

## EQUITY ANALYSIS

### INTRODUCTION

This section deals with the valuation of the individual firm. Equity valuation is one of the most studied areas in finance. Countless hours are spent by market professionals, academicians and investors as they try to calculate the intrinsic value of a stock.

Bond valuation is a simple process compared to stock analysis. The value of stock is the value of the firm itself. A share of stock is simply a portion of the value of the firm. All shares combined equal the firm's total value. The term VALUATION to accountants, financiers, and business leaders is a difficult term to quantify. Land, for example, on a firm's balance sheet can be valued by making an appraisal. However, even if an appraisal is done, will all appraisers agree on its price? Probably not. If we take that same example and extend it over the entire firm, its assets, holdings, investments, product, and most importantly, its earnings (and earnings potential), we may begin to see how many opinions may be formed about the firm, its value and *its anticipated future value*.

To begin the **Top Down** valuation process, it is necessary to begin with Economic Analysis. If we can envision an inverted pyramid with three sections; the first section (from the top) holds economic variables used to measure the health of the economy. The center section holds industry variables. The bottom section, the smallest section of the pyramid, holds valuation variables of the individual firm.

**Economic Analysis:** Business Cycles, Monetary & Fiscal Policy, Economic Indicators, World Events & Foreign Trade, Inflation, Public Sentiment, GDP Growth, Unemployment, Productivity, Capacity Utilization, etc.

**Industry Analysis:** Industry Structure, Competition, Supply-Demand Relationships, Product Quality, Cost Elements, Government Regulation, Business Cycle Exposure, etc.

**Analysis of the Individual Firm:** Forecasts of Earnings, Dividends and discount rates, Balance Sheet/Income Statement Analysis, Management, Research, Return, Risk, etc

This logical progression is used by most analysts to make value judgments on company value. The analyst would begin at the top of the pyramid, assess the economic climate from an investment perspective, select an industry that would best perform in the current economy, then select individual firms within that industry that would make the best investments.

One of our assignments uses the Value Line Investment Survey. Value Line holds a great reputation for investment research and information. They use this Top Down approach (no

surprise). We will see this as we use this assignment.

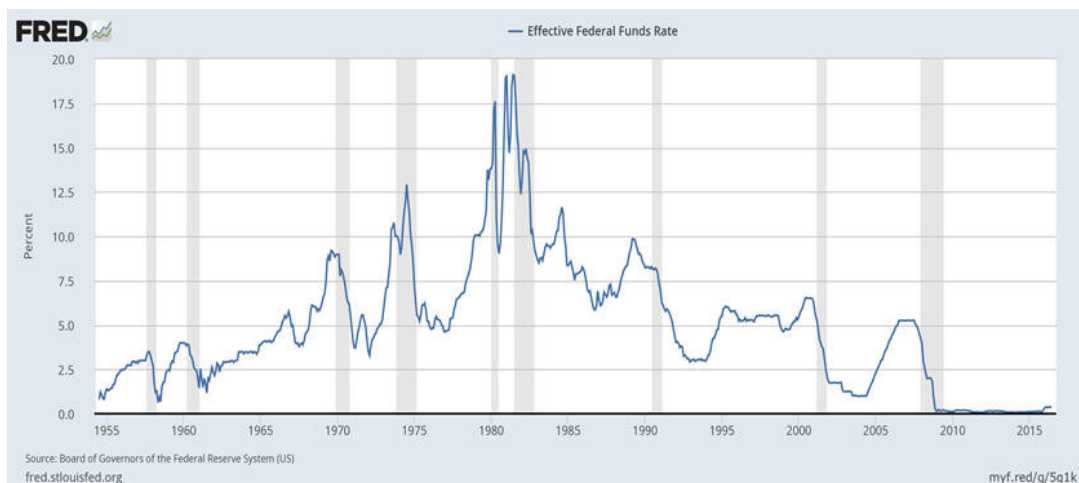
[ A Bottom-Up approach is the opposite of Top-Down. Those engaging in Bottom-Up investment analysis are many times called "Stock Pickers" because they begin with a stock then investigate the industry of that stock, then assess weather the economy is favoring that industry. Or they do no analysis at all, meaning that they were privy to a "hot stock" tip from a friend]

Actual article mentioning top-down and bottom-up analysis including company earnings and a market forecast: [CLICK HERE.](#)

## ECONOMIC VARIABLES

- Discussion of the general economy usually begin with the Business Cycle. Entire economics courses are devoted to the study of past business cycles, what they look like, why they behave the way they do and do we need them.
- Business Cycle - Swings in economic activity encompassing expansionary and recessionary periods. Some economists spend their careers studying the business cycle and trying to forecast its next move. When business activity reaches a high point, it *peaks*, a low point on the cycle is a *trough*.

