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1. MARKET PLACE

The stock market. To some it’s a puzzle. To others it’s a source of profit and endless fascination. The stock market is the financial nerve center of any country. It reflects any change in the economy. It is sensitive to interest rates, inflation and political events. In a very real sense, it has its fingers on the pulse of the entire world.

Taken in its broadest sense, the stock market is also a control center. It is the market place where businesses and governments come to raise money so that they can continue and expend their operations. It is the market place where giant businesses and institutions come to make and change their financial commitments. The stock market is also a place of individual opportunity.

The phrase “the stock market” means many things. In the narrowest sense, a stock market is a place where stocks are traded – that is bought and sold. The phrase “the stock market” is often used to refer to the biggest and most important stock market in the world, the New York Stock Exchange, which is as well the oldest in the US. It was founded in 1792. NYSE is located at 11 Wall Street in New York City. It is also known as the Big Board and the Exchange. In the mid-1980s NYSE-listed shares made up approximately 60% of the total shares traded on organized national exchanges in the United States.

AMEX stands for the American Stock Exchange. It has the second biggest volume of trading in the US. Located at 86 Trinity Place in downtown Manhattan, the AMEX was known until 1921 as the Curb Exchange, and it is still referred to as the Curb today. Early traders gathered near Wall Street. Nothing could stop those outdoor brokers. Even in the snow and rain they put up lists of stocks for sale. The gathering place became known as the outdoor curb market, hence the name the Curb. In 1921 the Curb finally moved indoors. For the most part, the stocks and bonds traded on the AMEX are those of small to medium-size companies, as contrasted with the huge companies whose shares are traded on the New York Stock Exchange.

The Exchange is non-for-profit corporation run by a board of directors. Its member firm are subject to a strict and detailed self-regulatory code. Self-regulation is a matter of self-interest for stock exchange members. It has built public confidence in the Exchange. It also required by law. The US Securities and Exchange Commission (SEC) administers the federal securities laws and supervises all securities exchange in the country. Whenever self-regulation doesn’t do the job, the SEC is likely to step in directly. The Exchange doesn’t buy, sell or own any securities nor does it set stock prices. The Exchange merely is the market place where the public, acting through member brokers, can buy and sell at prices set by supply and demand.

It costs money it become an Exchange member. There are about 650 memberships or “seats” on the NYSE, owned by large and small firms and in some cases by individuals. These seats can be bought and sold; in 1986 the price of a seat averaged around $600,000. Before you are permitted to buy a seat you must pass a test that strictly scrutinizes your knowledge of the securities industry as well as a check of experience and character.

Apart from the NYSE and the AMEX there are also “regional” exchange in the US, of which the best known are the Pacific, Midwest, Boston and Philadelphia exchange.

There is one more market place in which the volume of common stock trading begins to approach that of the NYSE. It is trading of common stock “over-the-counter” or “OTC”–that is not on any organized exchange. Most securities other than common stocks are traded over-the-counter. For example, the vast market in US Government securities is an over-the-counter market. So is the money market–the market in which all sorts of short-term debt obligations are traded daily in tremendous quantities. Like-wise the market for long-and short-term borrowing by state and local governments. And the bulk of trading in corporate bonds also is accomplished over-the-counter.

While most of the common stocks traded over-the-counter are those of smaller companies, many sizable corporations continue to be found on the “OTC” list, including a large number of banks and insurance companies.

As there is no physical trading floor, over-the-counter trading is accomplished through vast telephone and other electronic networks that link traders as closely as if they were seated in the same room. With the help of computers, price quotations from dealers in Seattle, San Diego, Atlanta and Philadelphia can be flashed on a single screen. Dedicated telephone lines link the more active traders. Confirmations are delivered electronically rather than through the mail. Dealers thousands of miles apart who are complete strangers execute trades in the thousands or even millions of dollars based on thirty seconds of telephone conversation and the knowledge that each is a securities dealer registered with the National Association of Securities Dealers (NASD), the industry self-regulatory organization that supervises OTC trading. No matter which way market prices move subsequently, each knows that the trade will be honoured.

# 2. TRADING ON THE STOCK EXCHANGE FLOOR

When an individual wants to place an order to buy or sell shares, he contacts a brokerage firm that is a member of the Exchange. A registered representative or “RR” will take his order. He or she is a trained professional who has passed an examination on many matters including Exchange rules and producers.

The individual’s order is relayed to a telephone clerk on the floor of the Exchange and by the telephone clerk to the floor broker. The floor broker who actually executes the order on the trading floor has an exhausting and high-pressure job. The trading floor is a larger than half the size of football field. It is dotted with multiple locations called “trading posts”. The floor broker proceeds to the post where this or that particular stock is traded and finds out which other brokers have orders from clients to buy or sell the stock, and at what prices. If the order the individual placed is a “market order”–which means an order to buy or sell without delay at the best price available–the broker size up the market, decides whether to bargain for a better price or to accept one of the orders being shown, and executes the trade–all this happens in a matter of seconds. Usually shares are traded in round lots on securities exchanges. A round lot is generally 100 shares, called a unit of trading, anything less is called an odd lot.

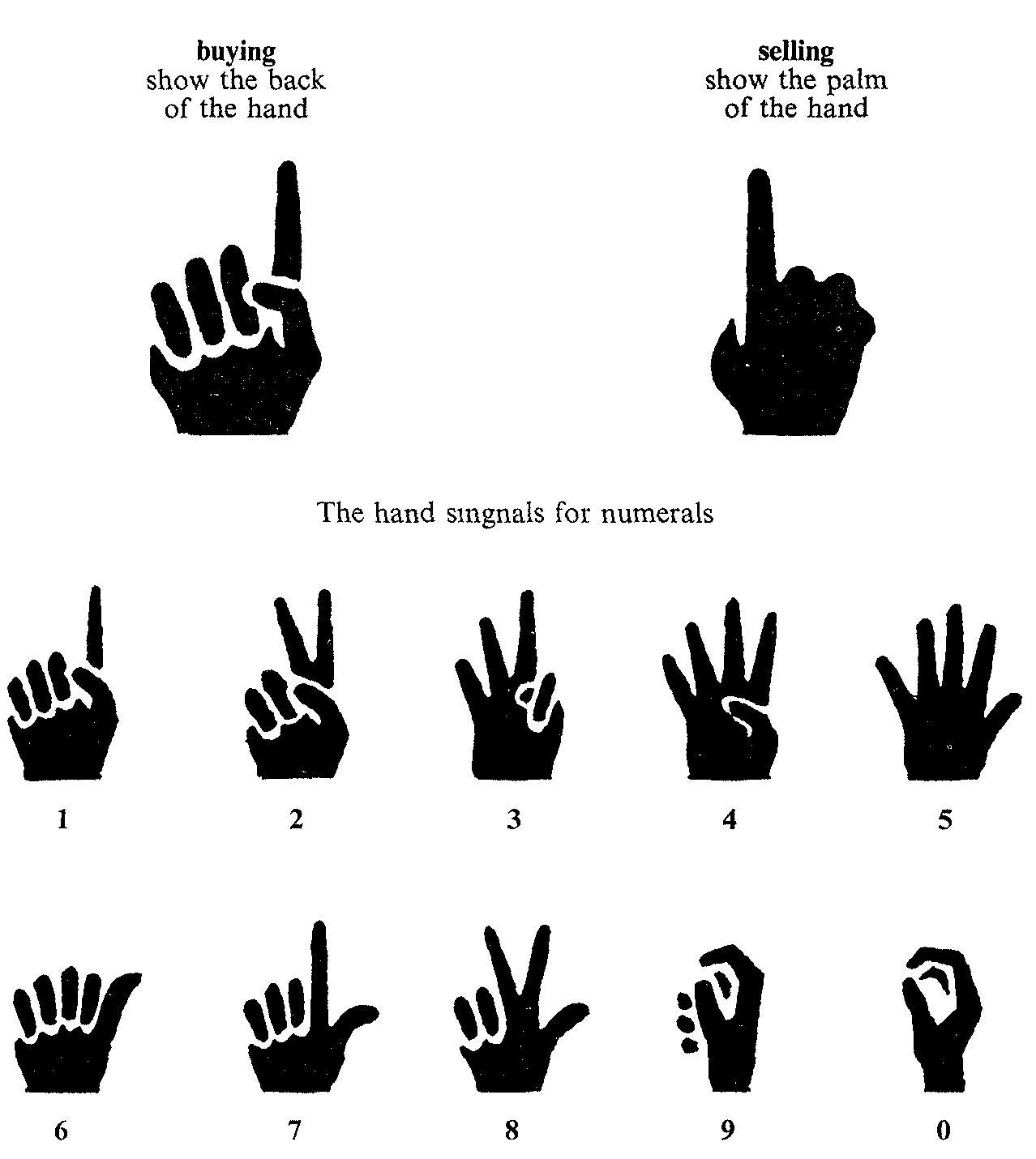
When you first see the trading floor, you might assume all brokers are the same, but they aren’t. There are five categories of market professionals active on the trading floor.

