.
- More frequently traded stocks are handled by the NASDAQ.



# Secondary Markets - Stocks

- In 1971, the National Association of Securities Dealers Automated Quotations system (NASDAQ) was created, allowing dealers to post bid and ask prices for OTC stocks via computers.
  - Bid price – price at which an individual is willing to purchase a security.
  - Ask price – price at which an individual is willing to sell a security.



# Secondary Markets - Bonds

- While some bonds trade at the NYSE, most trading is done through bond dealers.
- Bond dealers deal directly with large financial institutions. Smaller investors use a broker.
- Limited interest in the secondary market for corporate debt.
- Tremendous interest in the secondary market for government bonds, totaling billions of dollars monthly.



# International Markets

- Babylonians introduced debt financing as far back as 2000 B.C.
- The world bond market is valued at over \$25 trillion, dominated by the U.S. market.
- Japan, Germany, France, and the United Kingdom are major players.



# International Markets

- How can you buy international stocks?
  - Some foreign shares trade on U.S. exchanges.
  - Go online and invest directly in international stocks.
    - Visit [www.intltrader.com](http://www.intltrader.com)



# International Markets

- International stocks can be traded through American Depositary Receipts (ADRs).
  - The foreign stock is held on deposit in the foreign country's bank. The foreign bank issues an ADR, representing direct ownership of those shares. ADR then trades like a stock.



# Regulation of the Securities Markets

- Aim is to protect investors so that all have a fair chance of making money.
- 2 types of regulation:
  - General regulation by the Securities and Exchange Commission (SEC)
  - Self-regulation directly by the exchanges



# Regulation of the Securities Markets

## Securities Act of 1933

- Disclosure of relevant information on IPO's and registration with the Federal Trade Commission.

## Securities Exchange Act of 1934

- Focus on the secondary market.
- Created the SEC to enforce trading laws.
- Required annual reports for shareholders.



# Regulation of the Securities Markets

- Self-Regulation – much day-to-day market regulation, left to the securities industry, is performed by exchanges and the NASD.
- Self-regulation is preferred over government regulation.
- After the October 1987 crash, the NYSE imposed “circuit breakers” to stop or slow future crashes.



# The Role of the Specialist

- Maintains a fair and orderly market.
- Assigned to a stock, acts as both a broker and dealer.
- Acts as a facilitator, keeping track of all buy and sell orders, matching them when appropriate.
- Maintains an inventory to buy and sell stock and affect the price when necessary.



# Order Characteristics

## Order Size

- Odd lots
  - 1-99 shares
- Round lots
  - 100 shares

## Time Periods

- Day orders expire at end of day.
- Good-till-cancelled (GTC) orders remain in effect until filled or cancelled.



# Types of Orders

- Market Orders – buy or sell immediately at the best price available.
- Limit Orders – trade is to be made only if at a certain price or better.
- Stop Orders – order to sell if the price drops below a specified level or to buy if the price climbs above a specified level.



# Short Selling

- Short selling – the more the price drops, the more money you make.
- Borrow stock from the broker and then sell it, in anticipation of the price falling.
- Profit by buying back stock at a lower price and returning it to the broker.
- If price increases, you buy back for more than the sold price, and lose money.



# Short Selling

- Most trading involves buying a stock low and selling it high – making money as the price appreciates.
- Short selling involves selling high and then buying back later at a low price – making money as the stock declines.
- Short seller must put up collateral – margin requirement.



# Types of Brokers

- Full-Service Brokers – paid commissions based on sales volume. Broker gives advice to client and executes trades.
- Discount Brokers – execute trades but do not provide advice. Commissions are 50-70% less than full-service brokers.



# Types of Brokers

- Deep Discount Brokers – in 1994, they began executing trades for up to 90% less than full service brokers.
  - Charles Schwab and Fidelity are examples.
- Online Brokers – either discount or deep discount brokers trading electronically.
  - Costs are extremely low, some at \$5.
  - Some research is provided.



# Cash Versus Margin Accounts

## Cash Accounts

- Investor pays in full.
- Payment due in 3 business days.

## Margin Accounts

- Investors borrow a portion of the purchase price.
- Initial margin is 50%.
- Maintenance margin is the minimum you must maintain.



# Registration: Street Name or Your Name

- Securities can be registered in your name or “street name.”
- Street Name – registered securities remain in the broker’s custody and are a computer entry in your name.
  - More convenient to sell.
  - May have maintenance fee for inactivity.



# Joint Accounts

- Joint Tenancy with Right of Survivorship – when one owner dies, the other receives full ownership of assets in the account.
  - Asset by-pass probate but may be subject to taxes.
- Tenancy-in-Common – the deceased's portion of the account goes to the heirs of the deceased, not the surviving account holder.



# Tips for Online Investing

## Checklist 12.3

- Online trading is quick, but online investing takes time.
- Set price limits.
- If you cancel, make sure it worked before placing another trade.
- No regulations regarding the time to execute a trade.



# Online Trading

- Day traders trade with a very short-term time horizon.
- Goal is to ride momentum.
- It is speculating – not investing.



# Online Trading

- Remember:
  - Be prepared to suffer severe losses.
  - Don't confuse it with investing.
  - Don't believe claims of easy profits.
  - Watch out for “hot tips” or “expert advice.”



# Sources of Investment Information

- Corporate Sources – annual reports
- Brokerage Firm Reports – research reports by security analysts
- The Press – *Wall Street Journal*, *Forbes*, etc.
- Investment Advisory Services – *Moody's*, *S&P*, *Value Line*
- Internet Sources – [www.edgar-online.com](http://www.edgar-online.com)
- Investment Clubs – provide social, educational, and investment value.