Business Cycle: The business cycle is usually a graph of economic activity. The graph shown below would have all of the characteristics of a typical business cycle: Peaks, troughs, periods of expansion, periods of contraction activity. This interest rate graph of the Fed Funds Rate is a good example of how the economy's activity is tracked.



- **GOVERNMENT POLICY:** Monetary & Fiscal.
- **Monetary Policy** - The Federal Reserve's primary policy variables. Money Supply and Interest Rates. See my notes on the Fed to get a more complete definition.

- Fiscal Policy - Congress primary policy variables. Taxing and Spending. The US government is known for its deficits (spending more than income), many believe that this is sound economic policy. Great political debates have arisen out of deficit spending conversations. For the first time in over 30 years, the federal government ran a surplus (income exceeded spending) in year 2000.
- Economic Indicators - Primary economic variables that are used to determine our position on the business cycle. It is not important for us to memorize these; the most important one for us in this class is Stock Prices (S&P 500) as a major leading indicator.
  - Leading Indicators - 10 variables that may indicate where the economy will be in the next 3 to 6 months.
    - **The 10 Leading Indicators:**
    - Workweek
    - Unemployment Claims
    - Orders for Consumer Goods
    - Slower Deliveries
    - Plant and Equipment Orders
    - Building Permits
    - **Stock Prices (S&P500) YOU NEED TO REMEMBER THIS ONE.**
    - Money Supply
    - Interest Rate Spread
    - Consumer Expectations
  - Coincident Indicators - Economic indicators that change direction at roughly the same time as the general economy.
    - Employees on Non-Agricultural Payrolls
    - Personal Income Less Transfer Payments
    - Industrial Production
    - Manufacturing and Trade Sales
  - Lagging Indicators - Economic indicators that usually change direction after business conditions have changed.
    - Average duration of unemployment, in weeks
    - Ratio, manufacturing and trade inventories to sales
    - Change in labor cost per unit of output in manufacturing
    - Average Prime Rate charged by Banks
    - Commercial and Industrial Loans Outstanding
    - Ratio, consumer installment credit outstanding to personal income
    - Changes in Consumer Price Index for services
  - The economic indicators are the property of The Conference Board - [www.conference-board.org](http://www.conference-board.org).
- OTHER ECONOMIC INDICATORS
  - Public Attitudes - Consumer confidence.
  - Domestic Legislation - Laws and regulations.
  - Inflation - A general increase in the price of goods and services.
  - Gross Domestic Product (GDP) Growth - GDP is the measure of output from US factories and related consumption in the US. It does not include products made by

US companies in foreign markets.

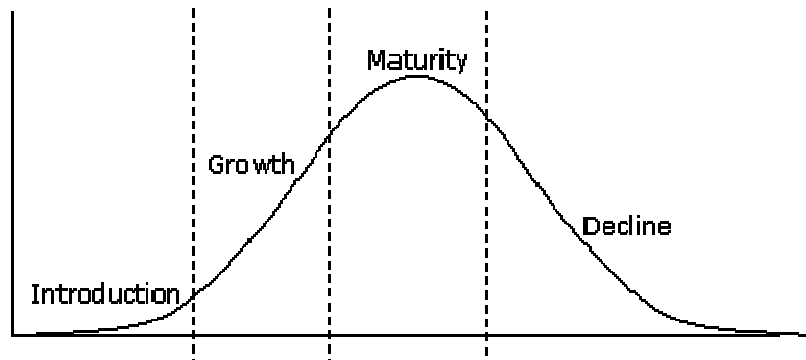
- Unemployment - The percent of the population that wants to work and are currently not working.
- Productivity - Output per worker.
- Capacity Utilization - Output by the firm.