Commission Brokers, usually floor brokers, work for member firms. They use their experience, judgment and execution skill to buy and sell for the firm’s customer for a commission.

Independent Floor Brokers are individual entrepreneurs who act for a variety of clients. They execute orders for other floor brokers who have more volume than they can handle, or for firms whose exchange members are not on the floor.

Registered Competitive Market Makers have specific obligations to trade for their own or their firm’s accounts–when called upon by an Exchange official–by making a bid or offer that will narrow the existing quote spread or improve the depth of an existing quote.

Competitive Traders trade for their own accounts, under strict rules designed to assure that their activities contribute to market liquidity.



And last, but not least, come Stock Specialists. The Exchange tries to preserve price continuity– which means that if a stock has been trading at, say, 35, the next buyer or seller should be able to an order within a fraction of that price. But what if a buyer comes in when no other broker wants to sell close to the last price? Or vice versa for a seller? How is price continuity preserved? At this point enters the Specialist. The specialist is charged with a special function, that of maintaining continuity in the price of specific stocks. The specialist does this by standing ready to buy shares at a price reasonably close to the last recorded sale price when someone wants to sell and there is a lack of buyers, and to sell when there is a lack of sellers and someone wants to buy. For each listed stock, there are one or more specialist firms assigned to perform this stabilizing function. The specialist also acts as a broker, executing public orders for the stock, and keeping a record of limit orders to be executed if the price of the stock reaches a specified level. Some of the specialist firms are large and assigned to many different stocks. The Exchange and the SEC are particularly interested in the specialist function, and trading by the specialists is closely monitored to make sure that they are giving precedence to public orders and helping to stabilize the markets, not merely trying to make profits for themselves. Since a specialist may at any time be called on to buy and hold substantial amounts of stock, the specialist firms must be well capitalized.

In today's markets, where multi-million-dollar trades by institutions (i. e. banks, pension funds, mutual funds, etc.) have become common, the specialist can no longer absorb all of the large blocks of stock offered for sale, nor supply the large blocks being sought by institutional buyers. Over the last several years, there has been a rapid growth in block trading by large brokerage firms and other firms in the securities industry. If an institution wants to sell a large block of stock, these firms will conduct an expert and rapid search for possible buyers; if not enough buying interest is found, the block trading firm will fill the gap by buying shares itself, taking the risk of owning the shares and being able to dispose of them subsequently at a profit. If the institution wants to buy rather than sell, the process is reversed. In a sense, these firms are fulfilling the same function as the specialist, but on a much larger scale. They are stepping in to buy and own stock temporarily when offerings exceed demand, and vice versa.

So the specialists and the block traders perform similar stabilizing functions, though the block traders have no official role and have no motive other than to make a profit.

# 3. SECURITIES. CATEGORIES OF COMMON STOCK

There is a lot to be said about securities. Security is an instrument that signifies (1) an ownership position in a corporation (a stock), (2) a creditor relationship with a corporation or governmental body (a bond), or (3) rights to ownership such as those represented by an option, subsription right, and subsription warrant.

People who own stocks and bonds are referred to as investors or, respectively, stockholders (shareholders) and bondholders. In other words a share of stock is a share of a business. When you hold a stock in a corporation you are part owner of the corporation. As a proof of ownership you may ask for a certificate with your name and the number of shares you hold. By law, no one under 21 can buy or sell stock. But minors can own stock if kept in trust for them by an adult. A bond represents a promise by the company or government to pay back a loan plus a certain amount of interest over a definite period of time.

We have said that common stocks are shares of ownership in corporations. A corporation is a separate legal entity that is responsible for its own debts and obligations. The individual owners of the corporation are not liable for the corporation's obligations. This concept, known as limited liability, has made possible the growth of giant corporations. It has allowed millions of stockholders to feel secure in their position as corporate owners. All that they have risked is what they paid for their shares.

A stockholder (owner) of a corporation has certain basic rights in proportion to the number of shares he or she owns. A stockholder has the right to vote for the election of directors, who control the company and appoint management. If the company makes profits and the directors decide to pay part of these profits to shareholders as dividends, a stockholder has a right to receive his proportionate share. And if the corporation is sold or liquidates, he has a right to his proportionate share of the proceeds.

What type of stocks can be found on stock exchanges? The question can be answered in different ways. One way is by industry groupings. There are companies in every industry, from aerospace to wholesale distributers. The oil and gas companies, telephone com­panies, computer companies, autocompanies and electric utilities are among the biggest groupings in terms of total earnings and market value. Perhaps a more useful way to distinguish stocks is according to the qualities and values investors want.

**3.1 Growth Stocks.**

The phrase "growth stock" is widely used as a term to describe what many investors are looking for. People who are willing to take greater-than-average risks often invest in what is often called "high-growth" stocks—stocks of companies that are clearly growing much faster than average and where the stock commands a premium price in the market. The rationale is that the company's earnings will continue to grow rapidly for at least a few more years to a level that justifies the premium price. An investor should keep in mind that only a small minority of companies really succeed in making earnings grow rapidly and consistently over any long period. The potential rewards are high, but the stocks can drop in price at incredible rates when earnings don't grow as expected. For example, the companies in the video game industry boomed in the early 1980s, when it appeared that the whole world was about to turn into one vast video arcade. But when public interest shifted to personal computers, the companies found themselves stuck with hundreds of millions of dollars in video game inventories, and the stock collapsed.

There is less glamour, but also less risk, in what we will call—for lack of a better phrase—"moderate-growth" stocks. Typically, these might be stocks that do not sell at premium, but where it appears that the company's earnings will grow at a faster-than-average rate for its industry. The trick, of course, is in forecasting which companies really will show better-than-average growth; but even if the forecast is wrong, the risk should not be great, assuming that the price was fair to begin with.

There's a broad category of stocks that has no particular name but that is attractive to many investors, especially those who prefer to stay on the conservative side. These are stocks of companies that are not glamorous, but that grow in line with the economy. Some examples are food companies, beverage companies, paper and packaging manufacturers, retail stores, and many companies in assorted consumer fields.

