

2. Financial Securities

- Money Market – short term, low risk
 - Debt instruments maturing in less than one year
 - Primarily – CD's, Commercial Paper, T-bills.

- Capital Market – Longer term, greater risk
 - Bonds
 - Treasury, Asset backed, GSE and Agencies, Municipal, Corporate
 - Equity
 - Preferred stock, common stock, ADRs, stock indexes
 - Derivatives
 - Futures and Options

Money Market Securities

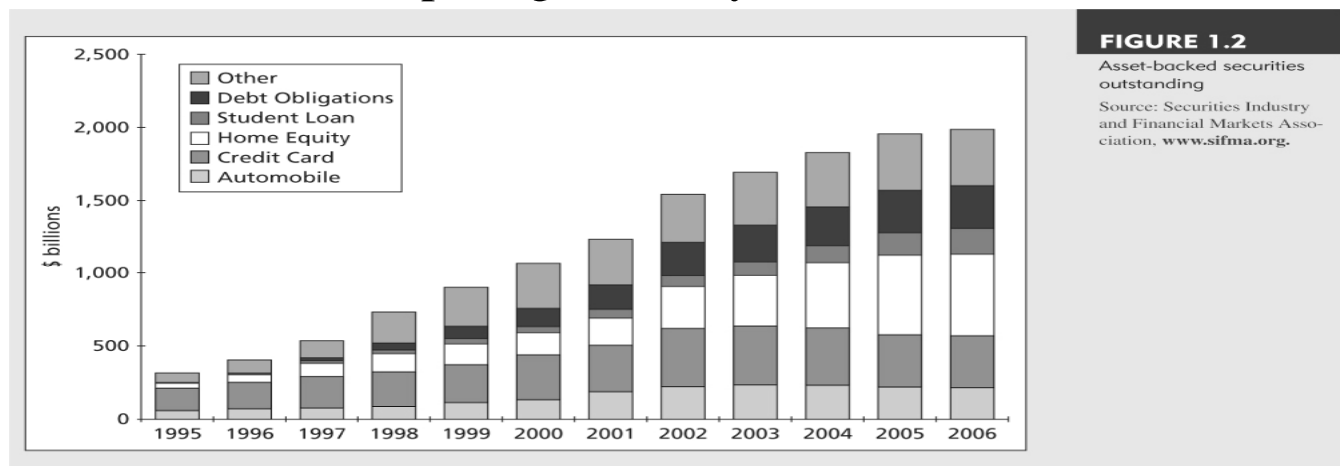
- Money Market – debt maturing in less than one year (fraction of money mkt)
 - CD (large/small) –
Interest paid at end of fixed term. Large > \$100k usually negotiable.
 - Commercial Paper -
issued by financial (GMAC, GECC) and other firms (utilities, retailers).
 - Treasury bills –
 - Savings deposits –
 - Other
 - Repos (and Reverse) – Dealer sells securities with agreement to repurchase.
 - Eurodollars - Deposits of U.S. dollars at foreign banks abroad.
 - Bankers Acceptance - A time draft a bank has agreed to pay on maturity.
 - Treasury dealers – Must be “qualified” to trade with FRBNY. ~40 firms.
 - Available for all trades (provide “realistic” quotes); Post capital > \$50M

Capital Market: Bonds

Size (T) %

- Treasury Securities – marketable only (total is much greater)
 - Mortgage Backed Securities – backed by pool of mortgages
 - Corporate Bonds
 - Govt Agencies and Sponsored Enterprises
 - Municipal – obligations of state and local govt
 - Asset Backed Bonds – backed credit cards receivables, A/R, etc
 - Total
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- Taxability of interest – in each case, capital gains are taxable.
 - Treasury bonds – Interest exempt from state/local tax but not federal
 - Municipal bonds – Interest exempt from fed tax and state/locality issued.
 - Corporate bonds – Interest and capital gains fully taxable

Asset Backed Bonds



Capital Market: Equities

- Common stock
 - Residual claim with limited liability
 - See stock screener at <http://finance.yahoo.com>
 - See Map of the Market <http://www.smartmoney.com> and Bigcharts

