CAPACITARTE

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Curso de inglés económico, de finanzas y tributos
Module 8

Trading Stocks

Financial Centers

Financial centers are places where there are many banks and other financial institutions.
London as a financial center is called the City or the Square Mile, and New York is Wall Street.
Financial centers bring together investors and the businesses that need their investment. A speculator is an investor who wants to make a quick profit, rather than invest over a longer period of time. Brokers, dealers and traders buy and sell for investors and in some cases, for themselves or the organizations they work for.

On these financial centers or markets, financial assets (also known as financial instruments or securities) are traded, this means that they are bought and sold.

Financial instruments are assets that can be traded. They can also be seen as packages of capital that may be traded. These assets can be cash, a contractual right to deliver or receive cash or another type of financial instrument, or evidence of one's ownership of an entity.

A **security** is a tradable financial asset of any kind. Securities are broadly categorized into: *debt securities* (e.g., banknotes, bonds and debentures) and *equity securities* (e.g., common stocks).

Economists tend to categorize financial markets based on two factors: **time** (how long the loan is for) and whether the financial assets can be resold – **resaleability.**

Based on time, economists distinguish between the **capital market**, the market for buying and selling long-term financial assets, and the **money market**, the market for buying and selling short-term financial assets.

In regard to resaleability, economists distinguish between the **primary market**, which is the market for buying newly created financial assets directly from the issuing entity, and the **secondary market**, which is the market where financial assets are resold.

The **over-the-counter market** is a decentralized market in which unlisted securities trade. It is not a physical location. Prices are negotiated, and trades are made through computer networks, phones and email. Dealers act as market makers, and quote prices at which they will buy and sell. OTC markets usually have both a customer market, where dealers trade with corporations and institutions, and an interdealer market where dealers trade with each other.

Thousands of unlisted securities trade on the OTC market. They are often small companies who don't meet the requirements to be listed on exchanges such as the New York Stock Exchange. They are considered more risky than exchange-traded stocks. OTC markets are less transparent than

exchanges, and subject to fewer regulations. Trades can be quietly made between two parties without others knowing the price.

Investors

Financial journalists use some animal names to describe investors.

Bulls are investors who expect prices to rise. On the contrary, **bears** are investors who expect them to fall.

Stags are investors who buy new share issues hoping that they will be **over-subscribed**, this means that there will be more demand than available stocks so successful buyers can immediately sell their stocks at a profit.

A period when most of the stocks on a market rise is called a **bull market**. A period when most of them fall in value is a **bear market**.

Institutional investors generally keep stocks for a long period, but there are also **speculators** – people who buy and sells stocks rapidly, hoping to make a quick profit, rather than invest over a longer period of time. These include **day traders** – people who buy stocks and sell them again before the **settlement day** (the day on which they have to pay for stock purchased). If day traders sell at a profit before settlement day, they never have to pay for their stocks.

Day traders usually work with **online brokers** on the internet, who charge low commissions (fees for buying and selling stocks for customers).

Speculators who expect the price to fall can take a **short position**, by agreeing to sell stocks in the future at their current price, before they actually own it. Then they wait for the price to fall before buying or selling the stock. The opposite, taking a **long position**, means actually owning a security or other assets: that is, buying it and having it recorded in their accounts.

Market Activity

When we describe market activity, we can use a variety of words and expressions, such as the followings:

Good times …

Trading has been heavy on the New York Stock	=buying and selling of securities….
Exchange, with a very high **turnover** of one and a	=large number…
half billion shares **changing hands**. We've seen	= being bought and sold …
spectacular gains, especially among blue chips	= big increases in value …
This **bull** market seems set to continue, after	= rising prices …
Yesterday's record high at the close.	= end of the working day …
Dealers seem **bullish** and expect the Dow	= optimistic …

to **go** through the 15,000 barrier son = to pass the ´round´number of …

and bad times …

There was **panic selling** on the New York Stock	= selling of securities for any price …
Exchange today as prices fell to new **five-year lows**.	= their lowest point for five years …
We've seen some **spectacular declines**, with billions	= large decreases …
of dollars **wiped off the value of** some America´s	= taken off the total share value …
best-known companies, and more than **10 per cent of total market capitalization**.	= the total value of shares listed on the market going down by 10% ...

