FCS 5510 Concept Review Notes:

Unit 01. Introduction, Creation of Financial Assets, and Security Markets

Chapter 01.
Definition of investment
Portfolio
Primary and secondary markets
Value and valuation
Return: income gains (e.g. dividends) vs. capital gains, dollar amounts vs. percentage
Risk: sources of risks: unsystematic risks vs. systematic risks
Unsystematic risks: business risk and financial risk
Systematic risks: market risk, interest rate risk, reinvestment risk, purchasing power risk,
exchange rate risk
Diversification and assets allocation
Efficient markets

Chapter 02
Financial claims: Debt claims (bonds) and equity claims (stocks)
Transfer methods: direct vs. indirect through a financial intermediary
Initial Public Offerings (IPOs)
The role of investment bankers
Underwriting
IPO pricing: the tendency to underprice IPOs
Regulation of IPOs: SEC’s role, prospectus, shelf registrations, lock-ups
Financial intermediaries (e.g. commercial banks) vs. investment bankers
Investment instruments: checking, saving, CDs, money market instruments (negotiable
CDs, Eurodollar CDs, U.S. Treasury bills, commercial papers, repos, bankers’
acceptances, tax (or revenue) anticipation notes).
FDIC

Chapter 3.
Secondary markets: organized exchanges (e.g., NYSE, AMEX) or over-the-counter
(NASDAQ)
Third and fourth markets: bulk trades
Security dealers (specialists on NYSE and Market makers in NASDAQ)
Bid and ask prices
Round lot vs. odd lot
Full service vs. discount service brokerage firms
Difference between security dealers and brokers
Long and short position
Types of orders: market orders, limit orders, stop orders
Cash vs. margin: margin requirement, maintenance margin, margin call
Delivery of securities: street name
Regulations: Securities Act of 1933, Security Exchange Act of 1934, SIPC, Sarbanes-
Oxley Act of 2002, Blue Sky laws
Unit 02. Tax Environment and Risk Management

Chapter 5
Tax philosophies: progressive, regressive, proportional
Tax shelter vs. tax fraud
Capital gains and losses: short term vs. long term
Capital gain and loss offsetting rules and wash sale rule
Tax shelter: Tax deferred pension plans (Traditional IRA (deductable), Roth IRA (non-deductable), Keogh accounts, 401K and 403b), tax deferred annuities, life insurance, stock option plans
Taxation on wealth: estate tax, gift tax, inheritance tax, and property tax

Chapter 6.
Return: Expected return, required return, realized return
Portfolio return: weighted average
Total risk = systematic risk (non-diversifiable) + unsystematic risk (diversifiable risk)
Measurement of risk: Standard Deviation (SD) and Beta
Portfolio theory: Markowitz model, Capital Assets Pricing model (CAPM), Arbitrage Pricing theory (APT)
Markowitz model: efficient frontier, risk indifference curves, and optimal portfolio choice
CAPM: capital market line or security market line, beta (individual security and portfolio beta)
APT: arbitrage

Unit 3. Investment companies: Mutual funds and closed-ended investment companies

Chapter 7
Advantages of mutual funds
Mutual fund net assets value (NAV)
Mutual fund prospectus
Load funds vs. no-load funds
Mutual fund portfolios: types of funds and investment style – Morningstar style box
Mutual fund fees and expenses: load, redemption fee, exchange fee, 12b-1 fee, etc.
Mutual fund returns: adjusting for fees and loads, before- and after-tax returns
Tax efficiency index
Performance evaluation adjusting for risk: Jensen index, Treynor index, and Sharpe index.

Chapter 8.
Differences between mutual fund and closed-ended investment companies
Cost of investing in closed-ended mutual funds
Unit Trusts (UITs)
Exchange-Traded Funds (ETFs)
Assets allocation over life cycle
Unit 4. Common Stock: Valuation and Measures of Stock Markets

Chapter 9.
Corporation
Rights of stockholders
Dividend growth valuation model
Estimating required return in dividend growth valuation model
Alternative valuation methods: P/E ratio, cash flow, P/B ratio, P/S ratio
PEG ratio, adjusted PEG ratio
The efficient market hypothesis: the weak form, the semi-strong form, and the strong form, anomalies

Chapter 10
Measures of stock performance: price-weighted averages, value-weighted averages, equal-weighted averages, and geometric weighted averages.
Comparison of prices over time: Graphic illustration, rate of return computation
Common stock market indexes: Dow Jones Industrial average, S&P 500, Nasdaq composite index, Dow Jones Wilshire 5000 index
Bond averages: Dow Jones Corporate Bond index
Rate of return on investments: holding period return, dollar-weighted return, time-weighted return
Averaging strategies: dollar cost averaging and averaging down

Unit 5. Common stocks: Dividends and macroeconomic environment

Chapter 11.
Cash dividend vs. stock dividend
Dividend payout ratio and retention ratio
Distribution of dividends: declaration date, ex-div date, date of record, distribution date
Stock split
Dividend reinvestment plan
Estimation of dividend growth rate method 1: using return on equity and retention ratio
Estimation of dividend growth rate method 2: using past data: arithmetic average, geometric average, future value approach, regression approach

Chapter 12.
Two approaches to stock analysis: fundamental and technical
Process of fundamental analysis: 1. economic environment, 2. industry analysis, and 3. individual firm analysis.
Business cycle: peak, contraction, trough and expansion
GDP
Index of leading economic indicators
Measures of consumer confidence: Consumer confidence index and Consumer Sentiment index
Measures of inflation: CPI and PPI
Monetary policy – the Federal Reserve: reserve requirement, discount rate, and federal fund rate, open market operations
Monetary policy – expansion policy vs. contractionary policy
The impact of interest rate change on stock prices
Money supply: M1 vs. M2
Fiscal policy: taxation, spending and debt management
Industrial life cycle
Cyclical vs. non-cyclical industries

Unit 06. Fundamental Analysis and Technical Analysis

Chapter 13.
Ratio analysis: time-series vs. cross-sectional
Data source for ratio analysis: balance sheet and income statement
Balance sheet: assets=liability +equity
Income statement: revenues and expenditures
Five types of ratios: liquidity ratios, activity ratios, profitability ratios, leverage ratios, and coverage ratios
Liquidity ratios: current ratio and quick ratio
Activity ratios: inventory turnover, average collection period, receivable turnover, fixed asset turnover
Profitability ratios: gross profit margin, operating profit margin, net profit margin, return on assets, return on equity, return on common equity, DuPont system return on equity
Leverage or capitalization ratios: debt to equity ratio, debt to total assets ratio
Coverage ratios: times-interest-earned
Ratios important to creditors: expanded coverage ratio
Ratios important to stockholders: payout ratio
Cash flow statement: operating activities, investment activities, and financing activities
Cash inflows and outflows
The relationship between fundamental analysis and efficient markets

Chapter 14
Behavioral finance concepts: overconfidence, disposition effect, house money effect, familiarity, mental accounting, cognitive dissonance, herding.
Technical analysis
The Dow theory
Barron’s confidence index
Advisory opinion theory
Advance-Declines Cumulative series
Point-and-figure charts (X-O charts)
Bar graphs: head and shoulder pattern
Candlestick graph
Moving averages
Volume analysis
Short sales by specialists
Verification of technical analysis – are they useful?
The dogs of the Dow