n Elizabethan days, the motley fool was the court jester who wore multicolored garb. Fools were the only people who could get away with telling the king or queen the truth. The Motley Fool Web site (www.fool.com) was created by two English majors who studied more Shakespeare than investments when in college but are now in the business of offering investment advice. David and Tom Gardner talk to their readers in a straightforward yet humorous manner, referring to readers as “fools” in search of the truth about investing. They ask investors to think for themselves—and give them the tools to do so. The Motley Fool’s strategy for beginners is (1) learn the rudiments of investment research, (2) pay down debt before beginning, (3) start with mutual funds that mimic the major stock indexes, and (4) invest in stocks you expect to hold for a long time. Meanwhile, their Motley Fool Rule Breaker and Rule Maker Portfolios consistently stack up well against market professionals. Through year-end 1999, these portfolios significantly outperformed the Standard & Poor’s 500 Index.

Fool.com is one of many Web sites where investors can learn about, choose, and buy and sell securities. The Internet has revolutionized the financial services industry, empowering individual investors and simplifying the investing process. In this chapter, you’ll learn how to use online investment resources wisely and find the information to make and monitor investment decisions. We’ll discuss the basics of making securities transactions through a traditional broker or online, as well as whether to hire an investment adviser or join an investment club. Most of this material is serious and straightforward. But as the Motley Fool has shown, some aspects of investing can also be fun.

Learning Goals
After studying this chapter, you should be able to:

LG 1 Discuss the growth in online investing, including educational sites and investment tools, and the effective use of the Internet.

LG 2 Identify the major types and sources of traditional and online investment information.

LG 3 Explain the characteristics, interpretation, and uses of the commonly cited stock and bond market averages and indexes.

LG 4 Review the roles of traditional and online stockbrokers, including the services they provide, selection of a stockbroker, opening an account, and transaction basics.

LG 5 Describe the basic types of orders (market, limit, and stop-loss), online transactions, transaction costs, and the legal aspects of investor protection.

LG 6 Discuss the roles of investment advisers and investment clubs.
Only a few years ago, online investing focused on finding the lowest transaction costs at one of a few discount brokers that offered cheap electronic trades. Today, the Internet is a major force in the investing environment. It has opened the world of investing to individual investors, creating a more level playing field and providing access to tools formerly restricted to professionals. You can trade many types of securities online and also find a wealth of information. This information ranges from real-time stock price quotes to securities analysts’ research reports and tools for investment analysis. The savings from online investing in terms of time and money are huge. Instead of wading through mounds of paper, investors can quickly sort through vast databases to find appropriate investments, monitor their current investments, and make securities transactions—all without leaving their computers.

This chapter introduces you to online investing, types and sources of investment information, and the basics of making securities transactions. We will continue discussing online investing in subsequent chapters focused on analysis and selection of various types of securities. In addition, throughout the book you will find descriptions of useful investing Web sites that will help you become a more proficient and confident investor.

Because new Web sites appear every day and existing ones change constantly, it’s impossible to describe all the good ones. Our intent is to give you a sampling of Web sites that will introduce you to the wealth of investing information available on the Internet. You’ll find plenty of good sources to help you stay current. Many business and personal finance magazines include online investing departments and periodically publish “best of the Web” sections. Magazines such as Online Investing are devoted just to finding and evaluating Web sites relevant to investing.

The Growth of Online Investing

Online investing’s popularity has grown almost as fast as stock market valuations. In just one year, from 1998 to 1999, the percentage of retail securities trades executed online jumped from 27% to more than 50%. Investors have opened over 16 million online accounts at the 170 brokerage firms that offer online services. About 4 million households manage over $550 billion in assets online. It’s easy to see why online investing attracts thousands of new investors daily: The Internet makes buying and selling securities convenient, relatively simple, inexpensive, and fast. In today’s rapidly changing stock markets, it provides the most current information, updated continuously. Even if you prefer to use a human broker, the Internet provides an abundance of resources to help you become a more informed investor.

How can you successfully navigate the cyberspace universe? You probably already have the technology you need: a computer, modem, and Internet service provider (ISP) to connect you to the Internet. Open your Web browser, and you are ready to explore the multitude of investing sites. These sites typically include a combination of resources for novice and sophisticated investors alike. For example, look at brokerage firm Charles Schwab’s homepage (www.schwab.com), shown in Figure 3.1. With a few mouse clicks you can learn about Schwab’s services, open an account, and place orders. In addition, you will find the day’s and week’s market activity, price quotes, and analysts’ research reports. You can use screening tools to select stocks and mutual
funds, register for an online course at the Learning Center, get advice on retirement planning, and even set up a customized page that delivers the news and stock quotes you request.

All this information can be overwhelming and intimidating. It takes time and effort to use the Internet wisely. But the Internet itself helps you sort through the maze. Educational sites are a good place to start. Then you can check out the many investment tools. In the following section, we’ll discuss how to use the Internet wisely to become a smarter investor.

**Investment Education Sites** The Internet offers many tutorials, online classes, and articles to educate the novice investor. Even experienced investors will find sites that expand their investing knowledge. Although most investing-oriented Web sites and financial portals (described later) include many educational resources, here are a few good sites that feature investing fundamentals.

- The Motley Fool Fool’s School (www.fool.com) has sections on investing basics, mutual fund investing, choosing a broker, and investment strategies and styles, as well as lively discussion boards and more.
America Online's (AOL) Money Basics, developed with Smart Money magazine and for subscribers only, offers Investing 101, which covers basic investment theory, risk management, asset categories, and taxes. Other departments include building and managing your portfolio, investment strategies, and personal finance topics.

Investopedia (www.investopedia.com) is an educational site featuring Investopedia University, articles on basic investing and personal finance topics, and a glossary of investing terms.

Zacks Investment Research (www.zacks.com) offers a comprehensive “Investing 101” tutorial and a glossary of financial terms.

WSJ.com Online Investing (www.investing.wsj.com), a free site from the Wall Street Journal, is an excellent starting place to learn what the Internet can offer investors.

Nasdaq (www.nasdaq.com) has an Investor Resources section that helps with financial planning and choosing a broker.

Other good educational sites include leading personal finance magazines such as Money (www.money.com), Kiplinger’s Personal Finance Magazine (www.kiplinger.com), and Smart Money (www.smartmoney.com).

Investment Tools Once you are familiar with investing basics, you can use the Internet to develop financial plans and set investment goals, find securities that meet your objectives, analyze potential investments, and organize your portfolio. Many of these tools, once used only by professional investment advisers, are free online. You’ll find financial calculators and worksheets, screening and charting tools, and stock quotes and portfolio trackers at general financial sites (described in the later section on financial portals) and at the Web sites of larger brokerage firms. You can even set up a personal calendar that notifies you of forthcoming earnings announcements and can receive alerts when one of your stocks has hit a predetermined price target.

Planning Online calculators and worksheets help you find answers to your financial planning and investing questions. With them you can figure out how much to save each month for a particular goal, such as the down payment for your first home, a college education for your children, or retiring when you are 60. For example, the brokerage firm Fidelity (www.Fidelity.com) has a wide selection of planning tools: investment growth, college planning, retirement planning—even a “spend or save” calculator. (Because not all calculators give the same answer, you may want to try out those at several sites.)

One of the best sites for financial calculators is FinanCenter.com (www.financenter.com). It includes over 100 calculators for financial planning, insurance, auto and home buying, and investing. Figure 3.2 shows a calculator that answers the following question about stock: “What selling price provides my desired return?” Other investment-related calculators show the difference between selling a stock before or after one year, your current yield from dividends, how exchange rates affect foreign stock transactions, how fees and costs affect your mutual fund purchases, bond yield to maturity, whether a taxable or a tax-exempt bond provides a better return, and more.
Screening  With screening tools, you can quickly sort through huge databases of stocks, bonds, and mutual funds to find those that have specific characteristics. For stocks, you can specify low or high price/earnings ratios, small market value, high dividend return, specific revenue growth, and/or a low debt-to-equity ratio. For bonds, you can specify a given industry, maturity date, or yield. For mutual funds, you might specify low minimum investment, a particular industry or geographical sector, and low fees. Each screening tool uses a different method to sort. You answer a series of questions to specify the type of stock or fund, performance criteria, cost parameters, and so on. Then you can do more research on the stocks, bonds, or mutual funds that meet your requirements.

Quicken.com (www.quicken.com) has some of the best free tools. Figure 3.3 shows the opening page for Quicken’s “EasyStep Search” stock screen, which walks you through a customized search and explains each variable. Other steps let you select valuation, growth rates, financial strength, and similar qualities. Morningstar (www.morningstar.com) offers some free tools but charges $9.95 a month or $99 a year for its premium tools. Wall Street City
WallStreetCity (www.wallstreetcity.com) offers some of the best screening tools. You can check out the site’s “standard” screens free—for example, “high insider buying” and “weak stocks recovering.” More experienced investors can subscribe to its ProSearch screening tool for $9.95 a month and customize stock screens with up to 40 of 700 criteria.