As long as the economy is healthy and growing, these companies are perfectly reasonable investments; and at certain times when everyone is interested in "glamour" stocks, these "non-glamour" issues may be neglected and available at bargain prices. Their growth may not be rapid, but it usually is reasonably consistent. Also, since these companies generally do not need to plow all their earnings back into the business, they tend to pay sizable dividends to their stockholders. In addition to the real growth that these companies achieve, their values should adjust upward over time in line with inflation—a general advantage of common stocks that is worth repeating.

**3.2 Cyclical Stocks.**

These are stocks of companies that do not show any clear growth trend, but where the stocks fluctuate in line with the business cycle (prosperity and recession) or some other recognizable pattern. Obviously, one can make money if he buys these near the bottom of a price cycle and sells near the top. But the bottoms and tops can be hard to recognize when they occur; and sometimes, when you think that a stock is near the bottom of a cycle, it may instead be in a process of long-term decline.

**3.3 Special Situations**.

There’s a type of investment that professionals usually refer to as “special situations”. These are cases where some particular corporate development–perhaps a merger, change of control, sale of property, etc.– seems likely to raise the value of a stock. Special situation investments may be less affected by general stock market movements than the average stock investment; but if the expected development doesn’t occur, an investor may suffer a loss, sometimes sizable. Here the investor has to judge the odds of the expected development’s actually coming to pass.

### 4. PREFERRED STOCKS

A preferred stock is a stock which bears some resemblances to a bond (see below). A preferred stockholder is entitled to dividends at a specified rate, and these dividends must be paid before any dividends can be paid on the company's common stock. In most cases the preferred dividend is cumulative, which means that if it isn't paid in a given year, it is owed by the company to the preferred stockholder. If the corporation is sold or liquidates, the preferred stockholders have a claim on a certain portion of the assets ahead of the common stockholders. But while a bond is scheduled to be redeemed by the corporation on a certain "maturity" date, a preferred stock is ordinarily a permanent part of the corporation's capital structure. In exchange for receiving an assured dividend, the preferred stockholder generally does not share in the progress of the company; the preferred stock is only entitled to the fixed dividend and no more (except in a small minority of cases where the preferred stock is "participating" and receives higher dividends on some basis as the company's earnings grow).

Many preferred stocks are listed for trading on the NYSE and other exchanges, but they are usually not priced very attractively for individual buyers. The reason is that for corporations desiring to invest for fixed income, preferred stocks carry a tax advantage over bonds. As a result, such corporations generally bid the prices of preferred stocks up above the price that would have to be paid for a bond providing the same income. For the individual buyer, a bond may often be a better buy.

### 4.1 Bonds-Corporate

Unlike a stock, a bond is evidence not of ownership, but of a loan to a company (or to a government, or to some other organization). It is a debt obligation. When you buy a corporate bond, you have bought a portion of a large loan, and your rights are those of a lender. You are entitled to interest payments at a specified rate, and to repayment of the full "face amount" of the bond on a specified date. The fixed interest payments are usually made semiannually. The quality of a corporate bond depends on the financial strength of the issuing corporation.

Bonds are usually issued in units of $1,000 or $5,000, but bond prices are quoted on the basis of 100 as "par" value. A bond price of 96 means that a bond of $1,000 face value is actually selling at $960 And so on.

Many corporate bonds are traded on the NYSE, and newspapers carry a separate daily table showing bond trading. The major trading in corporate bonds, however, takes place in large blocks of $100,000 or more traded off the Exchange by brokers and dealers acting for their own account or for institutions.

### 4.2 Bonds-U. S. Government

U.S. Treasury bonds (long-term), notes (intermediate-term) and bills (short-term), as well as obligations of the various U. S. government agencies, are traded away from the exchanges in a vast professional market where the basic unit of trading is often $ 1 million face value in amount. However, trades are also done in smaller amounts, and you can buy Treasuries in lots of $5,000 or $10,000 through a regular broker. U. S. government bonds are regarded as providing investors with the ultimate in safety.

### 4.3 Bonds-Municipal

Bonds issued by state and local governments and governmental units are generally referred to as "municipals" or "tax-exempts", since the income from these bonds is largely exempt from federal income tax.

Tax-exempt bonds are attractive to individuals in higher tax brackets and to certain institutions. There are many different issues and the newspapers generally list only a small number of actively traded municipals. The trading takes place in a vast, specialized over-the-counter market. As an offset to the tax advantage, interest rates on these bonds are generally lower than on U. S. government or corporate bonds. Quality is usually high, but there are variations according to the financial soundness of the various states and communities.

### 4.4 Convertible Securities

A convertible bond (or convertible debenture) is a corporate bond that can be converted into the company's common stock under certain terms. Convertible preferred stock carries a similar "conversion privilege". These securities are intended to combine the reduced risk of a bond or preferred stock with the advantage of conversion to common stock if the company is successful. The market price of a convertible security generally represents a combination of a pure bond price (or a pure preferred stock price) plus a premium for the conversion privilege. Many convertible issues are listed on the NYSE and other exchanges, and many others are traded over-the-counter

### 4.5 Options

An option is a piece of paper that gives you the right to buy or sell a given security at a specified price for a specified period of time. A "call" is an option to buy, a "put" is an option to sell. In simplest form, these have become an extremely popular way to speculate on the expectation that the price of a stock will go up or down. In recent years a new type of option has become extremely popular: options related to the various stock market averages, which let you speculate on the direction of the whole market rather than on individual stocks. Many trading techniques used by expert investors are built around options; some of these techniques are intended to reduce risks rather than for speculation.

### 4.6 Rights

When a corporation wants to sell new securities to raise additional capital, it often gives its stockholders rights to buy the new securities (most often additional shares of stock) at an attractive price. The right is in the nature of an option to buy, with a very short life. The holder can use ("exercise") the right or can sell it to someone else. When rights are issued, they are usually traded (for the short period until they expire) on the same exchange as the stock or other security to which they apply.

### 4.7 Warrants

A warrant resembles a right in that it is issued by a company and gives the holder the option of buying the stock (or other security) of the company from the company itself for a specified price. But a warrant has a longer life—often several years, sometimes without limit As with rights, warrants are negotiable (meaning that they can be sold by the owner to someone else), and several warrants are traded on the major exchanges.

### 4.8 Commodities and Financial Futures

The commodity markets, where foodstuffs and industrial commodities are traded in vast quantities, are outside the scope of this text. But because the commodity markets deal in "futures"—that is, contracts for delivery of a certain good at a specified future date— they have also become the center of trading for "financial futures", which, by any logical definition, are not commodities at all.

Financial futures are relatively new, but they have rapidly zoomed in importance and in trading activity. Like options, the futures can be used for protective purposes as well as for speculation. Making the most headlines have been stock index futures, which permit investors to speculate on the future direction of the stock market averages. Two other types of financial futures are also of great importance: interest rate futures, which are based primarily on the prices of U.S. Treasury bonds, notes, and bills, and which fluctuate according to the level of interest rates; and foreign currency futures, which are based on the exchange rates between foreign currencies and the U.S. dollar. Although, futures can be used for protective purposes, they are generally a highly speculative area intended for professionals and other expert inve­stors.

### 5. STOCK MARKET AVERAGES READING THE NEWSPAPER QUOTATIONS

The financial pages of the newspaper are mystery to many people. But dramatic movements in the stock market often make the front page. In newspaper headlines, TV news summaries, and elsewhere, almost everyone has been exposed to the stock market averages.

