

# CHAPTER SIX

Once you've established your investment plan you can determine which financial products are best suited for your goals. Besides stocks, a growing number of other types of securities trade on the New York Stock Exchange. The NYSE continues to fulfill its commitment to better serve investors by offering a broader range of products that meet the changing demands of today's marketplace.

## Types of Stock

The two main categories of stocks are common stock and preferred stock. Preferred stockholders have priority over common stockholders in terms of dividend payout and in recouping their investment if the company fails or liquidates. However, preferred stockholders, unlike common stockholders, cannot vote for directors of the company. There are five basic categories of stock:

- **Income Stocks** pay unusually large dividends that can be used as a means of generating income without selling the stock, but the price of the stock generally does not rise very quickly.
- **Blue-Chip Stocks** are issued by very solid and reliable companies with long histories of consistent growth and stability. Blue-chip stocks usually pay small but regular dividends and maintain a fairly steady price throughout market ups and downs.
- **Growth Stocks** are issued by young, entrepreneurial companies that are experiencing a faster growth rate than their general industries. These stocks normally pay little or no dividend because the company needs all of its earnings to finance expansion. Since they are issued by companies with no proven track record, growth stocks are riskier than other types of stocks but also offer more appreciation potential.

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- **Cyclical Stocks** are issued by companies that are affected by general economic trends. The prices of these stocks tend to go down during recessionary periods and increase during economic booms. Examples of cyclical stock companies include automobile, heavy machinery and home building.
- **Defensive Stocks** are the opposite of cyclical stocks. Defensive stocks — issued by companies producing staples such as food, beverages, drugs and insurance — typically maintain their value during recessionary periods.

## Mutual Funds

The most common way for individuals to invest in the stock market is through mutual funds. Mutual funds pool money from all their investors and buy different stocks with it. The risk and reward from all of the stocks is shared by all of the investors. This is a way for investors to diversify their risk and own many stocks with not a lot of money.

There are all kinds of mutual funds, including index funds that track market segments, and more specialized funds that invest in a certain industry or use a certain strategy. Many people invest through their employer through 401(k) retirement accounts, which generally allow employees to choose from a list of funds.

## Exchange Traded Funds

An Exchange Traded Fund (ETF) is an index fund representing a basket of stock that trades on an exchange throughout the day and are bought and sold like common stocks with continuous pricing (compared with mutual funds, which are bought and sold at the end of the trading day at their end-of-day net asset value [NAV]). Investors get the advantages of trading a diversified “basket” of stocks that reflects the performance of a market index, industry, sector, style or region—all in one security. They also offer diversified exposure and lower expense ratios than traditional mutual funds.

## Fixed-Income Securities

Bonds are considered fixed-income securities. The term bond, debenture and note are often used interchangeably. All three represent debt obligations of the issuing entity. The majority

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of these instruments are issued in multiples of \$1,000 face amounts at a specified coupon, or interest rate, with a set maturity date at which time the obligation must be repaid. Many debt issues may be redeemed, or called, by the issuer prior to the maturity date if specified in the issue's indenture.

The NYSE operates the largest centralized bond market of any U.S. securities exchange. It offers investors a broad selection of bonds: corporate (including convertibles), agency and government bonds. The majority of NYSE bond volume is in corporate debt issues. NYSE bonds trade through the Exchange's Automated Bond System® (ABS®), a screen-based system used by NYSE member firm subscribers. ABS reports real-time quotes and trades to market data vendors.

## Structured Products

The NYSE also trades debt and equity structured corporate issues. These specialized products are categorized into four main classifications: capital securities, retail debt securities, mandatory convertible securities and equity-linked debt securities. The NYSE trades more than 550 structured products with a total market value greater than \$120 billion.

## Options

An option is a contract to buy or sell a specific financial product, which is called the option's underlying instrument or underlying interest. For equity options, the underlying instrument is a stock, ETF or similar product. The contract itself is very precise. It establishes a specific price, called the strike price, at which the contract may be exercised. And it has an expiration date. When an option expires, it no longer has value and no longer exists. Options are most frequently used to remove market risk in owning or trading in an individual security or market segment.

Options come in two varieties: calls and puts. You can buy or sell either type. If you buy a call, you have the right to buy the underlying instrument at the price on or before the expiration date. If you buy a put, you have the right to sell the underlying instrument on or before expiration. In either case, as the option holder, you also have the right to sell the option to another buyer during its term or let it expire worthless. Options can be bought and sold on NYSE Arca.

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**KEY TERMS**

**Blue Chip:** A company known nationally for the quality of its products or services, its reliability, and its ability to operate profitably in good and bad economic times.

**Bond:** Basically, an I.O.U. or promissory note of a corporation or municipality, usually issued in multiples of \$1,000 or \$5,000. A bond is evidence of a debt on which the issuing company usually promises to pay the bondholder a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. A bondholder is a creditor of the corporation, not a part owner, as is the shareholder.

**Certificate of Deposit (CD):** An agreement with a bank that you will leave your money on deposit for a specified period of time in return for a specific amount of interest.

**Common Stock:** One of two types of stock an investor may purchase in a company. Most stock is common stock. Investors who purchase it have voting rights at the company's annual stockholders' meeting. Common stockholders are not guaranteed dividends, but they may receive dividends during the company's prosperous periods. If a company fails or liquidates, common stockholders are paid after bondholders and preferred stockholders.

**Exchange-Traded Fund (ETF):** An index fund representing a basket of stocks that trades on the Exchange throughout the day, with intra-day pricing. Investors get the advantages of trading a diversified "basket" of stocks that reflects the performance of a market index, industry, sector, style or region — all in one security.

**Money Market Account:** An account in which your money is reinvested in short-term securities by the bank or investment firm managing the account.

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**Options:** Options are derivative securities that give the holder the right to buy (call) or sell (puts and calls) a specified amount of the underlying security at a specific "strike price" and within a specified time frame.

**Preferred Stock:** A class of stock with a claim on the company's earnings before payment may be made on common stock and usually entitled to priority over common stockholders if the company fails or liquidates. Preferred stockholders also are entitled to dividends at a specified rate when declared by the company's board of directors and before payment of a dividend on the common stock. Preferred stock normally does not include voting rights.

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