Charting

Charting is a technique that plots the performance of stocks over a specified time period, from months to decades and beyond. Looking at the 1-year stock chart for Qualcomm (QCOM) in Figure 3.4, it’s obvious that charting can be tedious and expensive. But by going online, today you can see the chart for a selected stock in just seconds. With another click you can compare one company’s price performance to that of other stocks, industries, sectors, or market indexes, choosing the type of chart, time frame, and indicators. Several good sites are Barchart.com (www.barchart.com), BigCharts (www.bigcharts.com), and StockCharts (www.stockcharts.com). All have free charting features; Barchart.com charges a monthly fee for advanced capabilities.
Almost every investment-oriented Web site includes stock quotation and portfolio tracking tools. Simply enter the stock symbol to get the price, either in real-time or delayed several minutes. Once you create a portfolio of stocks in a portfolio tracker, the tracker automatically updates your portfolio’s value every time you check. You can usually link to more detailed information about each stock. Many sites let you set up multiple portfolios. The features, quality, and ease of use of stock trackers varies, so check several to find the one that best meets your needs.

Quicken.com, MSN MoneyCentral Investor (www.investor.msn.com), and E*Trade (www.etrade.com) have portfolio trackers that are easy to set up and customize. Quicken’s tracker, also available on Excite and AOL, alerts you whenever an analyst changes the rating on one of your stocks, and it tells you how well you are diversified among the major asset classes or sectors you hold.

Using the Internet Effectively

The power of the Internet as an investing tool is alluring. “Do-it-yourself” investing is now possible for the average investor, even novices who have never
before bought stock. However, online investing also carries risks. Trading on
the Internet requires that investors exercise the same—and possibly more—
caution than they would if they were getting information from and placing
orders with a human broker. You don’t have the safety net of a live broker sug-
gestig that you rethink your trade. The ease of point-and-click investing can
be the financial downfall of inexperienced investors. Drawn by stories of
others who have made lots of money, many novice investors take the plunge
before they acquire the necessary skills and knowledge—often with disastrous
results.

Online or off, the basic rules for smart investing are the same. Know what
you are buying, from whom, and at what level of risk. Be skeptical. If it sounds
too good to be true, it probably is! Always do your own research; don’t accept
someone else’s word that a security is a good buy. Perform your own analysis
before you buy, using the skills you will develop in later chapters of this book.

Here is some additional advice:

• Don’t let the speed and ease of making transactions blind you to the real-
  lities of online trading. More frequent trades mean high total transaction
costs. Although some brokers advertise per-trade costs as low as $8, the
average online transaction fee is higher (about $20 in March 2001). If you
trade often, it will take longer to recoup your costs. Studies reveal that the
more often you trade, the harder it is to beat the market. In addition, on
short-term trades of less than one year, you’ll pay taxes on profits at the
higher, ordinary income rates, not the lower capital gains rate.

• Don’t believe everything you read on the Internet. It’s easy to be
  impressed with a screen full of data touting a stock’s prospects or to act
on a hot tip you find on a discussion board or in an online chat (more on
these later). But what do you know about the person who posts the infor-
mation? He or she could be a shill for a dealer, posing as an enthusiastic
investor to push a stock. Stick to the sites of major brokerage firms,
mutual funds, academic institutions, and well-known business and
finance publications.

• If you get bitten by the online buying bug, don’t be tempted to use margin
debt to increase your stock holdings. You may instead be magnifying your
losses, as noted in Chapter 2.

We will return to the subject of online investment fraud and scams and will
discuss guidelines for online transactions in subsequent sections of this chapter.

IN REVIEW

3.1 Discuss the impact of the Internet on the individual investor, and summarize
the types of resources it provides.

3.2 Identify the four main types of online investment tools. How can they help you
become a better investor?

3.3 What are some of the pros and cons of using the Internet to choose and
manage your investments?
As you learned in Chapter 1, becoming a successful investor starts with developing investment plans and meeting your liquidity needs. Once you have done this, you can search for the right investments to implement your investment plan and monitor your progress toward achieving your goals. Whether you use the Internet or print sources, you should examine various kinds of investment information to formulate expectations of the risk-return behaviors of potential investments and to monitor them once they are acquired. This section describes the key types and sources of investment information; the following section focuses on market averages and indexes.

Investment information can be either descriptive or analytical. Descriptive information presents factual data on the past behavior of the economy, the market, the industry, the company, or a given investment vehicle. Analytical information presents available current data in conjunction with projections and recommendations about potential investments. The sample page from Value Line included in Figure 3.5 provides both descriptive and analytical information on PepsiCo, Inc. Items that are primarily descriptive are marked with a D, analytical items with an A. Examples of descriptive information are the company’s capital structure (7D) and monthly stock price ranges for the past 13 years (13D). Examples of analytical information are rank for timeliness (1A) and projected price range and associated annual total returns for the next 3 years (4A).

Some forms of investment information are free; others must be purchased individually or by annual subscription. You’ll find free information on the Internet; in newspapers, magazines, and at brokerage firms; and at public, university, and brokerage firm libraries. Alternatively, you can subscribe to free and paid services that provide periodic reports summarizing the investment outlook and recommending certain actions. Many Internet sites now offer free e-mail newsletters and alerts. You can even set up your own personalized homepage at many financial Web sites so that stock quotes, portfolio tracking, current business news, and other information on stocks of interest to you appear whenever you visit the site. Other sites charge for premium content, such as brokerage research reports, whether in print or online form.

Although the Internet has increased the amount of free information, it may still make sense to pay for services that save you time and money by gathering material you need. But first consider the value of potential information: For example, paying $40 for information that increases your return by $27 would not be economically sound. The larger your investment portfolio, the easier it is to justify information purchases, because they are usually applicable to a number of investments.

Types of Information

Investment information can be divided into five types, each concerned with an important aspect of the investment process.

1. Economic and current event information includes background as well as forecast data related to economic, political, and social trends on a domestic as well as a global scale. Such information provides a basis for assessing the environment in which decisions are made.
2. Industry and company information includes background as well as forecast data on specific industries and companies. Investors use such information to assess the outlook in a given industry or a specific company.
FIGURE 3.5  A Report Containing Descriptive and Analytical Information

Value Line's full-page report on PepsiCo, Inc. from February 9, 2001, contains both descriptive (marked D) and analytical (marked A) information. (Source: Adapted from The Value Line Investment Survey, Ratings and Reports, Edition 10, February 9, 2001, p. 1542. © Value Line Publishing, Inc.)
Because of its company orientation, it is most relevant to stock, bond, or options investments.

3. Information on alternative investment vehicles includes background and predictive data for securities other than stocks, bonds, and options, such as mutual funds and futures.

4. Price information includes current price quotations on certain investment vehicles, particularly securities. These quotations are commonly accompanied by statistics on the recent price behavior of the vehicle.

5. Information on personal investment strategies includes recommendations on investment strategies or specific purchase or sale actions. In general, this information tends to be educational or analytical rather than descriptive.

**Sources of Information**

A complete listing of the sources of each type of investment information is beyond the scope of this book. Our discussion focuses on the most common online and traditional sources of information on economic and current events, industries and companies, and prices, as well as other online sources.

**Economic and Current Event Information** Investors who are aware of current economic, political, and business events tend to make better investment decisions. Popular sources of economic and current event information include financial journals, general newspapers, institutional news, business periodicals, government publications, and special subscription services. These are available in print and online versions; often the online versions are free but may have limited content. Most offer free searchable article archives and charge a nominal fee for each article downloaded.

**Financial Journals** The *Wall Street Journal* is the most popular source of financial news. Published daily Monday through Friday in regional, European, and Asian editions, the Journal also has an online version called the WSJ Interactive Edition (www.wsj.com), which is updated frequently throughout the day and on the weekends. In addition to giving daily price quotations on thousands of investment vehicles, it reports world, national, regional, and corporate news. The first page of the third section of the Journal usually contains a column called “Heard on the Street” that focuses on specific market and company events. In addition, articles that address personal finance issues and topics are often included on that page. A print subscription to the Wall Street Journal costs $175 annually, compared to $59 per year for the online version; print subscribers pay $29 to add the online edition. WSJ Interactive includes features such as Briefing Books on individual companies and mutual funds; article searches; special online-only articles; and access to the Dow Jones Publications Library, a comprehensive database of articles from major general and business periodicals.