In a brokerage firm office, it’s common to hear the question “How’s the market?” and answer, “Up five dollars”, or “Down a dollar”. With 1500 common stocks listed on the NYSE, there has to be some easy way to express the price trend of the day. Market averages are a way of summarizing that information.

Despite all competition, the popularity crown still does to an average that has some of the qualities of an antique–the Dow Jones Industrial Average, an average of 30 prominent stocks dating back to the 1890s. This average is named for Charles Dow–one of the earliest stock market theorists, and a founder of Dow Jones & Company, a leading financial news service and publisher of the *Wall Street Journal*.

In the days before computers, an average of 30 stocks was perhaps as much as anyone could calculate on a practical basis at intervals throughout the day. Now, the Standard & Poor’s 500 Stock Index (500 leading stocks) and the New York Stock Exchange Composite Index (all stocks on the NYSE) provide a much more accurate picture of the total market. The professionals are likely to focus their attention on these “broad” market indexes. But old habits die slowly, and someone calls out, “How’s the market?” and someone else answers, “Up five dollars,” or “Up five”–it’s still the Dow Jones Industrial Average (the “Dow” for short) that they’re talking about.

The importance of daily changes in the averages will be clear if you view them in percentage terms. When the market is not changing rapidly, the normal daily change is less than ½ of 1%. A change of ½% is still moderate; 1% is large but not extraordinary; 2% is dramatic. From the market averages, it’s a short step to the thousands of detailed listings of stock prices and related data that you’ll find in the daily newspaper financial tables. These tables include complete reports on the previous day’s trading on the NYSE and other leading exchanges. They can also give you a surprising amount of extra information.

Some newspapers provide more extensive tables, some less. Since the *Wall* *Street Journal* is available world wide, we’ll use it as a source of convenient examples. You’ll find a prominent page headed “New York Stock Exchange Composite Transactions”. This table covers the day’s trading for all stocks listed on the NYSE. “Composite” means that it also includes trades in those same stocks on certain other exchanges (Pacific, Midwest, etc.) where the stocks are “dually listed”. Here are some sample entries:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 52 Weeks | |  |  | Yld | P-E | Sales |  |  |  | Net |
| High | Low | Stock | Div | % | Ratio | 100s | High | Low | Close | Chg. |
| 52 7/8 | 37 5/8 | Cons Ed | 2.68 | 5.4 | 12 | 909 | 49 3/8 | 48 7/8 | 49 1/4 | +1/4 |
| 91 1/8 | 66 1/2 | Gen El | 2.52 | 2.8 | 17 | 11924 | 91 3/8 | 89 5/8 | 90 | -1 |
| 41 3/8 | 26 1/4 | Mobil | 2.20 | 5.4 | 10 | 15713 | 41 | 40 1/2 | 40 7/8 | +5/8 |

Some of the abbreviated company names in the listings can be a considerable puzzle, but you will get used to them.

While some of the columns contain longer-term information about the stocks and the companies, we'll look first at the columns that actually report on the day's trading. Near the center of the table you will see a column headed "Sales 100s". Stock trading generally takes place in units of 100 shares and is tabulated that way; the figures mean, for example, that 90,900 shares of Consolidated Edison, 1,192,400 shares of General Electric, and 1,571,300 shares of Mobil traded on January 8. (Mobil actually was the 12th "most active" stock on the NYSE that day, meaning that it ranked 12th in number of shares traded.)

The next three columns show the highest price for the day, the lowest, and the last or "closing" price. The "Net Chg." (net change) column to the far right shows how the closing price differed from the previous day's close—in this case, January 7.

Prices are traditionally calibrated in eighths of a dollar. In case you aren't familiar with the equivalents, they are:

1/8 =$.125

1/4=$.25

3/8 =$.375

1/2 =$.50

5/8 =$.625

3/4=$.75

7/8 =$.875

Con Edison traded on January 8 at a high of $49.375 per share and a low of $48 875, it closed at $49.25, which was a gain of $0.25 from the day before. General Electric closed down $1.00 per share at $90 00, but it earned a "u" notation by trading during the day at $91 375, which was a new high price for the stock during the most recent 52 weeks (a new low price would have been denoted by a "d").

The two columns to the far left show the high and low prices recorded in the latest 52 weeks, not including the latest day. (Note that the high for General Electric is shown as 91 1/8, not 91 3/8.) You will note that while neither Con Edison nor Mobil reached a new high on January 8, each was near the top of its "price range" for the latest 52 weeks. (Individual stock price charts, which are published by several financial services, would show the price history of each stock in detail.)

The other three columns in the table give you information of use in making judgments about stocks as investments. Just to the right of the name, the "Div." (dividend) column shows the current annual dividend rate on the stock — or, if there's no clear regular rate, then the actual dividend total for the latest 12 months. The dividend rates shown here are $2.68 annually for Con Edison, $2.52 for GE, and $2.20 for Mobil. (Most companies that pay regular dividends pay them quarterly: it's actually $0.67 quarterly for Con Edison, etc.) The "Yid." (Yield) column relates tie annual dividend to the latest stock price. In the case of Con Edison, for example, $2.68 (annual dividend)/$49.25 (stock price) ==5.4%, which represents the current yield on the stock.

### 5.1 The Price-Earnings Ratio

Finally, we have the "P-E ratio", or price-earnings ratio, which represents a key figure in judging the value of a stock. The price-earnings ratio—also referred to as the "price-earnings multiple", or sometimes simply as the "multiple"—is the ratio of the price of a stock to the earnings per share behind the stock.

This concept is important. In simplest terms (and without taking possible complicating factors into account), "earnings per share" of a company are calculated by taking the company's net profits for the year, and dividing by the number of shares outstanding. The result is, in a very real sense, what each share earned in the business for the year — not to be confused with the dividends that the company may or may not have paid out. The board of directors of the company may decide to plow the earnings back into the business, or to pay them out to shareholders as dividends, or (more likely) a combination of both; but in any case, it is the earnings that are usually considered as the key measure of the company's success and the value of the stock.

The price-earnings ratio tells you a great deal about how investors view a stock. Investors will bid a stock price up to a higher multiple if a company's earnings are expected to grow rapidly in the future. The multiple may look too high in relation to current earnings, but not in relation to expected future earnings. On the other hand, if a company's future looks uninteresting, and earnings are not expected to grow substantially, the market price will decline to a point where the multiple is low.

Multiples also change with the broad cycles of the stock market, as investors become willing to pay more or less for certain values and potentials. Between 1966 and 1972, a period of enthusiasm and speculation, the average multiple was usually 15 or higher. In the late 1970s, when investors were generally cautious and skeptical, the average multiple was below 10. However, note that these figures refer to average multiples–whatever the average multiple is at any given time, the multiples on individual stocks will range above and below it.

Now we can return to the table. The P-E ratio for each stock is based on the latest price of the stock and on earnings for the latest reported 12 months. The multiples, as you can see, were 12 for Con Edison, 17 for GE, and 10 for Mobil. In January 1987, the average multiple for all stocks was very roughly around 15. Con Edison is viewed by investors as a relatively good-quality utility company, but one that by the nature if its business cannot grow much more rapidly that the economy as a whole. GE, on the other hand, is generally given a premium rating as a company that is expected to outpace the economy.

