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Equities Overview - An Introduction to Equities

Welcome to this introduction Equities – or Stocks as they're also known. In this course you'll learn about:

- What defines a 'stock'
- The basics of how they're traded
- Some of the key terminology used
- The difference between investors and speculators
- Domestic vs foreign stock trading.

Hopefully this course will act as a springboard to further learning and lead to you making smarter, more informed investments.

So, let's explore Equities.

So, What Exactly is a stock?

The Cambodian Stock Exchange introduced securities trading in 2012. Today, the world’s largest stock exchanges can be found around the globe.

So, why do companies list their shares on stock exchanges?

In attempts to grow and transform their businesses further, private companies will look to raise capital by offering their shares to the public. By doing so, the owners of the company will give up some of their ownership in exchange for the capital they need to expand. The process of listing shares is known as “underwriting”.

After shares of a company are issued at the “primary market” or at the initial public offering (IPO), they start to trade on an exchange. The pool of shares available to buy and sell at the open market is then known as the ‘float.’

So, let’s look a little further into stocks.

What Happens When You Own a Stock?

A stock is a ‘share’ of ownership in a company. By purchasing a stock, you become a shareholder IN that company. You may benefit from dividends, can vote on key corporate decisions and possess certain rights.

To buy 100 stocks in Company ABC at 10$ you need $1,000. Purchase equals ownership.

The price of a stock goes up and down depending on many factors. You purchase the stock at a quoted price and the rise or decline in the stocks value, results in either a profit or a loss. It is considered a traditional way to trade financial markets.

And trading stocks means you have to purchase them BEFORE you can sell, …meaning that you can profit from a rising price ONLY after you’ve bought the stock. If the stock drops below your purchase price, you lose out.

What About Buying a Stock?

You want to invest in company ABC. It’s trading at $10 per share. You believe that the STOCK is going to rise and therefore you want to invest. You want to purchase 1,000 shares.

With a traditional STOCK purchase, this would cost you $10,000 (10 x 1,000) plus and associated costs. So you buy the STOCK and it goes up to $11 per share. You decide to sell the STOCK and therefore get $11,000 back. This would net you a $1,000 profit. (Ignoring trading costs for the sake of this illustration.) Your $1,000 profit on an initial outlay of $10,000 means a 10% profit.

Stocks – Some Key Terminology

In the next few pages we'll take a look at some of the key terms and phrases associated with Stocks. You'll learn about the following terms:

- A Share
- Shares Outstanding
- Market Capitalization
- Investment vs Speculation
- Risk

This is not a definitive list by any means but it will give you a foundation to build on for later learnings.

So, let's explore these key terms.

Stocks – Some Key Terminology

Key Terminology: ‘A Share’

When you buy shares of a company, you become an owner in the company and thus you are entitled to the earnings generated from the company’s business. You become a shareholder. Stocks are also referred to as equities or securities.

Key Terminology: ‘Shares Outstanding’

The total number of shares issued by a company is defined as shares outstanding. Authorized shares describe the total number of shares a company is authorized to issue. This takes place when the business is first incorporated. For instance, if company’s articles of incorporation show that XYZ has authorized one million shares, then only one million shares can be issued and not more.

From the authorized shares, company XYZ may offer 300,000 shares through an IPO to the public. The company, in the form of treasury stock, retains the remaining shares of 700,000. At a later stage, the company may offer more shares or decrease the number of shares in the market in the form of ‘buyback.’ Buyback can occur when companies have extra cash on hand and are looking to ‘retire’ or cut down the supply of stocks in the market place. By cutting the supply, the value of the shares may increase further.

Key Terminology: ‘Market Capitalization’

The term ‘Market Capitalization’ refers to the market value of a business measured by its price per share multiplied by the shares outstanding. In international practice, with capitalization of $394 billion, Microsoft will be referred to as a large capitalization company, or just ‘large-cap’. By definition, if a company has a market value above $10 billion, it’s considered large-cap. If between $2 billion and $10 billion, that capitalization is considered ‘mid-cap’ and below $2 billion- ‘small cap’.

Stocks – Some Key Terminology

Key Terminology: ‘Investment vs Speculation’
There is a fine line between what constitutes investing and speculating, but it is important for stock investors to come in grips with the two as it may help them define their approach to the stock market.