A second popular source of financial news is *Barron’s*, which is published weekly. Barron’s generally offers lengthier articles on a variety of topics of interest to individual investors. Probably the most popular column in Barron’s is Alan Abelson’s “Up & Down Wall Street,” which provides a critical and
often humorous assessment of major developments affecting the stock market and business. Barron’s also includes current price quotations and a summary of statistics on a range of investment vehicles. Subscribers to WSJ Interactive also have access to Barron’s online edition (www.barrons.com) because both are published by Dow Jones & Co.

Investor’s Business Daily is a third national business newspaper published Monday through Friday. It is similar to the Wall Street Journal but contains more detailed price and market data. Its Web site (www.investors.com) has limited free content. Another source of financial news is the Financial Times (www.ft.com), with U.S., United Kingdom, and global editions.

**General Newspapers** Major metropolitan newspapers such as the New York Times, the Washington Post, and the Los Angeles Times provide investors with a wealth of financial information in their print and online editions. Most major newspapers contain stock price quotations for major exchanges, price quotations on stocks of local interest, and a summary of the major stock market averages and indexes. Local newspapers are another convenient source of financial news. In most large cities, the daily newspaper devotes at least a few pages to financial and business news. Another popular source of financial news is USA Today, the national newspaper published daily Monday through Friday. Each issue contains a “Money” section (Section B) devoted to business and personal financial news and to current security price quotations and summary statistics.

**Institutional News** The monthly economic letters of the nation’s leading banks, such as Bank of America (based in Charlotte, North Carolina), Northern Trust (Chicago), and Wells Fargo (San Francisco), provide useful economic information. Wire services such as Dow Jones, Bloomberg Financial Services, AP (Associated Press), and UPI (United Press International) provide economic and business news feeds to brokerages, other financial institutions, and Web sites that subscribe to them. Bloomberg has its own comprehensive site (www.bloomberg.com). Business.com (www.business.com) offers industry-by-industry news, targeted business searches, and market coverage. Web sites specializing in financial news include CNNfn (www.cnnfn.cnn.com) and CBS MarketWatch (www.cbs.marketwatch.com).

**Business Periodicals** Business periodicals vary in scope. Some present general business and economic articles, others cover securities markets and related topics, and still others focus solely on specific industries. Regardless of the subject matter, most business periodicals present descriptive information, and some also include analytical information. They rarely offer recommendations.

The business sections of general-interest periodicals such as Newsweek, Time, and U.S. News & World Report cover business and economic news. Strictly business- and finance-oriented periodicals, including Business Week, Fortune, Business Month, and Nation’s Business, provide more in-depth articles. These magazines also have investing and personal finance articles.

Some financial periodicals specialize in securities and marketplace articles. The most basic, commonsense articles appear in Forbes, Kiplinger’s Personal Finance Magazine, Money, Smart Money, and Worth. Forbes, published every two weeks, is the most investment-oriented. Each January it publishes an
“Annual Report on American Industry” that compares the growth and performance of key industries over the past five years. In August of each year, Forbes also publishes a comparative evaluation of mutual funds. Kiplinger’s Personal Finance Magazine, Money, Smart Money, and Worth are published monthly and contain articles on managing personal finances and on investments.

All these business and personal finance magazines have Web sites with free access to recent, if not all, content. Most include a number of other features. For example, Smart Money has interactive investment tools, including a color-coded “Map of the Market” that shows the current hot sectors.

**Government Publications** A number of government agencies publish economic data and reports useful to investors. The annual Economic Report of the President provides a broad view of the current and expected state of the economy. This document reviews and summarizes economic policy and conditions and includes data on important aspects of the economy. The Federal Reserve Bulletin, published monthly by the Board of Governors of the Federal Reserve System, and periodic reports published by each of the 12 Federal Reserve District Banks provide articles and data on various aspects of economic and business activity. (Visit www.federalreserve.gov to read many of these publications.) A useful Department of Commerce publication is the Survey of Current Business. Published monthly, it includes indicators and data related to economic and business conditions. A good source of financial statement information on all manufacturers, broken down by industry and asset size, is the Quarterly Financial Report for Manufacturing Corporations, published jointly by the Federal Trade Commission and the Securities and Exchange Commission. Most of these reports are now available at the Web sites of the issuing government agency; a good search engine such as Google (www.google.com) will quickly locate them for you.

**Special Subscription Services** Investors who want additional insights into business and economic conditions can subscribe to special services. These reports include business and economic forecasts and give notice of new government policies, union plans and tactics, taxes, prices, wages, and so on. One popular service is the Kiplinger Washington Letter, a weekly publication that provides a wealth of economic information and analyses.

**Industry and Company Information** Of special interest to investors is information on particular industries and companies. Often, after choosing an industry in which to invest, an investor will want to analyze specific companies. A recent change in disclosure rules, discussed below, gives individual investors access to more company information than before. General business periodicals such as Business Week, Forbes, the Wall Street Journal, and Fortune carry articles on the activities of specific industries and individual companies. Trade publications such as Chemical Week, American Banker, Computerworld, Industry Week, Oil and Gas Journal, and Public Utilities Fortnightly provide more focused industry and company information. Red Herring, The Industry Standard, Business 2.0, Fast Company, and Upside are magazines that can help you keep up with the high-tech world; all have good Web sites. Other specific popular sources are discussed in Table 3.1 on the next page.
The Internet makes it easy to research specific industries and companies at the company’s Web site, a publication’s archive search, or database services such as the Dow Jones Publications Library. Table 3.1 presents several free and subscription resources that emphasize industry and company information.

**Fair Disclosure Rules** Until recently, executives at public companies could disclose market-moving information privately to investment professionals—analysts, money managers, and large institutional investors—before releasing it to the general public. This selective disclosure gave broker-dealers and their clients an unfair advantage. They could act on the information before the average investor could act. In August 2000, the SEC passed the **fair disclosure rule**, known as **Regulation FD**, a new rule requiring senior executives to disclose critical information such as earnings forecasts and news of mergers and new products simultaneously to investment professionals and the public via press releases or SEC filings. However, it does not apply to communications with journalists and securities ratings firms like Moody’s Investor Services and Standard & Poor’s. Violations of the rule carry injunctions and fines but are not considered fraud.

The new regulations are not without controversy. The Securities Industry Association expressed concern that executives would be afraid to talk to anyone outside their companies, and that the rule would therefore curtail rather than increase the flow of information. Companies may limit contact with analysts if they are unsure whether the information requires a press release.

**Stockholders’ Reports** An excellent source of data on an individual firm is the **stockholders’ report**, or **annual report**, published yearly by publicly held corporations. These reports contain a wide range of information, including financial statements for the most recent period of operation, along with summarized statements for several prior years. These reports are free and may be obtained from the companies themselves or from brokers. A sample page from PepsiCo, Inc.’s 2000 stockholders’ report is shown in Figure 3.6. Most
FIGURE 3.6 A Page from a Stockholders' Report

This page of the 2000 Annual Report of PepsiCo, Inc. quickly acquaints the investor with the key information on the firm's operations over the past year, in tabular and graphical form. The contents of the Annual Report are also shown on this page. (Source: PepsiCo, Inc. 2000 Annual Report; available at PepsiCo’s Web site [www.pepsico.com]; PepsiCo, Inc. Investor Relations, 914-253-3055; PepsiCo, Inc., Purchase, NY 10577.)

### Financial Highlights

#### PepsiCo, Inc. and Subsidiaries

<table>
<thead>
<tr>
<th>Item</th>
<th>2000</th>
<th>1999</th>
<th>% Chg*</th>
<th>2000</th>
<th>1999</th>
<th>% Chg*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sales</td>
<td>$28,438</td>
<td>$29,267</td>
<td>-</td>
<td>$28,194</td>
<td>$18,566</td>
<td>9</td>
</tr>
<tr>
<td>Segment Operating Profit</td>
<td>$5,108</td>
<td>$3,068</td>
<td>66%</td>
<td>$3,462</td>
<td>$3,060</td>
<td>13%</td>
</tr>
<tr>
<td>Net Income</td>
<td>$2,183</td>
<td>$2,050</td>
<td>6%</td>
<td>$2,119</td>
<td>$1,850</td>
<td>16%</td>
</tr>
<tr>
<td>Net Income per Share</td>
<td>$1.66</td>
<td>$1.37</td>
<td>21%</td>
<td>$1.45</td>
<td>$1.24</td>
<td>17%</td>
</tr>
<tr>
<td>Other Data</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net cash provided by</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>operating activities</td>
<td>$3,591</td>
<td>$3,027</td>
<td>18%</td>
<td>$3,522</td>
<td>$2,921</td>
<td>20%</td>
</tr>
<tr>
<td>Share repurchases</td>
<td>$1,430</td>
<td>$1,285</td>
<td>11%</td>
<td>$1,540</td>
<td>$1,285</td>
<td>17%</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>$760</td>
<td>$770</td>
<td>-1%</td>
<td>$778</td>
<td>$778</td>
<td>-1%</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>$2,346</td>
<td>$2,812</td>
<td>-16%</td>
<td>$2,393</td>
<td>$2,624</td>
<td>-11%</td>
</tr>
<tr>
<td>Capital spending</td>
<td>$1,266</td>
<td>$1,118</td>
<td>13%</td>
<td>$1,230</td>
<td>$1,092</td>
<td>12%</td>
</tr>
</tbody>
</table>

*Percentage changes are based on unaudited amounts.