You can't buy a stock on the P-E ratio alone, but the ratio tells you much that is useful. For stocks where no P-E ratio is shown, it often means that the company showed a loss for the latest 12 months, and that no P-E ratio can be calculated. Somewhere near the main NYSE table, you'll find a few small tables that also relate to the day's NYSE-Composite trading. There's the table showing the 15 stocks that traded the greatest number of shares for the day (the "most active" list), a table of the stocks that showed the greatest percentage of gains or declines (low-priced stocks generally predominate here); and one showing stocks that made new price highs or lows relative to the latest 52 weeks.

You'll find a large table of "American Stock Exchange Composite Transactions", which does for stocks listed on the AMEX just what the NYSE-Composite table does for NYSE-listed stocks. There are smaller tables covering the Pacific Stock Exchange, Boston Exchange, and other regional exchanges.

The tables showing over-the-counter stock trading are generally divided into two or three sections. For the major over-the-counter stocks covered by the NASDAQ quotation and reporting system, actual sales for the day are reported and tabulated just as for stocks on the NYSE and AMEX. For less active over-the-counter stocks, the paper lists only "bid" and "asked" prices, as reported by dealers to the NASD.

It is worth becoming familiar with the daily table of prices of U.S. Treasury and agency securities. The Treasury issues are shown not only in terms of price, but in terms of the yield represented by the current price. This is the simplest way to get a bird's-eye view of the current interest rate situation—you can see at a glance the current rates on long-term Treasury bonds, intermediate-term notes, and short-term bills.

Elsewhere in the paper you will also find a large table showing prices of corporate bonds traded on the NYSE, and a small table of selected tax-exempt bonds (traded OTC). But unless you have a spe­cific interest in any of these issues, the table of Treasury prices is the best way to follow the bond market.

There are other tables listed. These are generally for more experi­enced investors and those interested in taking higher risks. For example, there are tables showing the trading on several different exchanges in listed options—primarily options to buy or sell common stocks (call options and put options). There are futures prices— commodity futures and also interest rate futures, foreign currency futures, and stock index futures. There are also options relating to interest rates and options relating to the stock index futures.

### 6. EUROPEAN STOCKMARKETS–GENERAL TREND

Competition among Europe’s securities exchanges is fierce. Yet most investors and companies would prefer fewer, bigger markets. If the exchanges do not get together to provide them, electronic usurpers will.

How many stock exchanges does a Europe with a single capital market need? Nobody knows. But a part-answer is clear: fewer than it has today. America has eight stock exchanges, and seven futures and options exchanges. Of these only the New York Stock Exchange, the American Stock Exchange, NASDAQ (the over-the-counter market), and the two Chicago futures exchanges have substantial turnover and nationwide pretensions.

The 12 member countries of the European Community (EC), in contrast, boast 32 stock exchanges and 23 futures and options exchanges. Of these, the market in London, Frankfurt, Paris, Amsterdam, Milan and Madrid–at least–aspire to significant roles on the European and world stages. And the number of exchanges is growing. Recent arrivals include exchanges in Italy and Spain. In eastern Germany, Leipzig wants to reopen the stock exchange that was closed in 1945.

Admittedly, the EC is not as integrated as the United States. Most intermediaries, investors and companies are still national rather than pan-European in character. So is the job of regulating securities markets; there is no European equivalent of America’s Securities and Exchange Commission (SEC). Taxes, company law and accounting practices vary widely. Several regulatory barriers to cross-border investment, for instance by pension funds, remain in place. Recent turmoil in Europe’s exchange rate mechanics has reminded cross0border investors about currency risk. Despite the Maastricht treaty, talk of a common currency is little more than that

Yet the local loyalties that sustain so many European exchanges look increasingly out-of-date. Countries that once had regional stock exchanges have seen them merged into one. A single European market for financial services is on its way. The EC's investment services directive, which should come into force in 1996, will permit cross-border stockbroking without the need to set up local subsidiaries. Jean-Francois Theodore, chairman of the Paris Bourse, says this will lead to another European Big Bang. And finance is the multinational business par excellence: electronics and the end of most capital controls mean that securities traders roam not just Europe but the globe in search of the best returns.

This affects more than just stock exchanges. Investors want financial market that are cheap, accessible and of high liquidity (the ability to buy or sell shares without moving the price). Businesses, large and small, need a capital market in which they can raise finance at the lowest possible cost If European exchanges do not meet these requirements, Europe's economy suffers.

In the past few years the favoured way of shaking up bourses has been competition. The event that triggered this was London's Big Bang in October 1986, which opened its stock exchange to banks and foreigners, and introduced a screen-plus-telephone system of securities trading known as SEAQ. Within weeks the trading floor had been abandoned. At the time, other European bourses saw Big Bang as a British eccentricity. Their markets matched buy and sell orders (order-driven trading), whereas London is a market in which dealers quote firm prices for trades (quote-driven trading). *Yet* many continental markets soon found themselves forced to copy London's example.

That was because Big Bang had strengthened London's grip on international equity-trading. SEAQ's international arm quickly grab­bed chunks of European business. Today the London exchange reckons to handle around 95% of all European cross-border share-trading It claims to handle three-quarters of the trading in blue-chip shares based in Holland, half of those in France and Italy and a quarter of those in Germany—though, as will become clear, there is some dispute about these figures.

London's market-making tradition and the presence of many international fund managers helped it to win this business. So did three other factors. One was stamp duties on share deals done in their home countries, which SEAQ usually avoided. Another was the shortness of trading hours on continental bourses. The third was the ability of SEAQ, with market-makers quoting two-way prices for business in large amounts, to handle trades in big blocks of stock that can be fed through order-driven markets only when they find counterparts.

A similar tussle for business has been seen among the ex­changes that trade futures and options. Here, the market which first trades a given product tends to corner the business in it. The European Options Exchange (EOE) in Amsterdam was the first derivatives exchange in Europe; today it is the only one to trade a European equity-index option. London's LIFFE, which opened in 1982 and is now Europe's biggest derivatives exchange, has kept a two-to-one lead in German government-bond futures (its most active contract) over Frankfurt's DTB, which opened only in 1990. LIFFE competes with several other European exchanges, not always successfully: it lost the market in ecu-bond futures to Paris's MATIF.

European exchanges armoured themselves for this battle in three ways. The first was to fend off foreign competition with rules. In three years of wrangling over the EC's investment-services directive, several member-countries pushed for rules that would require securities to be traded only on a recognized exchange. They also demanded rules for the disclosure of trades and prices that would have hamstrung SEAQ's quote-driven trading system. They were beaten off in the eventual compromise, partly because governments realized they risked driving business outside the EC. But residual attempts to stifle competition remain. Italy passed a law in 1991 requiring trades in Italian shares to be conducted through a firm based in Italy. Under pressure from the European Commission, it may have to repeal it.

### 6.1 New Ways for Old

The second response to competition has been frantic efforts by bourses to modernize systems, improve services and cut costs. This has meant investing in new trading systems, improving the way deals are settled, and pressing governments to scrap stamp duties. It has also increasingly meant trying to beat London at its own game, for instance by searching for ways of matching London's prowess in block trading.

Paris, which galvanized itself in 1988, is a good example. Its bourse is now open to outsiders. It has a computerized trading system based on continuous auctions, and settlement of most of its deals is computerized. Efforts to set up a block-trading mechanism continue, although slowly. Meanwhile, MATIF, the French futures exchange, has become the continent's biggest. It is especially proud of its ecu-bond contract, which should grow in importance if and when monetary union looms.