The **bear market** continues, with prices set to fall	= falling prices …
further in the next few days. Dealers are **bearish** with	= pessimistic …
many saying there is no sign of **a rally**. If prices	= prices starting to rise again…
continue to fall, there may be another Stock market collapse or **crash**, like the ones in 1929 and 1987.	= very serious drop in the value of stocks on the market, with serious economic consequences …

Note: The following words have a similar meaning.

Verb	**Noun**
to rally	a rally
to recover	a recovery

Market Indexes

If there is demand for shares in a company, for example because it is doing well, its share price goes up. If not, its price goes down. The overall value of shares traded on a stock market is shown by an index (plural: indexes or indices). Some of the main ones are:

1. London: FTSE (pronounced 'Footsie'): the Financial Times Stock Exchange index.
2. New York: the Dow Jones Industrial Average ('the Dow'). Especially long-established 'old economy' companies.
3. New York: NASDAQ. Especially hi-tech 'new economy' companies.
4. Paris: CAC 40.
5. Frankfurt: DAX.
6. Hong Kong: Hang Seng.
7. Tokyo: Nikkei.

Money Markets

Money markets consist of a network of corporations, financial institutions, investors and governments which need to borrow or invest short term capital (up to 12 months). For example, a business or government that needs cash for a few weeks only can use money markets.

Through money markets, borrowers can find short-term **liquidity** by turning assets into cash. They can also deal with irregular cash flows more cheaply than borrowing from commercial banks. Similarly, investors can make short-term deposits with investment companies at **competitive interest rates** (higher ones than they would get from a bank).

Borrowers and lenders in the money markets use banks and investment companies whose business is trading financial instruments such as stocks, bonds and short term loans and debts, rather than lending money.

There are different kinds of money market instruments:

- **Treasury bills** (or **t-bills**), bonds issued by the governments. The most common maturity (the length of time before a bond becomes repayable) is 3 months up to 1 year. It is the safest possible investment. They are usually sold **at a discount** from their **nominal value** (the value written on them) rather than paying interest. They can be sold at 99 per cent of their face value and **redeemed** (paid back) at 100 % at maturity.

- **Commercial paper** is a short term loan issued by major companies, sold at a discount. It is **unsecured**, which means it is not guaranteed by the Company's assets.

- **Certificates of deposit (CDs)** are short or medium term, interest-paying debt instruments, issued by Banks to large depositors who can then trade them in the short term money markets. They are known as **time deposits**. The holder, by buying the certificate, agrees to lend money for a specified amount of time.

Note: Nominal value is also called **par value** or **face value.**

Bonds

A bond is a contract issued by governments and corporations promising to repay borrowed money, plus interest, on a fixed schedule.

The amount that the bond issuer promises to pay the buyer at **maturity** is its **par value**.

Maturity is the date when the bond is due to be repaid. The **coupon rate** is the interest rate a bondholder receives every year until a bond matures.

There are two reasons to invest in bonds: the **interest** paid on bonds and the **gains** made by selling bonds.

Most people buy bonds for their **guaranteed interest income**. Bonds are considered less risky than shares of stock because bondholders are paid before stockholders.

Yield —the annual rate of return of a bond—will be most important to those investors when deciding to buy and sell bonds.

There are different types of yield:

- **Coupon** yield, which is the bond interest rate fixed at issuance;
- **Current** yield, the bond interest rate as a percentage of the current price of the bond,
- **Yield to maturity**, which is an estimate of what an investor will receive if the bond is held to its maturity date.

Investors who want to sell bonds before they reach maturity study the bond market to see if they can sell their investment at a profit.

The main risk that bond buyers face is that the issuer can **default**, or be unable to repay the borrowed money at maturity. Therefore, the level of risk is directly tied to the financial strength of the bond issuer.