### INDUSTRY VARIABLES

- An analyst will focus on, or specialize in a particular industry. They accumulate all of the knowledge possible on the industry then they "follow" (analyze by maintaining a mathematical model on the firm's financials) one or several firms in that industry. The end of their analysis is to present earnings forecasts and investment recommendations on the firms that they follow.
- Industry Structure - An industry is a collection of firms that sell a like product or engage in a like activity. Examples: The steel industry, computer industry, travel industry, auto industry.
- Pure Competition - Firms that are classified as being in a "Purely Competitive" environment are one of many firms. These firms all sell the same goods and services at the same price, they are said to be Price Takers. Pure Competition is a theoretical economic concept. A convenience store may be the closest example of a purely competitive business. Entrance into this industry is unlimited.
- Imperfect Competition is a more realistic example of an actual firm than is pure competition. Although there are many convenience stores, they can sell different products and services and can have some variation in prices. They are too small, however, to be price makers, they are dictated prices by the demand of the good or service that they are providing.
- Oligopoly is a collection of a few, large firms, like the auto industry. There are large barriers to enter this industry as it is capital intense. An oligopolistic firm attempts to differentiate its product from other firms in its industry. Through advertising, Toyota makes every attempt to differentiate itself away from other car makers; they, through advertising, want us to believe that their product is superior to Nissan or Chevrolet.
- Monopoly. This is a single firm that has a good or service with no close substitutes. The barriers to entry are many times impossible. Monopolists are price makers.

This is a graph of the typical Industry Life Cycle.

### Product (Industry) Life Cycle stages



When an industry is young, it is in the Introduction or Development Stage, sales or profits are not strong but developing.

Ideally, the industry, if at all successful, will expand at a rate superior to the over-all economy. We all want investment that are in the Growth & Expansion phase, the steep portion of the graph. How many of us dreamed of being one of the few who invested in Microsoft, Dell, Wal-Mart, Home Depot, etc., from the start of the firm's life!

As an industry matures, it's profits (sales) level off. The firm is not expected to grow faster than the over-all economy. At this point, the mature firm is making money and not expanding like the growth phase. Investors (owners) expect the firm to begin paying dividends. The auto industry is a great example of an industry in maturity. Their plants are built, they change the manufacturing process for each model year and continue making their product. The auto industry is also an example of an industry that makes durable goods - those goods are designed to last for more than a year. A durable goods industry is one that performs poorly in a recession. It is not a "recession resistant" industry. What would a consumer stop buying if they felt their job was unstable? Durable goods. They would not commit to big purchases if they did not have to. They would wait for the bad economic times to pass, then perhaps update the "big ticket" items like cars. A recession resistant industry would be food, pet food, etc. Where bad economic times barely alter our purchases of these items. When a recession is coming, many professional money managers sell out of industries that fare poorly and buy into industries that survive recessions.

We will discuss the subject of dividend paying stocks very completely in class. The act of a firm paying dividends is a signal to investors that they are (1) not able to reinvest the money into the firm profitably; (2) they are beyond Phase B; (3) the amount of the dividend is "usually equal to the percentage return of a savings account." A very important figure.

- Other Factors that Affect Industry Firms:
  - Competition
  - Supply/Demand Relationships
  - Product Quality
  - Cost Elements
  - Government Regulation
  - Business Cycle Exposure
  - Financial Norms and Standards
  - Dividend Yields and Earnings calculations are the two valuation methods most commonly referred to in financial publications (like the WSJ).
  - Forecasts of Earnings - Earnings are the "bottom line" of the business. Analysts digest all of the variables listed on this site, plus perhaps hundreds or even thousands, all to estimate the earnings of the firm. A firm's earnings add to capital, which increases net worth, which brings a higher stock price.
  - Dividends and Discount Rates - Dividends are a divided portion of earnings distributed to the owners (stockholders) of the firm. The discount rates apply to the analysis of a firm's stock price by making calculations on its dividends. We will use a stock valuation model that shows this.
  - Financial Statements (Balance Sheet and Income Statement) - The two primary financial statements of the firm.
  - Management - Quality of management.
  - Return - Return on assets, return to shareholders, returns of stock prices.
  - Risk - VOLATILITY of stock prices. Risk of the industry in the current economic climate, etc.