#### Pro Forma PepsiCo Net Sales

Total: $20,144

#### Pro Forma Segment Operating Profit

Total: $3,482

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To help us toast a great year, we invite several PepsiCo shareholders to pose for a few pictures eating, drinking, and being merry. As you’ll see, they’re very kindly obliged.

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Michael Thomas
Shareholder since 2001.
companies now place their annual reports on their Web sites. Annual Report Gallery (www.reportgallery.com) provides links to many company reports.

In addition to the stockholders’ report, many serious investors review a company’s Form 10-K. This is a statement that firms with securities listed on an organized exchange or traded in the Nasdaq market must file annually with the SEC. Finding 10-K and other SEC filings is now a simple task, thanks to SEC/Edgar (Electronic Data Gathering and Analysis Retrieval), which has reports filed by any company traded on a major exchange. You can read them free at EDGAR Online’s FreeEdgar site (www.freeedgar.com).

Comparative Data Sources Sources of comparative data, typically broken down by industry and firm size, are a good tool for analyzing the financial condition of companies. Among these sources are Dun & Bradstreet’s Key Business Ratios, Robert Morris and Associates’ Annual Statement Studies, the Quarterly Financial Report for Manufacturing Corporations (cited above), and the Almanac of Business and Industrial Financial Ratios. These sources, which are typically available in public and university libraries, are a useful benchmark for evaluating a company’s financial condition.

Subscription Services A variety of subscription services provide data on specific industries and companies. Today, many of these services are available on the Internet. (See the Investor’s Resources section on the book’s Web site.) Generally, a subscriber pays a basic fee to access the service’s information and can purchase premium services for greater depth or range. The major subscription services provide both descriptive and analytical information, but they generally do not make recommendations. Most investors, rather than subscribing to these services, access them through their stockbrokers or a large public or university library. The Web sites for most services offer some free information and charge for the rest.

The dominant subscription services are those offered by Standard & Poor’s Corporation, Moody’s Investor Services, and Value Line. Table 3.2 summarizes the most popular services of these companies. Standard & Poor’s Corporation (S&P) offers a large number of different financial reports and services. Its Personal Wealth Web site, owned by Business Week (www.businessweek.com/investor) is geared toward individual investors. Although basic news and market commentary is free, for just $100 a year subscribers get access to S&P stock reports on 4,600 companies and screening tools. Moody’s Investor Services also publishes a variety of material, including its securities ratings, corporate research, and well-known reference manuals on eight industries. The Value Line Investment Survey is one of the most popular subscription services used by individual investors; it is available at most libraries and online (www.valueline.com).

Brokerage Reports Brokerage firms often make available to their clients reports from the various subscription services and research reports from their own securities analysts. They also provide clients with prospectuses for new security issues and back-office research reports. As noted in Chapter 2, a prospectus is a document that describes in detail the key aspects of the issue, the issuer, and its management and financial position. The cover of the prospectus describing the 2001 stock issue of Reliant Resources, Inc. was shown in Figure 2.1. Back-office research reports include the brokerage firm’s analyses of and recommendations on prospects for the securities markets, specific industries, or

Form 10-K
a statement that must be filed annually with the SEC by all firms having securities listed on an organized exchange or traded in the Nasdaq market.

Standard & Poor’s Corporation (S&P)
publisher of a large number of financial reports and services, including Corporation Records and Stock Reports.

Moody’s Investor Services
publisher of a variety of financial material, including Moody’s Manuals.

Value Line Investment Survey
one of the most popular subscription services used by individual investors; subscribers receive three basic reports weekly.

back-office research reports
a brokerage firm’s analyses of and recommendations on investment prospects; available on request at no cost to existing and potential clients or for purchase at some Web sites.
Investment letters newsletters that provide, on a subscription basis, the analyses, conclusions, and recommendations of experts in securities investment.

**Investment Letters** Investment letters provide, on a subscription basis, the analyses, conclusions, and recommendations of experts in securities investment. Some letters concentrate on specific types of securities; others are concerned solely with assessing the economy or securities markets. Among the more popular investment letters are Bob Nurock’s Advisory, the Dick Davis Digest, Dines Letter, Dow Theory Letters, the Growth Stock Outlook.

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### Table 3.2 Popular Offerings of the Major Subscription Services

<table>
<thead>
<tr>
<th>Subscription Service/Offerings</th>
<th>Coverage</th>
<th>Frequency of Publication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard &amp; Poor’s Corporation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporation Records</td>
<td>Detailed descriptions of publicly traded securities of over 10,000 public corporations.</td>
<td>Annually with updates throughout the year.</td>
</tr>
<tr>
<td>Stock Reports (sample shown in Figure 7.1, page 299)</td>
<td>Summary of financial history, current finances, and future prospects for thousands of companies. Statistical data and analytical rankings of investment desirability for major stocks.</td>
<td>Annually with updates throughout the year.</td>
</tr>
<tr>
<td>The Outlook</td>
<td>Analytical articles with investment advice on the market, industries, and securities.</td>
<td>Weekly magazine.</td>
</tr>
<tr>
<td>Moody’s Investor Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Handbook of Common Stocks Dividend Record</td>
<td>Common stock data. Recent dividend announcements and payments.</td>
<td>Quarterly.</td>
</tr>
<tr>
<td>Dividend Record</td>
<td>Bond market conditions and new offerings.</td>
<td>Twice weekly, with annual summary.</td>
</tr>
<tr>
<td>Bond Survey</td>
<td>Price and interest rate behavior of thousands of bonds.</td>
<td>Monthly.</td>
</tr>
<tr>
<td>Bond Record</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value Line Investment Survey</td>
<td>Covers 1,700 of the most widely held stocks. Current ratings for each stock. Full-page report including financial data, descriptions, analysis, and ratings for each of about 130 stocks. Selected investment, business, and stock market prospects, and advice on investment strategy.</td>
<td>Weekly.</td>
</tr>
</tbody>
</table>
Professional Tape Reader, the Prudent Speculator, and Street Smart Investing. Most newsletters come out weekly or monthly and cost from $75 to $400 a year. Advertisements for many of these investment letters can be found in Barron’s and in various business periodicals.

The Hulbert Financial Digest ([www.hulberndigest.com](http://www.hulberndigest.com)) monitors the performance of investment letters. It is an excellent source of objective information on investment letters and a good place to check out those that interest you. Many newsletters now offer online subscriptions. Use a general search engine or the Newsletter Access ([www.newsletteraccess.com](http://www.newsletteraccess.com)), a searchable database of newsletters that lists over 1,600 stock-investing newsletters!

**Price Information** Price information about various types of securities is contained in their **quotations**, which include current price data and statistics on recent price behavior. The Web makes it easy to find price quotes for actively traded securities, and many financially oriented sites include a stock price look-up feature or a stock ticker running across the screen, much like the ones that used to be found only in brokerage offices. The ticker consolidates and reports stock transactions made on the NYSE, AMEX, regional exchanges, and Nasdaq National Market as they occur. Cable TV subscribers in many areas can watch the ticker at the bottom of the screen on certain channels, including CNNfn, CNN Headline News, and MSNBC. The ticker symbols for some well-known companies are listed in Table 3.3.

Investors can easily find the prior day’s security price quotations in the published news media, both nonfinancial and financial. They also can find delayed or real-time quotations at numerous Web sites, including financial portals (described below), most business periodical Web sites, and brokerage sites. The Web sites for CNNfn and CNBC-TV have real-time stock quotes, as do sites that subscribe to their news feed. Stock quotes are usually free, but investors may have to pay for bond quotes. For example, Quote.com ([www.quote.com](http://www.quote.com)) charges $9.95 a month for prices on Treasury securities.