When governments or corporations want to issue bonds, they pay a **credit-rating** company to evaluate how likely it is that they will repay the loans. In this way, investors have a standard by which to judge the risk of the bonds.

The two most well-known systems of bond ratings are those established by Standard & Poor's and Moody's. These companies use a system of letters to designate the relative credit risk of bonds. Bonds are rated from the lowest risk of government securities (Aaa or AAA) to the higher risks associated with junk bonds.

Bond Rating		Grade	Risk
Moody's	**Standard & Poor's**		
Aaa	AAA	Investment	Lowest risk
Aa	AA	Investment	Low risk
A	A	Investment	Low risk
Baa	BBB	Investment	Medium risk
Ba, B	BB, B	Junk	High risk

Caa/Ca	CCC/CC/C	Junk	Higher risk
C	D	Junk	In a default

Investors may choose to invest in many different kinds of bonds. The yields and risks associated with these bonds vary considerably. As is the case with stocks, the higher the risk the greater the potential yield of a bond.

Bonds are classified based on who issues the bonds.

The U.S. government issues securities called **Treasury bonds, notes, or bills**. Because they are backed by the "full faith and credit" of the federal government, these securities are considered to be virtually risk free. The risk level of international bonds issued by government of various countries depends on the financial strength of the particular government.

One way that companies finance expansion is by issuing **corporate bonds**. These bonds generally pay a higher coupon rate than government bonds because the risk is higher. One kind of corporate bond, a **junk bond**, is considered high risk but has the potential for high yields.

When interest rates are high, some companies issue **convertible shares** or **convertibles**, which are bonds that the owner can later change into shares. Convertibles pay lower interest rates than ordinary bonds, because the buyer gets the chance of making a profit with the convertible option.

There are also **zero coupon bonds** that pay no interest but are sold at a big discount on their par value, they are repaid at 100% at maturity. Bondholders do not receive money every year, as these bonds pay no interest. Instead, they make a **capital gain** at maturity.

Bonds with a low credit rating (and a high chance of default), but paying a high interest rate are called **junk bonds**. These are also known as **fallen angels** - bonds of companies which were previously in a good financial position, while others are issued to finance leveraged buyouts.

Debentures

A debenture is a type of debt instrument that is not secured by physical assets or collateral. Debentures are backed only by the general **creditworthiness** and reputation of the issuer.

Both corporations and governments frequently issue this type of bond to **secure** capital. Like other types of bonds, debentures are documented in a **Trust Indenture**, which is an agreement between the issuing corporation and the trust that manages the interest of the investors

Bond buyers generally purchase debentures based on the belief that the bond issuer is unlikely to default on the repayment. An example of a government debenture would be any government-issued Treasury bond (T-bond) or Treasury bill (T-bill). T-bonds and T-bills are generally considered risk free because governments, at worst, can print off more money or raise taxes to pay these types of debts.

Debentures are the most common form of long-term loans that can be taken out by a corporation. These loans are normally repayable on a fixed date and pay a fixed rate of interest. A company normally makes these interest payments prior to paying out dividends to its shareholders, similar to most debt instruments. In relation to other types of loans and debt instruments, debentures are advantageous in that they carry a lower interest rate and have a repayment date that is far in the future.

There are two types of debentures: convertible and non-convertible.

Convertible debentures are bonds that can convert into equity shares of the issuing corporation after a specific period of time. These types of bonds are the most attractive to investors because of the ability to convert, and they are most attractive to companies because of the low interest rate. This rate can be either fixed or floating and depends on the company's credit rating or the bond's credit rating.

Non-convertible debentures are regular debentures that cannot be converted into equity of the issuing corporation. To compensate, investors are rewarded with a higher interest rate when compared to convertible debentures.

For non-convertible debentures, the date of maturity is an important feature. This date dictates when the issuing company must pay back the debenture holders.

However, the company has a few options for how it will repay. The most common form of repayment is called a **redemption out of capital**, in which the issuing company makes a **lump sum payment** on the date of maturity. A second option is called a **debenture redemption reserve**, in which the issuing company transfers a specific amount of funds each year until the debenture is repaid on the date of maturity.

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