## STOCK VALUATION

A beginning point on stock valuation is to calculate the *required rate of return* of the stock that we are valuing. Since every company functions differently, even those in the same industry, their risk/return combinations will be unique. As an investor, one of our first tasks will be to choose firms that have risk/return elements that will fit our own investment objective.

### CAPM - The Required Rate of Return of a Risky Asset

Before the 1950's, investment professionals and investors had a loose definition of risk and how it related to the expected return of an investment. The *Capital Asset Pricing Model* is a mathematical formula to assist investors in understanding where an investment may be on the risk-return graph. We know that risk and return hold direct relationships with each other; when one increases, the other variable is expected to increase.

Risk in this model is measured by the volatility of a stock compared to market (S&P 500) volatility. The Beta ( $\beta$ ). The Beta of the market (S&P 500) is always equal to one. If a stock

has a beta of one, it is expected to be as volatile as the market. A beta of 1.5 is indicative of a security that is 50% more volatile than the market. The more volatility in an investment, the more risk.

The *Capital Asset Pricing Model* is used to calculate the required rate of return on a risky asset - a share of stock.

The Model:  $K_e = R_F + \beta (R_F + \text{Premium} - R_F)$ ;  $K_e$  is the required rate of return of a risky asset.

We also need to mention here that the expected return of the market is equal to:  $R_F + \text{Premium}$ , and is usually denoted as  $K_m$ .

The above model can be re-written as:  $K_e = R_F + \beta (K_m - R_F)$

**$R_F$  is the risk free rate of money.** This can be measured as the rate of return on a bank savings account or usually the rate on a treasury bill.

**Premium is the equity risk premium.** This is the rate of return required to entice an investor out of risk free investments into risky ones. The risk premium, measured over time has been about 7%.

Beta was described above.

### THE DIVIDEND DISCOUNT MODEL (DDM)

Before the 1980's, dividends on stocks comprised an average of 46% of the total return on a stock investment, the remaining 54% came from capital gains. The 1980's brought the technology boom and numerous rapidly growing companies that served investors healthy returns and no mention of dividends. The "tech-wreck" of 1999-2001, renewed many investor's interest in stable firms that provided both ingredients of total return: capital gains and dividends.

Check out this article from Money Magazine on the subject, it will supplement the lecture on the idea of dividends on stocks. ["Dividends Are Back in Style"](#)

Another article that I found on "The Motley Fool" (August, 2006) reiterated how important stock dividends are to investor's total return: [The Secret of Dividends](#).

A traditional stock valuation model that will appear in almost every finance text on investments is the *Dividend Discount Model* or the Dividend Valuation Model. [If you typed that title in your favorite internet search engine, you will get some 30,000 hits on the subject.] The idea is similar to bond valuation. Finance professionals get excited over any idea that has a known cash flow; first because it is known (as opposed to being unknown), secondly because it is cash. A present value calculation can be made on these cash flows to form a value. With dividends comprising such a large part of total return, this model was and still is a popular valuation method.

The Value of a Stock is the present value of its expected dividends plus the present value of the

expected share price at some point in the future. One model that I found on the internet is:

The dividend discount model:

$$V_0 = \sum_{t=1}^{t=n} \frac{D_t}{(1+R)^t} + \frac{V_n}{(1+R)^n}$$

where

- t, n -- the year
- V -- the value of the stock.
- D -- the dividend.
- R -- the discount rate (the required rate of return for a risky asset, as required by the investor)

We can see in this "compact" version of the model that the dividends are represented by "D" and that part of the equation is added to the "V" (stock value component). The large [greek] Sigma letter in front of the formula is simply saying that we are summing or adding several components.

The models that we use in this class are: The General Dividend Model and the Constant Growth model.