### Table 3.3 Symbols for Some Well-Known Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Symbol</th>
<th>Company</th>
<th>Symbol</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amazon.com</td>
<td>AMZN</td>
<td>McDonald’s Corp.</td>
<td>MCD</td>
</tr>
<tr>
<td>America Online</td>
<td>AOL</td>
<td>Microsoft</td>
<td>MSFT</td>
</tr>
<tr>
<td>Apple Computer</td>
<td>AAPL</td>
<td>Merrill Lynch</td>
<td>MER</td>
</tr>
<tr>
<td>AT&amp;T</td>
<td>T</td>
<td>Nike</td>
<td>NKE</td>
</tr>
<tr>
<td>Cisco</td>
<td>CSCO</td>
<td>Oracle</td>
<td>ORCL</td>
</tr>
<tr>
<td>Dell Computer</td>
<td>DELL</td>
<td>PepsiCo, Inc.</td>
<td>PEP</td>
</tr>
<tr>
<td>Eastman Kodak</td>
<td>EK</td>
<td>Reebok</td>
<td>RBK</td>
</tr>
<tr>
<td>ExxonMobil</td>
<td>XOM</td>
<td>Sears, Roebuck</td>
<td>S</td>
</tr>
<tr>
<td>Genentech</td>
<td>DNA</td>
<td>Starbucks</td>
<td>SBUX</td>
</tr>
<tr>
<td>General Electric</td>
<td>GE</td>
<td>Sun Microsystems</td>
<td>SUNW</td>
</tr>
<tr>
<td>Hewlett-Packard</td>
<td>HWP</td>
<td>Texas Instruments</td>
<td>TXN</td>
</tr>
<tr>
<td>Intel</td>
<td>INTC</td>
<td>United Airlines</td>
<td>UAL</td>
</tr>
<tr>
<td>Int’l. Business Machines</td>
<td>IBM</td>
<td>Xerox Corporation</td>
<td>XRX</td>
</tr>
<tr>
<td>Lucent Technologies</td>
<td>LU</td>
<td>Yahoo!</td>
<td>YHOO</td>
</tr>
</tbody>
</table>
The major published source of security price quotations is the Wall Street Journal, which presents quotations for each previous business day’s activities in all major markets. (We’ll explain how to read and interpret actual price quotations in later chapters.)

Prior to April 2000, stock prices were quoted in fractional form: eighths and, more recently, sixteenths. Starting in August 2000, some stocks began trading in decimals instead of this awkward pricing—1⁄8 of a point equals 12.5¢, 1⁄16 equals 6.25¢. Today all stocks are priced in decimals, a format that is much easier to read and understand.

Other Online Investment Information Sources  Many other excellent Web sites provide information of all sorts to increase your investment skills and knowledge. Let’s now look at financial portals, sites for bonds and mutual funds, international sites, and investment discussion forums. Table 3.4 lists some of the most popular financial portals, bond sites, and mutual fund sites. We’ll look at online brokerage and investment adviser sites later in the chapter, and you’ll find more specialized Web links in all chapters.

Financial Portals  Financial portals are supersites that bring together a wide range of investing features, such as real-time quotes, stock and mutual fund screens, portfolio trackers, news, research, and transaction capabilities, along with other personal finance features. These sites want to be your investing homepage. Some portals are general sites such as Yahoo! and Excite that offer a full range of investing features along with their other services, or they may be investing-oriented sites. You should check out several to see which best suits your needs, because their strengths and features vary greatly. For example, is primarily a collection of links to other financial Web sites. Other portals want you to stay at their site and offer customization options so that your start page includes the data you want. Although finding one site where you can manage your investments is indeed appealing, you may not be able to find the best of what you need at one portal. You’ll want to explore several sites to find the ones that meet your needs. Table 3.4 includes a summary of the features of several popular financial portals.

Although you can personalize financial portals, you generally have to visit several sites to manage your financial affairs. A new breed of financial portal aggregates all your financial information on one Web page: bank accounts, credit cards, brokerage and mutual fund accounts, retirement funds, and even frequent-flyer mileage! You provide the passwords, and the software gathers the financial information from other sites. With one click you can view summaries of all your personal accounts—finances, shopping, travel, e-mail, and more. You can even access your data from Web-enabled wireless devices. Figure 3.7 shows a sample of Yodlee’s summary page. Although these sites can save you a lot of time, many consumers are hesitant to submit account numbers and passwords to one site. To counter these concerns, aggregators use multiple encryption techniques and limit employee access to client data. Banks and brokerage firms, already very security-conscious, are among the companies that offer these sites. Independent aggregation services include Yodlee (www.yodlee.com) and 1View Network (www.1viewnetwork.com).
### TABLE 3.4 Popular Investment Web Sites

The following Web sites are just a few of the thousands of sites that provide investing information. Unless otherwise mentioned, all are free.

<table>
<thead>
<tr>
<th>Web Site</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Portals</strong></td>
<td></td>
</tr>
<tr>
<td>America Online (<a href="http://www.aol.com">www.aol.com</a>)</td>
<td>Offers free Quicken analysis tools. Its Personal Finance channel for subscribers has 14 areas, including market and business news, research, education, tools, message boards, and a stock-trading simulation game. Ease of use is a big plus. Links to 14,000 financial sites; personal homepage; stock power-search feature.</td>
</tr>
<tr>
<td>Investorama (<a href="http://www.investorama.com">www.investorama.com</a>)</td>
<td>More editorial content than many sites; good research and interactive tools like Research Wizard; can consolidate accounts in portfolio tracker. (Many tools don't run on Macintosh.)</td>
</tr>
<tr>
<td>MSN MoneyCentral Investor (<a href="http://www.moneycentral.msn.com">www.moneycentral.msn.com</a>)</td>
<td>More editorial content than many sites; good research and interactive tools like Research Wizard; can consolidate accounts in portfolio tracker. (Many tools don't run on Macintosh.)</td>
</tr>
<tr>
<td>Motley Fool (<a href="http://www.fool.com">www.fool.com</a>)</td>
<td>Comprehensive and entertaining site with educational features, research, news, and message boards. Model portfolios cover a variety of investment strategies. Free but offers premium services such as Portfolio Trade Alerts for $25 a year.</td>
</tr>
<tr>
<td>Wall Street City (<a href="http://www.wallstreetcity.com">www.wallstreetcity.com</a>)</td>
<td>For more experienced investors, with live Webcasts of company presentations and analysts' reports; advanced market analysis and stock-screening tools. ProSearch custom screening tool costs $9.95 per month.</td>
</tr>
<tr>
<td>Yahoo! Finance (<a href="http://finance.yahoo.com">finance.yahoo.com</a>)</td>
<td>Simple design, content-rich; easy to find information quickly. Includes financial news, price quotes, portfolio trackers, bill paying, personalized homepage, and a directory of other major sites.</td>
</tr>
<tr>
<td>Yodlee (<a href="http://www.yodlee.com">www.yodlee.com</a>)</td>
<td>Aggregation site that collects financial account data from banking, credit card, brokerage, mutual fund, mileage, and other sites. One-click access saves time; offers e-mail accounts; easy to set up and track finances. Security issues concern potential users; few analytical tools.</td>
</tr>
<tr>
<td><strong>Bond Sites</strong></td>
<td></td>
</tr>
<tr>
<td>Investing in Bonds (<a href="http://www.investinginbonds.com">www.investinginbonds.com</a>)</td>
<td>The Bond Market Association's Web site; good for novice investors. Investing guides, research reports, historical data, and links to other sites. Searchable database. Comprehensive site for news, education, free research, ratings, and other bond information; strong emphasis on municipal bonds. Searchable database; Some charges for research.</td>
</tr>
<tr>
<td>BondsOnline (<a href="http://www.bondsonline.com">www.bondsonline.com</a>)</td>
<td>Individual investors can search for bond-related news, market data, and bond offerings.</td>
</tr>
<tr>
<td>CNNfn Bond Center (<a href="http://www.cnnfn.com/markets/bondcenter">www.cnnfn.com/markets/bondcenter</a>)</td>
<td>Run by U.S. Treasury Department; information about U.S. savings bonds and Treasury securities; can also buy Treasury securities online through Treasury Direct program.</td>
</tr>
<tr>
<td>Bureau of the Public Debt Online (<a href="http://www.publicdebt.treas.gov">www.publicdebt.treas.gov</a>)</td>
<td></td>
</tr>
<tr>
<td><strong>Mutual Fund Sites</strong></td>
<td></td>
</tr>
<tr>
<td>Morningstar (<a href="http://www.morningstar.com">www.morningstar.com</a>)</td>
<td>Profiles of over 6,500 funds with ratings; screening tools, portfolio analysis and management; fund manager interviews, e-mail newsletters; educational sections. Advanced screening and analysis tools are $9.95 a month or $99 per year.</td>
</tr>
<tr>
<td>Mutual Fund Investor's Center (<a href="http://www.mfea.com">www.mfea.com</a>)</td>
<td>Not-for-profit, easy-to-navigate site from the Mutual Fund Education Alliance with investor education, search feature, and links to profiles of funds, calculators for retirement, asset allocation, and college planning.</td>
</tr>
<tr>
<td>Fund Alarm (<a href="http://www.fundalarm.com">www.fundalarm.com</a>)</td>
<td>Takes a different approach and identifies underperforming funds to help investors decide when to sell; alerts investors to fund manager changes. Lively commentary from the site founder, a CPA.</td>
</tr>
<tr>
<td>Findafund (<a href="http://www.maxfunds.com">www.maxfunds.com</a>)</td>
<td>In addition to the basics, has a tool to compare funds based on stocks they own to build a diversified portfolio.</td>
</tr>
<tr>
<td>IndexFunds.com (<a href="http://www.indexfunds.com">www.indexfunds.com</a>)</td>
<td>Comprehensive site covering only index funds.</td>
</tr>
<tr>
<td>Personal Fund (<a href="http://www.personalfund.com">www.personalfund.com</a>)</td>
<td>Especially popular for its fund expense calculator that shows the true cost of ownership, after fees, brokerage commissions, and taxes. Suggests lower-cost alternatives with similar investment objectives.</td>
</tr>
</tbody>
</table>
**CHAPTER 3 | ONLINE INVESTING, INFORMATION, AND TRADING**