Frankfurt, the continent's biggest stock-market, has moved more ponderously, partly because Germany's federal system has kept regional stock exchange in being, and left much of the regulation of its markets at Land (state) level. Since January 1st 1993 all German exchanges (including the DTB) have been grouped under a firm called Deutsche Borse AG, chaired by Rolf Breuer, a member of Deutsche Bank’s board. But there is still some way to go in centralizing German share-trading. German floor brokers continue to resist the inroads made by the bank’s screen-based IBIS trading system. A law to set up a federal securities regulator (and make insider-dealing illegal) still lies becalmed in Bonn.

Other bourses are moving too. Milan is pushing forward with screen-based trading and speeding up its settlement. Spain and Belgium are reforming their stock-markets and launching new futures exchanges. Amsterdam plans an especially determined attack on SEAQ. It is implementing a McKinsey report that recommended a screen-based system for wholesale deals, a special mechanism for big block trades and a bigger market-making role for brokers.

Ironically, London now finds itself a laggard in some respects. Its share settlement remains prehistoric; the computerized project to modernize it has just been scrapped. The SEAQ trading system is falling apart; only recently has the exchange, belatedly, approves plans draw up by Arthur Andersen for a replacement, and there is plenty of skepticism in the City about its ability to deliver. Yet the exchange’s claimed figures for its share of trading in continental equities suggest that London is holding up well against its competition.

Are these figures correct? Not necessarily: deals done through an agent based in London often get counted as SEAQ business even when the counterpart is based elsewhere and the order has been executed through a continental bourse. In today’s electronic age, with many firms members of most European exchanges, the true location of a deal can be impossible to pin down. Continental bourses claim, anyway, to be winning back business lost to London.

Financiers in London agree that the glory-days of SEAQ’s international arm, when other European exchanges were moribund, are gone. Dealing in London is now more often a complement to, rather than a substitute for, dealing at home. Big blocks of stock may be bought or sold through London, but broken apart or assembled through local bourses. Prices tend to be derived from the domestic exchanges; it is notable that trading on SEAQ drops when they are closed. Baron van Ittersum, chairman of the Amsterdam exchange, calls this the “queen’s birthday effect”: trading in Dutch equities in London slows to a trickle on Dutch public holidays.

Such competition-through-diversity has encourage European exchanges to cut out the red tape that protected their members from outside competition, to embrace electronics, and to adapt themselves to the wishes of investors and issuers. Yet the diversity may also have had a cost in lower liquidity. Investors, especially from outside Europe, are deterred if liquidity remains divided among different exchanges. Companies suffer too: they grumble about the costs of listing on several different markets.

So the third response of Europe’s bourses to their battle has been pan-European co-operative ventures that could anticipate a bigger European market. There are more wishful words here than deeds. Work on two joint EC projects to pool market information, Pipe and Euroquote, was abandoned, thanks mainly to hostility from Frankfurt and London. Eurolist, under which a company meeting the listing requirements for one stock exchange will be entitled to a listing on all, is going forward–but this is hardly a single market. As Paris’s Mr Theodore puts it, "there is a compelling business case for the big European exchanges building the European-regulated market of to-morrow" Sir Andrew Hugh-Smith, chairman of the London ex­change has also long advocated one European market for profes­sional investors

One reason little has been done is that bourses have been coping with so many reforms at home. Many wanted to push these through before thinking about Europe. But there is also atavistic nationalism. London, for example, is unwilling to give up the leading role it has acquired in cross-border trading between institutions; and other exchanges are unwilling to accept that it keeps it. Mr. Theodore says there is no future for the European bourses if they are forced to row in a boat with one helmsman. Amsterdam's Baron van Ittersum also emphasises that a joint European market must not be one under London's control.

Hence the latest, lesser notion gripping Europe's exchanges: bilateral or multilateral links. The futures exchanges have shown the way. Last year four smaller exchanges led by Amsterdam's EOE and OM, an options exchange based in Sweden and London, joined together in a federation called FEX In January of this year the continent's two biggest exchanges, MATIF and the DTB, announced a link-up that was clearly aimed at toppling London's LIFFE from its dominant position Gerard Pfauwadel, MATIF's chairman, trumpets the deal as a precedent for other European exchanges. Mr Breuer, the Deutsche Borse's chairman, reckons that a network of European exchanges is the way forward, though he concedes that London will not warm to the idea. The bourses of France and Germany can be expected to follow the MATIF/DTB lead.

It remains unclear how such link-ups will work, however. The notion is that members of one exchange should be able to trade products listed on another. So a Frenchman wanting to buy German government-bond futures could do so through a dealer on MATIF, even though the contract is actually traded in Frankfurt. That is easy to arrange via screen-based trading: all that are needed are local terminals. But linking an electronic market such as the DTB to a floorbased market with open-outcry trading such as MATIF is harder Nor have any exchanges thought through an efficient way of pooling their settlement systems

In any case, linkages and networks will do nothing to reduce the plethora of European exchanges, or to build a single market for the main European blue-chip stocks. For that a bigger joint effort is needed It would not mean the death of national exchanges, for there will always be business for individual investors, and in securities issued locally Mr Breuer observes that ultimately all business is local. Small investors will no doubt go on worrying about currency

risk unless and until monetary union happens. Yet large wholesale investors are already used to hedging against it. For them, investment in big European blue-chip securities would be much simpler on a single wholesale European market, probably subject to a single regulator

More to the point, if investors and issuers want such a market, it will emerge—whether today's exchanges provide it or not. What, after all, is an exchange? It is no more than a system to bring together as many buyers and sellers as possible, preferably under an agreed set of rules. That used to mean a physically supervised trading floor. But computers have made it possible to replicate the features of a physical exchange electronically. And they make the dissemination of prices and the job of applying rules to a market easier.

Most users of exchanges do not know or care which exchange they are using: they deal through brokers or dealers. Their concern is to deal with a reputable firm such as S. G. Warburg, Gold-man Sachs or Deutsche Bank, not a reputable exchange. Since big firms are now members of most exchanges, they can choose where to trade and where to resort to off-exchange deals—which is why there is so much dispute over market shares within Europe This fluidity creates much scope for new rivals to undercut established stock exchanges.

### 6.2 Europe, Meet Electronics

Consider the experience of the New York Stock Exchange, which has remained stalwartly loyal to its trading floor. It has been losing business steadily for two decades, even in its own listed stocks. The winners have included NASDAQ and cheaper regional exchanges. New York's trading has also migrated to electro­nic trading systems, such as Jeffries & Co's Posit, Reuters's Instinct and Wunsch (a computer grandly renamed the Arizona Stock Exchange).

Something similar may happen in Europe. OM, the Swedish options exchange, has an electronic trading system it calls Click. It recently renamed itself the London Securities and Derivatives Exchange. Its chief executive, Lynton Jones, dreams of offering clients side-by-side on a screen a choice of cash products, options and futures, some of them customised to suit particular clients The Chicago futures exchanges, worried like all established exchanges about losing market share, have recently launched "flex" contracts that combine the virtues of homogeneous exchange-traded products with tailor-made over-the-counter ones.

American electronic trading systems are trying to break into European markets with similarly imaginative products Instinet and Posit are already active, though they have had limited success so far. NASDAQ has an international arm in Europe. And there are homegrown systems, too. Tradepoint, a new electronic order-driver trading system for British equities, is about to open in London. Even bond-dealers could play a part. Their trade association, ISMA, is recognized British exchange for trading in Eurobonds; it has a computerized reporting system known as TRAX; most of its members use the international clearing-houses Euroclear and Cedel for trade settlement. It would not be hard for ISMA to widen its scope to include equities or futures and options. The association has recently announced a link with the Amsterdam Stock Exchange.