**The General Model:** This model has only a dividend (D) in the numerator; the dividend is divided by the investors required rate of return for this stock ( $k_e$ ). The present value of the dividend is being taken using the required rate of return as the "i" in a present value formula. The  $(1+k_e)^1$  looks like  $(1+i)^n$  in a present value model. The negative sign on the exponent is not present because  $(1+k_e)^1$  is in the denominator, this is mathematically equivalent to a negative exponent in the numerator. *I know that you are confused.*

$$V_0 = D_1/(1+k_e)^1 + D_2/(1+k_e)^2 + D_3/(1+k_e)^3 + D_4/(1+k_e)^4 + V_4/(1+k_e)^4$$

**The Constant Growth Model:**

$$V_0 = D_1(1+g)^1 / (1+k_e)^1 + D_2(1+g)^2 / (1+k_e)^2 + D_3(1+g)^3 / (1+k_e)^3 + D_4(1+g)^4 / (1+k_e)^4 + V_4 / (1+k_e)^4$$

This model has a growth rate in the numerator  $(1+g)^1$

If dividends of the firm are being increased over time, a growth rate must be added to the model. In the general model, there was no dividend growth, the firm is paying the same dividend quarter after quarter. This model is more cumbersome to calculate due to the added component, but it is more realistic. Firms that pay dividends want to increase dividends over time. We are



increasing dividends by applying the future value of a single sum formula then, dividing it by the present value of a single sum formula! The dividends are being appropriately increased by the growth rate, the present value must be taken to value those amounts *today*.

The " $V_4$ " entry on the last element is different from the others;  $V_4$  is going to be the estimated Value of the Stock, 4 years from now. Using the Value Line we would extract information from the specific stock page to do the following three methods:

- (1) In the upper left of the Value Line page for a specific company, there is an estimated Hi and Low for the stock over the next three to five years. Simply take an average of these two values and this would be one estimate of the future stock price.
- (2) On the right side of the Value Line, there are statistics about the financial position of the company also estimated from three to five years in the future. The Dividend Yield method is a stock valuation tool equal to the annual dividend/Price is the Dividend Yield. Use the information on the right side of the page, looking for "annual dividend" or "estimated annual dividend" and "Dividend Yield." With both of these numbers, solve for price.
- (3) On the right side of the Value Line, there are statistics about the financial position of the company also estimated from three to five years in the future. The PR Ratio method is another stock valuation tool equal to the Price per Share/Earnings per Share = PE Ratio. Use the information on the right side of the page, looking for "PE Ratio" or "estimated PE Ratio" and "Earnings per Share." With both of these numbers, solve for price.
- Now we have estimated numbers to be used for " $V_4$ ". We can average the three, use the lowest one, use the highest one, or, technically none of them. With that, the model is complete. Calculate to solve for the value of the stock. Done.

What Investopedia says about Dividend Signaling:

A theory that suggests company announcements of an increase in dividend payouts acts as an indicator of the firm possessing strong future prospects. The rationale behind dividend signaling models stems from game theory. A manager that has good investment opportunities is more likely to "signal", than one who doesn't, because it is in their best interest to do so.

Over the years the concept that dividend signaling can predict positive future performance has been a hotly contested subject. Many studies have been done to see if the markets reaction to a "signal" is significant enough to support this theory. For the most part the tests have shown that dividend signaling does occur when companies either increase or decrease the amount of dividends they will be paying out.

The theory of dividend signaling is also a key concept used by proponents of inefficient markets.

[Motley Fool Article about Stock Dividends and how important they are](#)

## STOCKS



At the start of the semester, we studied rates of return, standard deviation and geometric mean of stocks and bonds. We noticed that stocks have far outpaced and outperformed bonds since 1926 [stocks do not and have not outperformed stocks *every* year, but they have for most years].

Stocks represent ownership in the firm. Stockholders hold an *equity interest* in the company. Firms raising capital through stock issues are *equity financing*.

Stockholders have a say in the operation of the company. Not directly, but through electing a Board of Directors who in turn hire management to oversee the business on a daily basis. Directors set policy and help develop operating procedures. One main Board function is to *declare dividends and stock splits* to stockholders.

Common stocks are the "riskiest type" of corporate security as reflected in the standard deviation of returns. Common stockholders are called *residual claimants* - they are entitled to what remains of a company after all other claims have been paid in the case of bankruptcy. They are compensated by being offered the greatest opportunity for reward: Dividends and Capital Gains = Total Return.