**Figure 3.7**

**An Aggregation Site: Bringing It All Together**

Yodlee offers users summaries and one-click access to personal account information—including bank balances, credit card balances, investments, travel reservations, e-commerce sites, e-mail, news, and more—from thousands of leading Web sites.

(Source: [www.yodlee.com/demo/demo.html](http://www.yodlee.com/demo/demo.html) Yodlee Inc., Redwood Shores, California; 650-980-3600; info@yodlee.com)

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**Bond Sites** Although many general investment sites include bond and mutual fund information, you can also visit sites that specialize in these investments. Because Internet bond-trading activity is fairly limited at the present time, there are fewer online resources for individuals. Some brokerage firms are starting to allow clients access to bond information that formerly was restricted to investment professionals. In addition to the sites listed in Table 3.4, other good sites for bond and interest rate information include Briefing.com ([www.briefing.com](http://www.briefing.com)), TheStreet.com ([www.thestreet.com](http://www.thestreet.com)), and WSJ.com ([wsj.com](http://wsj.com)).

The sites of the major bond ratings agencies—Moody’s Investor Services ([www.moodys.com](http://www.moodys.com)), Standard & Poor’s ([www.standardpoor.com](http://www.standardpoor.com)), and Fitch IBCA ([www.fitchibca.com](http://www.fitchibca.com))—provide ratings lists, recent ratings changes, and information about how they determine ratings. Moody’s free services also include a daily summary of the bond markets and some research reports.

**Mutual Fund Sites** With thousands of mutual funds, how do you find the ones that match your investment goals? The Internet makes this task much easier, offering many sites with screening tools and worksheets. Almost every major mutual fund family has its own Web site as well. Some allow visitors to
hear interviews or participate in chats with fund managers. Fidelity (www.fidelity.com) is one of the most comprehensive sites, with educational articles, fund selection tools, fund profiles, and more. Portals and brokerage sites also offer these tools. Table 3.4 includes some independent mutual fund sites that are worth checking out.

International Sites The international reach of the Internet makes it a natural resource to help investors sort out the complexity of global investing, from country research to foreign currency exchange. WorldlyInvestor (www.worldlyinvestor.com) is a comprehensive portal just for international investing. Free newsletters, articles, economic insights, and screening tools for mutual funds and ADRs are among this site's features. For more localized coverage, check out European Investor (www.europeaninvestor.com), UK-Invest (www.uk-invest.com), LatinFocus (www.latin-focus.com), and similar sites for other countries and regions. J.P. Morgan's ADR site (www.adr.com) is a good place to research American depositary receipts and includes analysts' recommendations. For global business news, the Financial Times site (www.ft.com) gets high marks. CBS Marketwatch (www.cbs.marketwatch.com) has good technology and telecommunications news, as well as coverage of international markets and an ADR report.

Investment Discussion Forums Investors can exchange opinions about their favorite stocks and investing strategies at the online discussion forums (message boards and chat rooms) found at most major financial Web sites. However, remember that the key word here is opinion. You don’t really know much about the qualifications of the person posting the information. Always do your own research before acting on any hot tips! The Motley Fool’s (www.fool.com) boards are among the most popular, and Fool employees monitor the discussions. Message boards at Yahoo! Finance (finance.yahoo.com) are among the largest online, although many feel that the quality is not so good as at other sites. The Raging Bull (www.ragingbull.com) includes commentary, news, and analysis along with its discussion groups. Technology investors flock to Silicon Investor (www.siliconinvestor.com), a portal site whose high-tech boards are considered among the best. You can read messages free, but to post you’ll pay $120 a year or $200 for a lifetime membership.

If you want to check what people are saying about a stock on several different message boards, megasite Cnet (www.cnet.com) makes this easy. It compiles postings from six sites, including Motley Fool, Yahoo!, and Raging Bull. You’ll get unlimited messages if you register at Eprobity; otherwise, you only get three per board.

Avoiding Online Scams Just as the Internet increases the amount of information available to all investors, it also makes it easier for scam artists and others to spread false news and manipulate information. Anyone can sound like an investment expert online, posting stock tips with no underlying substance. As mentioned earlier, you may not know the identity of the person touting or panning a stock on the message boards. The person panning a stock could be a disgruntled former employee or a short seller. For example, the ousted former chief executive of San Diego’s Avanir Pharmaceuticals posted
negative remarks on stock message boards, adversely affecting share price. The company sued and won a court order prohibiting him from ever posting derogatory statements about the company on any Internet message boards.

In the fast-paced online environment, two types of scams turn up frequently: “pump-and-dump” schemes and get-rich-quick scams. In pump-and-dump schemes, promoters hype stocks, quickly send the prices sky-high, and then dump them at inflated prices. In get-rich-quick scams, promoters sell worthless investments to naïve buyers. One well-publicized pump-and-dump scheme demonstrates how easy it is to use the Internet to promote stocks. In September 2000, the SEC caught a 15-year-old boy who had made over $270,000 by promoting small-company stocks. The self-taught young investor would buy a block of a company’s shares and then send out a barrage of false and/or misleading e-mail messages and message board postings singing the praises of that stock and the company’s prospects. Once this misinformation pushed up the stock price, he sold and moved on to a new target company. His
postings were so articulate that others at Silicon Investor’s message boards thought he was a 40-year-old. The Investing in Action box on page 93 describes other online hoaxes and how they were shut down.

To crack down on cyber-fraud, the SEC created the Office of Internet Enforcement. The agency now has 15 staff members and several regional offices that quickly investigate reports of suspected hoaxes and prosecute the offenders. Former SEC Chairman Arthur Levitt cautions investors to remember that the Internet is basically another way to send and receive information, one that has no controls for accuracy or truthfulness. The SEC Web site (www.sec.gov/investor/pubs/cyberfraud.htm) includes tips to avoid investment scams. Three key questions that investors should ask are:

- Is the stock registered? Check the SEC’s EDGAR database (www.sec.gov/edgar.shtml) and with your state securities regulator (www.nasaa.org).
- Who is making the sales pitch? Make sure the seller is licensed in your state. Check with the NASD for any record of complaints or fraud.
- Is it too good to be true? Then it probably is. Just being on the Web doesn’t mean it’s legitimate.

Another place to check on possible frauds is Stock Detective, a section of the Financial Web portal site (www.financialweb.com/skdindex.asp) that investigates suspicious stocks and reports on SEC activities against investment fraud.

IN REVIEW

3.4 Differentiate between descriptive information and analytical information. How might one logically assess whether the acquisition of investment information or advice is economically justified?

3.5 What popular financial business periodicals would you use to follow the financial news? General news? Business news? Would you prefer to get your news from print sources or online, and why?

3.6 Briefly describe the types of information that the following resources provide.
   a. Stockholders’ report.
   b. Comparative data sources.
   c. Standard & Poor’s Corporation.
   d. Moody’s Investor Services.
   e. Value Line Investment Survey.

3.7 How would you access each of the following types of information, and how would the content help you make investment decisions?
   a. Prospectuses.
   b. Back-office research reports.
   c. Investment letters.
   d. Price quotations.

3.8 Briefly describe several types of information that are especially well-suited to being made available on the Internet. What are the differences between the online and print versions, and when would you use each?