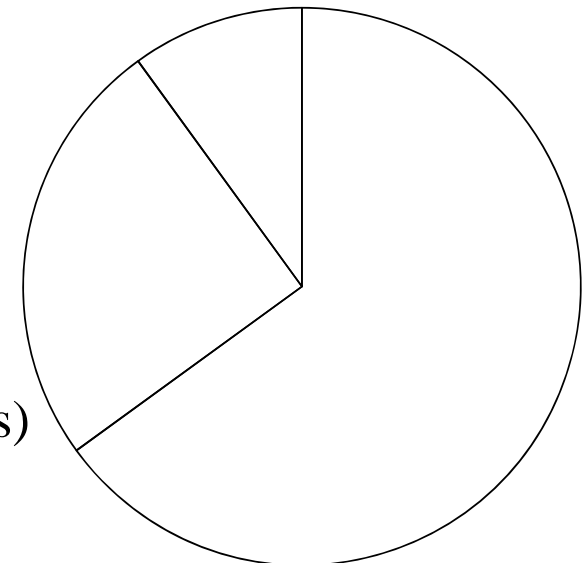
- Preferred stock
 - Fixed dividends (limited) with priority over common
 - Mostly owned by corporations, because up to 70% of dividends rec'd not taxed.

- ADRs – American Depository Receipts –
 – Certificates that trade in the US representing ownership in foreign firms.

Sector	NC	Mkt Cap
S&P 500	500	
Energy		
Materials		
Industrials		
Consumer Discretionary		
Consumer Staples		
Health Care		
Financials	22	21 20/
Information Techn		
Telecom Services		
Utilities		

Capital Market: Equity Indexes (1)

- Equity indexes
 - Used to track average returns; compare mgr performance; derivative contracts
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- United States
 - S&P 500 (vw) – 500 large firms.
 - Also S&P 100 (large), S&P 400 (mid), S&P 600 (small), S&P 1500 (total)
 - NASDAQ Composite (vw)
 - Dow Jones Industrial Average (pw) – created in 1896. AA, AXP, BA, BAC, CAT, C, CVX, KO, DD, XOM, GE, GM, HPQ, H-Depot, IBM, INTC, JNJ, KFT, McD, MRK, 3M, MSFT, JPM, PFE, PG, T, UTX, WMT, DIS, VZ.
 - Russell 3000 – broad market index.
 - 200 large cap
 - 800 mid cap
 - 2000 small cap (
- International
 - Country - Nikkei 225; Dax (Ger); FTSE (Fin Times)
 - Regional - EAFE (Europe, Australia, Far East)



Capital Market: Equity Indexes (2)

	Sh	Price ₁	Price ₂	Mkt Cap ₁	Mkt Cap ₂	% ΔP
Intel	50M	\$20				
AMD	1M	\$100				
Average						
		Price-weighted		Value-weighted		Equal-wght
<i>AMD w/ Split</i>	<i>2M</i>					

- Adjusting Price-weighted index for stock split by adjusting divisor.
 - Old divisor was “2”.

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Capital Market: Derivatives

- Derivative – legal contract whose value is derived from some underlying asset.
- Options –
 - Call – right to buy an asset
 - Put – right to sell an asset
 - Terms –
 - Consider call and put options with exercise (strike) price of 100.
Table gives payoffs to options at maturity.
- Future contract – obligation to purchase or sell an asset (or cash value) at a specified price on a specified date.
 - Long (Buy) – obligation to purchase commodity
 - Short (Sell) – obligation to deliver commodity.
 - Terms – delivery date; commodity, etc..

Stock Price	Payoff to Call	Payoff to Put
94		
97		
100		
103		
106		

Tips for the Savvy Investors from Overview of Capital Markets

- There are a variety of financial instruments, each with different characteristics
- There are a variety of market indices, each revealing different information.
- Before investing, we should understand
 - The characteristic of a financial instrument
 - The risk profile of a financial instrument
 - How to hedge risks we don't want to take