## STOCK VALUES

<b>PAR VALUE</b>	Unlike the par value of a bond, the par value of a stock is strictly a legal concept. Most companies issue stock with one cent or even zero as the par value. Bonds have a \$1000 par value due to the bond being sold for that amount when issued. Stock, when issued, takes on a market value, what the investment community is willing to pay for the prospects of the company. The par value keeps the attorneys happy when registering the stock with the Securities and Exchange Commission.
<b>BOOK VALUE</b>	The Book Value of a company is simply the assets minus liabilities. This is an accounting concept. Much analysis is made using the book value of the firm. But, the price that matters to us as investors is the market price.
<b>MARKET VALUE</b>	Price on the stock exchange. Set by supply and demand. This is how much we will pay for ownership in the firm.

## VOTING RIGHTS

As mentioned above, stockholder, while owners of the firm, do not run the firm on a daily basis. We exercise our rights of ownership through the election of members of the Board of Directors. Board members hire management and set policy. When you own stock, you will eventually get an invitation to the firm's annual stockholder meeting. Held annually, this meeting provides an opportunity for shareholders to meet, listen to reports given by directors and management of the firm and to cast your vote for Board members.

As an example, a company may have a Board consisting of nine members, each member has a three-year term to serve on the board. They meet monthly to hear from management, set or change policy, etc. Each year, this sample board will have three directors coming up for re-election. Stockholders will be asked to vote on these vacating seats on the board. Of the three members up for re-election, a fourth person may be on the ballot, running for a seat. A stockholder owning 100 shares of stock, has 100 votes for each vacant seat on the board, called Ordinary Voting. If you owned 10,000 shares, you would be able to cast 10,000 votes for each vacant seat. If you want to take over a company, buy a BUNCH of shares, vote yourself and friends onto the board! This is the way companies get 'taken over.'

<b>ORDINARY VOTING</b>	Stockholder may cast one vote per share owned for each vacancy on the Board of Directors.
<b>CUMULATIVE VOTING</b>	Stockholder may accumulate all of his votes and vote for one director. This benefits the small stockholder. If you own 100 shares, you could 'accumulate' 100 votes for the three vacant seats (a total of 300 votes) and place those votes on one seat. Stockholders that have a relatively few shares would benefit by having at least one director of their choice on the board.

## DIVIDENDS and SPLITS

Some companies will pay dividends on their stock. Dividend theory is a big conversation in finance. When a company is newly formed, they rarely have the money to pay a cash dividend. They use what money could be paid out in dividends to help expand the firm and obtain a foothold in the industry. Firms like Wal-Mart, Home Depot, AOL, Microsoft pay little or no dividend. Imagine a company like Wal-Mart, that may have 2 billion shares outstanding, that they pay \$1 per share per year as a cash dividend. Wal-Mart management will argue that the \$2 billion could better be spent opening new stores, refurbishing existing stores or expanding into other areas of retail, like groceries (Super Wal-Mart).

When a company reaches a stage of maturity and rapid expansion is no longer likely, they will distribute some of their profits back to the stockholders. General Motors' days of rapid, above average growth rates are probably over. A firm like GM will pay a dividend per share per year that will yield an amount equal to a savings account at a bank. For example, if GM stock is trading at \$50 per share, an annual cash dividend of about \$1 per share would be expected.

## STOCK SPLITS and BUYBACKS

As a firm's stock increases in price, management will have an idea when they will declare a *Stock Split*. Put simply, to an existing stockholder a 2:1 (read, "two-for-one") split is like getting two five dollar bills for a ten. If you own 100 shares at \$100 per share before the split, you will have 200 shares at \$50 per share after the split.

A split keeps the existing stockholder's position of ownership equal to their position before the split.

A split is done for two reasons:

First, it puts the shares in a more affordable trading range for the individual investor. At \$100 per share, \$10,000 would be required to purchase a round lot of 100 shares. The individual investor would be encouraged, by a 2:1 (read two-for-one) split and purchase her 100 shares after the split for \$5000. i.e. the share price "splits" by the ratio of the split. If you owned 100 shares at \$100 per share, after the split, you would have 200 shares worth \$50 per share. If you were not a shareholder at the time of the split, you could buy the shares at the post-split price of \$50 per share.