3.9 Using information in the text and the Investing in Action box on page 93, describe some common types of online investment scams and hoaxes. How can you protect yourself from them?
The investment information we have discussed in this chapter helps investors understand when the economy is moving up or down and how individual investments have performed. Investors can use this and other information to formulate expectations about future investment performance. It is also important to know whether market behavior is favorable or unfavorable. The ability to interpret various market measures should help you to select and time investment actions.

A widely used way to assess the behavior of securities markets is to study the performance of market averages and indexes. These measures allow you conveniently to (1) gauge general market conditions, (2) compare your portfolio's performance to that of a large, diversified (market) portfolio, and (3) study market cycles, trends, and behaviors in order to forecast future market behavior. Here we discuss key measures of stock and bond market activity. In later chapters, we will discuss averages and indexes associated with other investment vehicles. Like price quotations, these measures of market performance are available at many Web sites.

**Understanding Market Averages and Indexes**

**Averages**

Numbers used to measure the general behavior of stock prices by reflecting the arithmetic average price behavior of a representative group of stocks at a given point in time.

**Indexes**

Numbers used to measure the general behavior of stock prices by measuring the current price behavior of a representative group of stocks in relation to a base value set at an earlier point in time.

**The Dow Jones Industrial Average (DJIA)**

A stock market average made up of 30 high-quality stocks selected for total market value and broad public ownership and believed to reflect overall market activity.

Stock market averages and indexes measure the general behavior of stock prices over time. Although the terms average and index tend to be used interchangeably when people discuss market behavior, technically they are different types of measures. **Averages** reflect the arithmetic average price behavior of a representative group of stocks at a given point in time. **Indexes** measure the current price behavior of a representative group of stocks in relation to a base value set at an earlier point in time.

Averages and indexes provide a convenient method of capturing the general mood of the market. They also can be compared at different points in time to assess the relative strength or weakness of the market. Current and recent values of the key averages and indexes are quoted daily in the financial news, in most local newspapers, and on many radio and television news programs. Figure 3.8, a version of which is published daily in the Wall Street Journal, provides a summary and statistics on the major stock market averages and indexes. Let's look at the key averages and indexes listed there.

**Stock Market Averages and Indexes**

**The Dow Jones Averages** Dow Jones & Company, publisher of the Wall Street Journal, prepares five stock averages. The most popular is the **Dow Jones Industrial Average (DJIA)**. This average is made up of 30 stocks selected for total market value and broad public ownership. The group consists of high-quality stocks whose behaviors are believed to reflect overall market activity. The box within Figure 3.9 lists the stocks currently included in the DJIA.

Occasionally, a merger, bankruptcy, or extreme lack of activity causes a change in the makeup of the average. Citicorp's merger with Travelers moved it (Citigroup) to the DJIA. Changes to the 30 stocks also occur when Dow Jones believes that the average does not reflect the broader market. For example, in recent years technology companies such as Microsoft and Intel and financial services companies such as American Express replaced Allied Signal, Goodyear, and Union Carbide; Home Depot replaced Sears. When a
new stock is added, the average is readjusted so that it continues to behave in a manner consistent with the immediate past.

The value of the DJIA is calculated each business day by substituting the closing share prices of each of the 30 stocks in the average into the following equation:

\[
\text{DJIA} = \frac{\text{Closing share price of stock 1} + \text{Closing share price of stock 2} + \cdots + \text{Closing share price of stock 30}}{\text{DJIA divisor}}
\]

The value of the DJIA is merely the sum of the closing share prices of the 30 stocks included in it, divided by a “divisor.” The purpose of the divisor is to adjust for any stock splits, company changes, or other events that have occurred over time. Without the divisor, whose calculation is very complex, the DJIA value would be totally distorted. The divisor makes it possible to use the DJIA to make time-series comparisons. On September 28, 2000, the sum of the closing prices of the 30 industrials was 1829.27, which, when divided by the divisor of 0.169, resulted in a DJIA value of 10824.06. The current

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**FIGURE 3.8**

Major Stock Market Averages and Indexes

The “Stock Market Data Bank” summarizes the key stock market averages and indexes. It includes statistics showing the change from the previous day, the annual change, and the year-to-date change.

Because the DJIA results from summing the prices of the 30 stocks, higher-priced stocks tend to affect the index more than do lower-priced stocks. For example, a 5% change in the price of a $50 stock (i.e., $2.50) has less impact on the index than a 5% change in a $100 stock (i.e., $5.00). In spite of this and other criticisms leveled at the DJIA, it remains the most widely cited stock market indicator.

The actual value of the DJIA is meaningful only when compared to earlier values. For example, the DJIA on September 28, 2000, closed at 10824. This value is meaningful only when compared to the previous day’s closing value of 10629, a change of 1.84%. Many people mistakenly believe that one DJIA “point” equals $1 in the value of an average share. Actually, one point currently translates into about 0.56 cents in average share value. Figure 3.9 shows the DJIA over the 6-month period March 31, 2000, to September 29, 2000. During this 6-month period, the stock market remained generally bullish, although it experienced two significant dips. It started at 11200 and dropped to 10300 in mid-April. During the following 90 days, the market was
somewhat sideways until it increased steadily from late July to early September, when it again began to slide.

The four other Dow Jones averages are the transportation, utilities, composite, and U.S. total market. The Dow Jones Transportation Average is based on 20 stocks, including railroads, airlines, freight forwarders, and mixed transportation companies. The Dow Jones Utilities Average is computed using 15 public utility stocks. The Dow Jones 65 Stocks Composite Average is made up of the 30 industrials, the 20 transportations, and the 15 utilities. The Dow Jones U.S. Total Market Index is a market-weighted index. “Market-weighted” means that companies with large total market values have the most effect on the index’s movement. The Dow Jones U.S. Total Market Index reflects 95% of the total market value for large-sized, medium-sized, and small-sized companies. The base value of the index is 100, which represents its value on June 30, 1997. Like the DJIA, each of the other Dow Jones averages is calculated using a divisor to allow for continuity of the average over time. The transportation, utilities, and 65-stocks composite are often cited in the financial news along with the DJIA, as shown in Figure 3.8.

In early 1999, Dow Jones introduced a new measure to monitor performance of U.S. Internet stocks. The Dow Jones Internet Index (DJII), a 40-stock benchmark, includes only companies that generate a minimum of 50 percent of their revenues from the Internet. It has two component indexes, “Internet Commerce” and “Internet Services.”

Standard & Poor's Indexes  Standard & Poor's Corporation, another leading financial publisher, publishes six major common stock indexes. One oft-cited S&P index is the 500-stock composite index. Unlike the Dow Jones averages, Standard & Poor's indexes are true indexes. They are calculated each business day by substituting the closing market value of each stock (closing price × number of shares outstanding) into the following equation:

\[
\frac{\text{Current closing market value of stock 1}}{\text{Base period closing market value of stock 1}} \times \frac{\text{Current closing market value of stock 2}}{\text{Base period closing market value of stock 2}} \times \cdots \times \frac{\text{Current closing market value of last stock}}{\text{Base period closing market value of last stock}} = \frac{\text{S&P Index}}{10}
\]

The value of the S&P index is found by dividing the sum of the market values of all stocks included in the index by the market value of the stocks in the base period and then multiplying the resulting quotient by 10, the base value of the S&P indexes. Most S&P indexes are calculated in a similar fashion. The main differences lie in the stocks included in the index, the base period, and the base value of the index. For example, on September 28, 2000, the ratio of the closing market values of the S&P 500 composite stocks to the 1941–1943 base-period closing market values was 145.829, which, when multiplied by the base value of the S&P index of 10, results in an index value of 1458.29 (as shown in Figure 3.8).

Certain of the S&P indexes contain many more shares than the Dow averages do, and all of them are based on market
values rather than share prices. Therefore, many investors feel that the S&P indexes provide a more broad-based and representative measure of general market conditions than do the Dow averages. Although some technical computational problems exist with these indexes, they are widely used—frequently as a basis for estimating the “market return,” an important concept that will be introduced in Chapter 4.

Like the Dow averages, the S&P indexes are meaningful only when compared to values in other time periods or to the 1941–1943 base-period value of 10. For example, the September 28, 2000, value of the S&P 500 Stock Composite Index of 1458.29 means that the market values of the stocks in the index increased by a factor of 145.829 (1458.29 ÷ 10) since the 1941–1943 period. The September 28, 2000, market value of the stocks in the index was 1.17 times the lowest index value of 1247.41 in the preceding 365-day period (1458.29 ÷ 1247.41), and hence represented an increase of 17%.

