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Chapter 11: Stocks

Check Your Answers: Section Assessment

Section 1

Review Key Concepts
1. Companies issue common stock to raise money to start up their businesses and then to help pay for ongoing activities. Some companies offer preferred stock as another method of financing, which may attract more conservative investors.

2. Reasons for investing in common stock include: receiving dividends, appreciation of stock value, and increased value from stock splits. Investors are also given certain rights in return for the money they invest, such as voting at stockholder meetings.

3. The yield on preferred stock is generally lower than on corporate bonds but higher than the yield on common stock. Preferred stock is considered a safer investment than common stock. People who want a steady source of income often buy preferred stock.

Higher Order Thinking
4. The company can bring the stock price down to a price it considers reasonable, making the stock more affordable. Also, a split attracts investors who believe a company splits its stock when it is doing well.

English Language Arts
5. Investing People fear the unknown. For some people, it is easier to do nothing than take a chance. Many people feel safer with more predictable investments, like bonds or CDs. Suggestions for making sound decisions include: research, talk to professionals, and limit funds in riskier investments.

Mathematics
6. Preferred Stock Dividend Annual dividend per share = $52.00 × 4.25% = $2.21; Total dividend per year = $2.21 × 95 shares = $209.95

Section 2

Review Key Concepts
1. Newspapers, the Internet, stock advisory services, corporate new publications.

2. Current yield is the annual dividend of an investment divided by the current market value. Total return includes the annual dividend and any increase or decrease in the original purchase price. Earnings per share are a corporation's net earnings divided by the number of outstanding shares of common stock. The price-earnings (PE) ratio is the price of one share of stock divided by the corporation's earnings per share over 12 months.

3. The fundamental theory assumes that a stock's real value is determined by looking at the company's future earnings. The technical theory is based on the idea that a stock's value is determined by forces in the stock market itself. The efficient market theory argues that stock prices are purely random.

4. Blue chip stocks are issued by strong, respected companies and are usually a safe investment. Income stocks, often issued by gas and electric companies, pay higher-than-average, predictable dividends. Growth stocks generally do not pay dividends, and are issued by a corporation whose potential earnings may be higher than the average earnings. Cyclical stocks have a market value that reflects the state of the economy. Defensive stocks remain stable during declines in the economy, and dividends continue to be paid. Large-cap stocks are from a corporation that has issued a large number of shares and has a large amount of capitalization. Small-cap stocks are issued by a company with a capitalization of $500 million or less. Penny stocks, issued by new companies or companies whose sales are very unsteady, typically sell for less than $1 a share, and are risky.

Higher Order Thinking

5. Answers will vary. For example, students who chose the fundamental theory may say it is the most concrete and predictable. Those who selected the technical theory may say it is the most sound.

21st Century Skills

6. Interact Effectively Articles will vary depending on interview results, but should include information about the professional's day-to-day activities, skills and requirements, and education and training. Students may include details about testing, licenses, ongoing education, and background checks.

Mathematics

7. Price-Earnings Ratio

Earnings per Share = $1,250,000/120,000 = $10.42; Price-Earnings Ratio = $56.50/$10.42 = 5.42

Section 3

Review Key Concepts

1. The primary market is a market in which investors purchase new security issues from a corporation through an investment bank or some other representative of the corporation. The secondary market is a market for existing financial securities currently traded among investors.

2. Full-service, discount, or online brokerage firms charge commissions (fees) for buying and selling securities for you. An account executive (stockbroker) is an individual licensed to buy or sell securities or stocks for clients. A market order is a request to buy or sell a stock at the current market value. A limit order is a request to buy or sell stock at a specified price. A stop order is a type of limit order to sell a particular stock at the next available opportunity when the market price reaches a specified amount. Firms, stockbrokers, and individuals also have access to software and Web sites for evaluating stocks, tracking portfolios, monitoring value, and buying and selling securities online.

3. Long-term techniques (buy-and-hold, dollar cost averaging, direct investment, dividend reinvestment) are used by investors who want to avoid losses in their investments. Some investors use more speculative, short-term techniques (buying on margin, selling short) which can be risky. Only investors who fully understand the risks should use short-term techniques.

Higher Order Thinking

4. Answers should emphasize that individuals must take responsibility for their investments and make all final decisions. Stockbrokers are human and they may make mistakes. It is also possible to inadvertently become involved with a dishonest account executive who may take advantage of clients' trust.

English Language Arts

5. Choosing Your Broker Students may question the broker about: commissions and additional fees or charges; level of advice they offer; accessibility and availability; recommendations from other clients; how the broker assesses the needs of each client (conservative, aggressive, or middle-of-the road); his or her experience, training, and certifications; how he or she approaches investing (investment philosophy); and tools or research options available to clients.

Mathematics

6. Dollar Cost Averaging Shares purchased in 2007 = $3,000/$97.42 = 30.79 shares; Shares purchased in 2008 = $3,000/$97.67 = 30.72 shares; Shares purchased in 2009 = $3,000/$84.92 = 35.33 shares; Shares purchased in 2010 = $3,000/$130.85 = 22.93 shares; Total shares accumulated = 30.79 + 30.72 + 35.33 + 22.93 = 119.77; Dollar cost average = [($97.42 × 30.79) + ($97.67 × 30.72) + ($84.92 × 35.33) + ($130.85 × 22.93)]/119.77 = $100.19 or ($3,000 × 4 years)/119.77 = $100.19