Investment may take many forms; you may invest in land, commodity like gold or in a company as in the case of stocks. You may hold on to the investment for anything from a few months to many years.

As a speculator, however, you may not take time to know the business that intimately. You would look to benefit from the fluctuations of the stock prices and buy shares in order to sell them at a higher price to someone else. As a time horizon, you may hold these shares from a few days to a few weeks

Key Terminology: ‘Risk’
In finance, the possibility of losing some or all of your investment is referred to as risk. The more risk you take in the market, the bigger the potential for loss or gain. Sometimes, risk is referred to as volatility or how much an investment can fluctuate up or down. It is imperative for novice and experienced investors alike to understand the implied risks of a stock investment.

Type, Size, Domestic, Foreign

So you understand the basics of Stocks. Now we’ll take a look at:

- Different types of Stocks
- How a companies size can affect share prices
- Investing on domestic or foreign stocks

Please note - in the next section we discuss these topics at high-level and in general terms. We will take a more in-depth look at how a companies Stocks are valued in a later module.

Types of Stock

A publically traded company will offer two kinds of stocks - common and preferred. A common stock is typically what most businesses will issue. As mentioned in section one, common stock represents an equity ownership in a company. Owners of common shares may or may not receive dividends from holding the equity.

Preferred shares will almost always distribute dividends to shareholders. Due to its “preferred” status, the payment of dividends will occur before any payments made to common stockholders.

The Size of Companies and their Stock

Size – in section one, we mentioned that according to their market capitalization stocks are divided in three different categories: large-cap, mid-cap and small-cap. Large capitalization companies are more established and tend to have more stable earnings. Stable earnings can often translate to stability in the share price. On the contrary, small capitalization companies tend to have unstable earnings and share prices. Investors could find a compromise with mid-cap stocks, which offer growth and stability of a larger company.

Domestic vs Foreign Stocks

Stocks are defined as domestic or foreign simply based on your location. If you're based in the Cambodia then stocks in the PPWSA, GTI, PPAP, PPSEZ and SAP would be considered 'domestic'.

One of the main benefits to investing in foreign stocks is diversification. Most of investors have near-site vision when it comes to investing and invest in we know best – their own market. This bias towards domestic companies has its benefits but it also has its risks. For instance, if you invested your entire portfolio in Greek stocks over the last decade, you probably got "crushed" by the economic meltdown in that country.

Foreign stocks, particularly in emerging markets as these economies are in the middle of rapid economic growth, could also reward investors looking for higher growth.

Between 2010 and the end of 2014 shares of American tech giant Google returned an outstanding 103%, whilst shares of its Chinese counterpart Baidu, have gained a formidable 460%. One must mention here that potentially higher returns could lead to higher investment risks…

One of the biggest disadvantages of investing in foreign stocks could be the risk of foreign exchange. Foreign companies trade and pay dividends in their own currencies. So if you're based in Germany and get a dividend from a Cambodian company, it would be in Khmer Riel and therefore need exchanging into Euros.

Last but not least, smaller markets around the world trade significantly less volume than some of the bigger exchanges. This may lead to lack of liquidity where investors might be at risk of not being able to easily sell their stock holdings.

Summary

So let's review what we learnt on this topic:

- ✓ Exchanges around the world have become an important mechanism for companies to raise capital by issuing shares. Shares worth trillions of dollars are bought and sold every day on the secondary markets through exchanges.

- ✓ Whether you are looking to invest in the stock market for the long term or you're looking to speculate on the next company shares, you must take time to learn and understand the risk involved in the market and manage it. Only by minimizing the risk and the potential losses will you be able to hold onto your gains and move forward.

- ✓ Corporations will generally issue common and preferred shares. Preferred shares have advantage over common shares, as their shareholders will receive any paid out dividends before the common shareholders. Investors looking for a long-term return could consider stocks that pay out dividends and also provide growth.

- ✓ The market capitalization of a company is determined by the number shares outstanding multiplied by it's price per share. Large-caps are stocks of companies in "mature" stage with stable or limited growth potential. These companies tend to grow from acquisitions of other companies.

- ✓ Investing in foreign stocks can potentially require a higher tolerance for risk but could reward investors by providing diversification away from domestic assets.

We hope you enjoyed this topic.