Electronics poses a threat to established exchanges that they will never meet by trying to go it alone. A single European securities market (or derivatives market) need not look like an established stock exchange at all. It could be a network of the diverse trading and settlement systems that already exists, with the necessary computer terminals scattered across the EC. It will need to be regulated at the European level to provide uniform reporting; an audit trail to allow deals to be retraced from seller to buyer; and a way of making sure that investors can reach the market makers offering the best prices. Existing national regulators would prefer to do all this through co-operation; but some financiers already talk of need for a European SEC. An analogy is European civil aviation’s reluctant inching towards a European system of air-traffic control.

Once a Europe-wide market with agreed regulation is in place, competition will window out the winners and losers among the member- bourses, on the basis of services and cost, or of the rival charms of the immediacy and size of quote-driven trading set against the keener prices of order-driven trading. Not a cosy prospect; but if the EC’s existing exchanges do not submit to such a European framework, other artists will step in to deny them the adventure.

### 7. NEW ISSUES

Up to now, we have talked about the function of securities markets as trading markets, where one investor who wants to move out of a particular investment can easily sell to another investor who wishes to buy. We have not talked about another function of the securities markets, which is to raise new capital for corporations–and for the federal government and state and local governments.

When you buy shares of stock on one of the exchanges, you are not buying a “new issue”. In the case of an old established company, the stock may have been issued decades ago, and the company has no direct interest in your trade today, except to register the change in ownership on its books. You have taken over the investment from another investor, and you know that when you are ready to sell, another investor will buy it from you at some price.

New issues are different. You have probably noticed the advertisements in the newspaper financial pages for new issues of stocks or bonds–large advertising which, because of the very tight restrictions on advertising new issues, state virtually nothing except the name of the security, the quantity being offered, and the names of the firms which are “underwriting” the security or bringing it to market.

Sometimes there is only a single underwriter; more often, especially if the offering is a large one, many firms participate in the underwriting group. The underwriters plan and manage the offering. They negotiate with the offering company to arrive at a price arrangement which will be high enough to satisfy the company but low enough to bring in buyers. In the case of untested companies, the underwriters may work for a prearranged fee. In the case of established companies, the underwriters usually take on a risk function by actually buying the securities from the company at a certain price and reoffering them to the public at a slightly higher price; the difference, which is usually between 1% and 7%, is the underwriters’ profit. Usually the underwriters have very carefully sounded out the demand is disappointing–or if the general market takes a turn for the worse while the offering is under way–the underwriters may be left with securities that can’t be sold at the scheduled offering price. In this case the underwriting “syndicate” is dissolved and the underwriters sell the securities for whatever they can get, occasionally at a substantial loss.

The new issue process is critical for the economy. It’s important that both old and new companies have the ability to raise additional capital to meet expanding business needs. For you, the individual investor, the area may be a dangerous one. If a privately owned company is “going public” for the fist time by offering securities in the public market, it is usually does so at a time when its earnings have been rising and everything looks particularly rosy. The offering also may come at a time when the general market is optimistic and prices are relatively high. Even experienced investors can have great difficulty in assessing the real value of a new offering under these conditions.

Also, it may be hard for your broker to give you impartial advice. If the brokerage firm is in the underwriting group, or in the “selling group” of dealers that supplements the underwriting group, it has a vested interest in seeing the securities sold. Also, the commissions are likely to be substantially higher than on an ordinary stock. On the other hand, if the stock is a “hot issue” in great demand, it may be sold only through small individual allocations to favored customers (who will benefit if the stock then trades in the open market at a price well above the fixed offering price)

If you are considering buying a new issue, one protective step you can take is to read the prospectus The prospectus is a legal document describing the company and offering the securities to the public. Unless the offering is a very small one, it can't be made without passing through a registration process with the SEC. The SEC can't vouch for the value of the offering, but it does act to make sure that essential facts about the company and the offering are disclosed in the prospectus.

This requirement of full disclosure was part of the securities laws of the 1930s and has been a great boon to investors and to the securities markets. It works because both the underwriters and the offering companies know that if any material information is omitted or misstated in the prospectus, the way is open to lawsuits from investors who have bought the securities.

In a typical new offering, the final prospectus isn't ready until the day the securities are offered. But before that date you can get a "preliminary prospectus" or "red herring"—so na­med because it carries red lettering warning that the prospectus hasn't yet been cleared by the SEC as meeting disclosure require­ments

The red herring will not contain the offering price or the final underwriting arrangements But it will give you a description of the company's business, and financial statements showing just what the company's growth and profitability have been over the last several years It will also tell you something about the management. If the management group is taking the occasion to sell any large percentage of its stock to the public, be particularly wary.

It is a very different case when an established public company is selling additional stock to raise new capital. Here the company and the stock have track records that you can study, and it's not so difficult to make an estimate of what might be a reasonable price for the stock The offering price has to be close to the current market price, and the underwriters' profit margin will generally be smaller But you still need to be careful. While the SEC has strict rules against promoting any new offering, the securities industry often manages to create an aura of enthusiasm about a company when an offering is on the way On the other hand, the knowledge that a large offering is coming may depress the market price of a stock, and there are times when the offering price turns out to have been a bargain

New bond offerings are a different animal altogether. The bond markets are highly professional, and there is nothing glamorous about a new bond offering. Everyone knows that a new A-rated corporate

bond will be very similar to all the old A-rated bonds. In fact, to sell the new issue effectively, it is usually priced at a slightly higher "effective yield" than the current market for comparable older bonds—either at a slightly higher interest rate, or a slightly lower dollar price, or both. So for a bond buyer, new issues often offer a slight price advantage.

What is true of corporate bonds applies also to U.S. government and municipal issues. When the Treasury comes to market with a new issue of bonds or notes (a very frequent occurrence), the new issue is priced very close to the market for outstanding (existing) Treasury securities, but the new issue usually carries a slight price concession that makes it a good buy. The same is true of bonds and notes brought to market by state and local governments; if you are a buyer of municipals, these new offerings may provide you with modest price concessions. If the quality is what you want, there's no reason you shouldn't buy them—even if your broker makes a little extra money on the deal.

### 8. MUTUAL FUNDS. A DIFFERENT APPROACH

Up until now, we have described the ways in which securities are bought directly, and we have discussed how you can make such investments through a brokerage account.

But a brokerage account is not the only way to invest. For many investors, a brokerage has disadvantages–the difficulty of selecting an individual broker, the commission costs (especially on small transactions), and the need to be involved in decisions that many would prefer to leave to professionals. For people who feel this way, there is an excellent alternative available—mutual funds.

It isn't easy to manage a small investment account effectively. A mutual fund gets around this problem by pooling the money of many investors so that it can be managed efficiently and economically as a single large unit. The best-known type of mutual fund is probably the money market fund, where the pool is invested for complete safety in the shortest-term income-producing investments. Another large group of mutual funds invest in common stocks, and still others invest in long-term bonds, tax-exempt securities, and more specialized types of investments.

The mutual fund principle has been so successful that the funds now manage over $400 billion of investors' money—not including over $250 billion in the money market funds.

### 8.1 Advantages of Mutual Funds

Mutual funds have several advantages. The first is professional management. Decisions as to which securities to buy, when to buy and when to sell are made for you by professionals. The size of the pool makes it possible to pay for the highest quality management, and many of the individuals and organizations that manage mutual funds have acquired reputations for being among the finest managers in the profession.