Some companies split their stock 3:1, 4:1, even 5:1.

The more important reason for a split is that it is a signal by management that the future outlook for the firm looks bright. NO firm would want to split their stock if they expect the stock price to fall in the future. During the 1990's, splits were common. Stock prices were growing at rapid paces and expected to continue to do so, splits of 2:1, 3:1, 4:1 and even 5:1 were being declared. Dell Computer's stock price increased 4200% between the years 1996 and 1998. Dell stock was splitting every 6 months. Cisco systems' stock increased 9000% in value within the first 6 years of the company's operation, they declared many splits.

During the year 2000 and 2001, splits were uncommon. The market was falling, the economy was trying to avoid a recession, and the terrorist attack in New York and Washington prompted news of war. All together, this made the future of company earnings uncertain. Wall Street hates uncertainty. When the market fell the week after the terrorist attack, an unprecedented number of firms were buying back their own stock on the stock exchanges. This action is encouraging. Who best knows the direction of the company than the company management? When management buys back \$500 million of their stock as some companies did, the signal was that a bottom was near or that the shares were very under priced. The buyback also takes the dividend liability from the company as they do not pay dividends on stock that they own.

## PREFERRED STOCKS

Preferred stocks hold a position of preference between bond holders and common stock

holders. In case of bankruptcy, bond holders get paid first, followed by preferred stock holders, followed by common stock holders. Because of their position, they share some of the characteristics of both bonds and stocks.	
Preferreds look like a stock because:	Preferreds look like a bond because:
<ol style="list-style-type: none"> <li>1. They do represent ownership of the firm.</li> <li>2. They are shares of stock.</li> <li>3. Sometimes they have voting rights like common stock.</li> <li>4. They do not mature.</li> </ol>	<ol style="list-style-type: none"> <li>1. They have a stated rate of return stamped on the face of the stock, like a bond.</li> <li>2. They do not generally share in increased earnings of the firm.</li> <li>3. Par value is different from common shares. Typical par value is \$25, \$50, \$75, \$100 per share.</li> <li>4. Dividends must be paid to preferred holders before common stockholders get paid any dividend.</li> <li>5. They have several issues of preferred stock.</li> <li>6. They are rated like bonds.</li> </ol>
<b>PARTICIPATING PREFERRED</b>	Share in common stock dividends. After preferred holders get their regular dividend, they may share in the common stockholders dividend (if firm declares a common dividend). These shares 'participate' in the common stock dividend in addition to their own dividend.
<b>CUMULATIVE PREFERRED</b>	<i>Dividends in arrears</i> occurs when the company cannot afford to pay dividends to preferred holders. They accumulate the liability "in arrears". When a stock dividend is again declared, arrearages must first be satisfied before common stockholders receive their dividend. Cumulative Preferred: cash dividends accumulate to be paid.
<b>CALL FEATURES</b>	Preferred stocks are usually perpetual (no maturity date) but can be called by the firm, just like a bond.
A Preferred Stock Web Source: <a href="http://www.quantumonline.com">www.quantumonline.com</a>	

TYPES OF STOCKS
<p>Blue Chip - Major firms, strong financial statements. Examples are Exxon, General Electric.</p> <p>Growth Stocks - Rapid growth companies, reinvesting dividends. Wal-Mart, Home Depot, Google</p> <p>Cyclical - Earnings move with business cycle. Examples are Auto stocks.</p> <p>Income - Stable earnings, high dividend yields. Utilities.</p>
ADVANTAGES OF COMMON STOCK OWNERSHIP

Growing Values. Capital gains.

Safety. Matches in quality.

Growing Dividends. Quality companies with increasing dividends.

Liquidity. Stocks traded on major exchanges.

### **RISKS OF COMMON STOCK OWNERSHIP**

Total and permanent loss of capital.

Stock market risk. Stock price subject to market movements.

Interest Rate Risk. Interest rate swings cause stock prices to change.

[Stock Market Performance Chart](#)

12/30/16