Another of the advantages of a mutual fund is diversification. Because of the size of the fund, the managers can easily diversify its investments, which means that they can reduce risk by spreading the total dollars in the pool over many different securities. (In a common stock mutual fund, this means holding different stocks representing many varied companies and industries.)

The size of the pool gives you other advantages. Because the fund buys and sells securities in large amounts, commission costs on portfolio transactions are relatively low And in some cases the fund can invest in types of securities that are not practical for the small investor.

The funds also give you convenience First, it's easy to put money in and take it out The funds technically are "open-end" investment companies, so called because they stand ready to sell additional new shares to investors at any time or buy back ("redeem") shares sold previously You can invest in some mutual funds with as little as $250, and your investment participates fully in any growth in value of the fund and in any dividends paid out. *You* can arrange to have dividends reinvested automatically.

If the fund is part of a larger fund group, you can usually arrange to switch by telephone within the funds in the group—say from

a common stock fund to a money market fund or tax-exempt bond fund, and back again at will. You may have to pay a small charge for the switch. Most funds have toll-free "800" numbers that make it easy to get service and have your questions answered.

### 8.2 Load vs. No-load

There are "load" mutual funds and "no-load" funds. A load fund is bought through a broker or salesperson who helps you with your selection and charges a commission ("load")—typically (but not always) 8.5% of the total amount you invest. This means that only 91.5% of the money you invest is actually applied to buy shares in the pool. You choose a no-load fund yourself without the help of a broker or salesperson, but 100% of your investment dollars go into the pool for your account.

Which are better—load or no-load funds? That really depends on how much time and effort you want to devote to fund selection and supervision of your investment. Some people have neither the time, inclination nor aptitude to devote to the task—for them, a load fund may be the answer. The load may be well justified by long-term results if your broker or salesperson helps you invest in a fund that performs outstandingly well.

In recent years, some successful funds that were previously no-load have introduced small sales charges of 2% or 3%. Often, these "low-load" funds are still grouped together with the no-loads, you generally still buy directly from the fund rather than through a broker. If you are going to buy a high-quality fund and hold it a number of years, a 2% or 3% sales charge shouldn't discourage you.

## 8.3 Common Stock Funds

Apart from the money market funds, common stock funds make up the largest and most important fund group. Some common stock funds take more risk and some take less, and there is a wide range of funds available to meet the needs of different investors.

When you see funds "classified by objective", the classifications are really according to the risk of the investments selected, though the word "risk" doesn't appear in the headings. "Aggressive growth" or "maximum capital gain" funds are those that take the greatest risks in pursuit of maximum growth. "Growth" or "long-term growth" funds may be a shade lower on the risk scale. "Growth-income" funds are generally considered middle-of-the-road. There are also common stock "income" funds, which try for some growth as well as income, but stay on the conservative side by investing mainly in established companies that pay sizable dividends to their owners. These are also termed "equity income" funds, and the best of them have achieved excellent growth records.

Some common stock funds concentrate their investments in par­ticular industries or sectors of the economy. There are funds that invest in energy or natural resource stocks; several that invest in gold-mining stocks, others that specialize in technology, health care, and other fields. Formation of this type of specialized or "sector" fund has been on the increase.

### 8.4 Other Types of Mutual Funds

There are several types of mutual funds other than the money market funds and common stock funds. There are a large number of bond funds, investing in various assortments of corporate and govern­ment bonds There are tax-exempt bond funds, both long-term and shorter-term, for the high-bracket investor There are "balanced" funds which maintain portfolios including both stocks and bonds, with the objective of reducing risk And there are specialized funds which invest in options, foreign securities, etc.

### 8.5 The Daily Mutual Fund Prices

One advantage of a mutual fund is the ease with which you can follow a fund's performance and the daily value of your investment. Every day, mutual fund prices are listed in a special table in the financial section of many newspapers, including the *Wall Street Journal.* Stock funds and bond funds are listed together in a single alphabetical table, except that funds which are part of a major fund group are usually listed under the group heading (Dreyfus, Fidelity, Oppenheimer, Vanguard, etc.).

The listings somewhat resemble those for inactive over-the-counter stocks. But instead of "bid" and "asked", the columns are usually headed "NAV" and "Offer Price". "NAV" is the net asset value per share of the fund. it is each share's proportionate interest in the total market value of the fund's portfolio of securities, as calculated each night It is also, generally, the price per share at which the fund redeemed (bought back) shares submitted on that day by shareholders who wished to sell The "Offer Price" (offering price) column shows the price paid by investors who bought shares from the fund on that day. In the case of a load fund, this price is the net asset value plus the commission 01 "load" In the case of a no-load fund, the symbol "N.L." appears in the offering price column, which means that shares of the fund were sold to investors at net asset value per share, without commission. Finally, there is a column on the far right which shows the change in net asset value compared with the previous day.

### 8.6 Choosing a Mutual Fund

Very few investments of any type have surpassed the long-term growth records of the best-performing common stock funds. It may help to say more about how you can use these funds.

If you intend to buy load funds through a broker or fund salesperson, you may choose to rely completely on this person's recommendations. Even in this case, it may be useful to know something about sources of information on the funds.

If you have decided in favor of no-load funds and intend to make your own selections, some careful study is obviously a necessity. The more you intend to concentrate on growth and accept the risks that go with it, the more important it is that you entrust your money only to high-quality, tested managements.

There are several publications that compile figures on mutual fund performance for periods as long as 10 or even 20 years, with emphasis on common stock funds. One that is found in many libraries is the *Wiesenberger Investment Companies Annual Handbook.* The *Wiesen-berger Yearbook* is the bible of the fund industry, with extensive descriptions of funds, all sorts of other data, and plentiful perform­ance statistics. You may also have access to the *Lipper Mutual Fund Performance Analysis,* an exhaustive service subscribed to mainly by professionals. It is issued weekly, with special quarterly issues showing longer-term performance. On the newsstands, *Money* magazine pub­lishes regular surveys of mutual fund performance; *Barren's* weekly has quarterly mutual fund issues in mid-February, May, August and November; and *Forbes* magazine runs an excellent annual mutual fund survey issue in August.

These sources (especially *Wiesenberger)* will also give you descrip­tion of the funds, their investment policies and objectives. When you have selected several funds that look promising, call each fund (most have toll-free "800" numbers) to get its prospectus and recent financial reports. The prospectus for a mutual fund plays the same role as that described in "New Issues." It is the legal document describing the fund's history and policies and offering the fund's shares for sale. It may be dry reading, but the prospectus and financial reports together should give you a picture of what the fund is trying to do and how well it has succeeded over the latest 10 years.

In studying the records of the funds, and in requesting material, don't necessarily restrict yourself to a single "risk" group. The best investment managers sometimes operate in ways that aren't easily classified. What counts is the individual fund's record.

Obviously, you will want to narrow your choice to one or more funds that have performed well in relation to other funds in the same risk group, or to other funds in general. But don't rush to invest in the fund that happens to have performed best in the previous year; concentrate on the record over five or ten years. A fund that leads the pack for a single year may have taken substantial risks to do so. But a fund that has made its shareholders' money grow favorably over a ten-year period, covering both up and down periods in the stock market, can be considered well tested. It’s also worth looking at the year-to-year record to see how consistent management has been.

You will note that the range of fund performance over most periods is quite wide. Don’t be surprised. As we have stressed, managing investments is a difficult art. Fund managers are generally experienced professionals, but their records have nevertheless ranged from remarkably good to mediocre and, in a few cases, quite poor. Pick carefully.