The eight major common stock indexes published by Standard & Poor’s are

- The industrials index, made up of the common stock of 400 industrial firms.
- The transportation index, which includes the stock of 20 transportation companies.
- The utilities index, made up of 40 public utility stocks.
- The financials index, which contains 40 financial stocks.
- The composite index (described above), which consists of the total of 500 stocks that make up the industrials, transportation, utilities, and financials indexes.
- The midcap index, made up of the stocks of 400 medium-sized companies.
- The smallcap index, made up of 600 small-sized companies.
- The 1500 index, which includes all stocks in the composite, midcap, and smallcap indexes.

The S&P midcap, smallcap, and 1500 indexes are the newest. Their popularity results from strong investor interest in the stocks of medium-sized and small companies. Like the Dow averages, many of the S&P indexes are frequently quoted in the financial news, as shown in Figure 3.8.

Although the Dow Jones averages and S&P indexes tend to behave in a similar fashion over time, their day-to-day magnitude and even direction (up or down) can differ significantly because the Dows are averages and the S&Ps are indexes.

**NYSE, AMEX, and Nasdaq Indexes** Three indexes measure the daily results of the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), and the National Association of Securities Dealers Automated Quotation (Nasdaq) system. Each reflects the movement of stocks listed on its exchange. The **NYSE composite index** includes all of the 3,000 or so stocks listed on the “Big Board.” The index’s base of 50 reflects the December 31, 1965, value of stocks listed on the NYSE. In addition to the composite index,
the NYSE publishes indexes for industrials, utilities, transportation, and finance subgroups. The behavior of the NYSE industrial index is normally similar to that of the DJIA and the S&P 500 indexes.

The **AMEX composite index** reflects the price of all shares traded on the American Stock Exchange, relative to a base of 100 set at August 31, 1973. Although it does not always closely follow the S&P and NYSE indexes, the AMEX index tends to move in the general direction they do.

The **Nasdaq indexes** reflect over-the-counter market activity. They are based on a value of 100 set at February 5, 1971. The most comprehensive of the Nasdaq indexes is the OTC composite index, which is calculated using the 6,400 or so domestic common stocks traded on the Nasdaq system. Also important is the Nasdaq 100, which includes the top 100 nonfinancial companies listed on Nasdaq. The other five commonly quoted Nasdaq indexes are the industrials, the insurance, the banks, the computer, and the telecommunications indexes. Although their degrees of responsiveness may vary, the Nasdaq indexes tend to move in the same direction at the same time as the other major indexes.

**Value Line Indexes** Value Line publishes a number of stock indexes constructed by equally weighting the price of each stock included. This is accomplished by considering only the percentage changes in stock prices. This approach eliminates the effects of differing market price and total market value on the relative importance of each stock in the index. The **Value Line composite index** includes the approximately 1,700 stocks in the Value Line Investment Survey that are traded on the NYSE, AMEX, and OTC markets. The base of 100 reflects the stock prices on June 30, 1961. In addition to its composite index, Value Line publishes indexes for industrials, rails, and utilities.

**Other Averages and Indexes** A number of other indexes are available. The **Wilshire 5000 index**, published by Wilshire Associates, Inc., is reported daily in the Wall Street Journal. It represents the total dollar value (in billions of dollars) of 5,000 actively traded stocks, including all those on the NYSE and the AMEX in addition to active OTC stocks. Frank Russell Company, a pension advisory firm, publishes three primary indexes. The Russell 1000 includes the 1,000 largest companies, the Russell 2000 includes 2,000 small companies, and the Russell 3000 includes the 3,000 largest U.S. companies. Barron’s publishes a 50-stock average. The New York Times publishes its own average, which is similar to the Dow Jones averages. Moody’s Investor Services prepares market indicators for a variety of groupings of common stock.

In addition, the Wall Street Journal publishes a number of global and foreign stock market indexes in Section C. These indexes are summarized in the “International Stocks” section on the first page and are listed in greater detail in “World Stock Markets.” Included are Dow Jones indexes for countries in the Americas, Latin America, Europe, South Africa, and the Asia-Pacific region that are based on a value of 100 set at December 31, 1991. More than 20 foreign stock market indexes and the Morgan Stanley Indexes are also given for major countries, including a World Index and the Europe/Australia/Far East (EAFE) Index. Each of the Morgan Stanley Indexes is calculated in local currencies and based on a value of 100 set at December 31, 1969. Like the purely domestic averages and indexes, these international averages and indexes measure the general price behavior of the stocks that are listed and...
traded in the given market. Useful comparisons of the market averages and indexes over time and across markets are often made to assess both trends and relative strengths of foreign markets throughout the world.

**Bond Market Indicators**

A number of indicators are available for assessing the general behavior of the bond markets. A “Bond Market Data Bank” that includes a wealth of return and price index data for various types of bonds and various domestic and foreign markets is published daily in the *Wall Street Journal*. However, there are fewer indicators of overall bond market behavior than of stock market behavior. The key measures of overall U.S. bond market behavior are bond yields, the Dow Jones bond averages, and the New York Stock Exchange bond diary.

**Bond Yields**

A bond yield is a summary measure of the total return an investor would receive on a bond if it were purchased at its current price and held to maturity. Bond yields are reported as annual rates of return. For example, a bond with a yield of 8.50% would provide its owner with a total return from periodic interest and capital gain (or loss) that would be equivalent to an 8.50% annual rate of earnings on the amount invested, if the bond were purchased at its current price and held to maturity.

Typically, bond yields are quoted for a group of bonds that are similar with respect to type and quality. For example, Barron’s quotes the yields on the Dow Jones bond averages of 10 utilities, 10 industrials, and 20 bond composites, as well as for specified grades of corporate bonds. In addition, like the *Wall Street Journal*, it quotes numerous other bond indexes and yields, including those for Treasury and municipal bonds. Similar bond yield data are available from S&P, Moody’s, and the Federal Reserve. Like stock market averages and indexes, bond yield data are especially useful when viewed over time.

**Dow Jones Bond Averages**

The Dow Jones bond averages include a utility, an industrial, and a composite bond average. Each average reflects the simple mathematical average of the closing prices, rather than yields, for each group of bonds included. The utility bond average is based on the closing prices of 10 utility bonds; the industrial bond average is based on the closing prices of 10 industrial bonds; and the composite bond average is based on the closing prices of 10 utility and 10 industrial bonds.

Like bond price quotations, the bond averages are presented in terms of the percentage of face value at which the bond sells. For example, the September 28, 2000, Dow Jones 20-bond composite average of 95.97 indicated that, on average, bonds were on the day reported selling for 95.97 percent of their par or face value. For a $1,000 bond, the average price of an issue would equal about $959.70. The Dow Jones bond averages are published daily in the *Wall Street Journal* and summarized weekly in Barron’s. Similar bond market indexes, prepared primarily by leading investment bankers such as Lehman Brothers and Merrill Lynch, are also published daily in the *Wall Street Journal* and summarized weekly in Barron’s.

**NYSE Bond Diary**

The New York Stock Exchange is the dominant organized exchange on which bonds are traded. Thus certain summary statistics on daily bond-trading activity on the NYSE provide useful insight into the behavior of
the bond markets in general. These statistics include the number of issues traded and the number that advanced, declined, or remained unchanged. On September 28, 2000, 136 domestic issues were traded; 64 advanced, 53 declined, and 19 remained unchanged. Of the issues traded, 6 achieved a new price high for the year, and 4 fell to new price lows. Total sales volume was $7,489,000. The NYSE bond diary is published daily in the Wall Street Journal and summarized weekly in Barron’s.

**IN REVIEW**

3.10 Describe the basic philosophy and use of stock market averages and indexes. Explain how the behavior of an average or index can be used to classify general market conditions as bull or bear.

3.11 List each of the major averages or indexes prepared by (a) Dow Jones & Company and (b) Standard & Poor’s Corporation. Indicate the number and source of the securities used in calculating each average or index.

3.12 Briefly describe the composition and general thrust of each of the following indexes.
   a. NYSE composite index.
   b. AMEX composite index.
   c. Nasdaq indexes.
   d. Value Line composite index.
   e. Wilshire 5000 index.

3.13 Discuss each of the following as they are related to assessing bond market behavior.
   a. Bond yields.
   b. Dow Jones bond averages.
   c. NYSE bond diary.

**Making Securities Transactions**

Now that you know how to find information to help you locate attractive security investments, you should understand how to make securities transactions. Whether you decide to start a self-directed online investment program or to use a traditional stockbroker, you must first open an account with a stockbroker to buy and sell securities. In this section we will look at the role stockbrokers play and how that role has changed with the growth in online investing. We will also explain the basic types of orders you can place, the procedures required to make regular and online securities transactions, the costs of investment transactions, and investor protection.

**The Role of Stockbrokers**

Stockbrokers—also called account executives, investment executives, and financial consultants—act as intermediaries between buyers and sellers of securities. They typically charge a commission to facilitate these securities transactions. Stockbrokers must be licensed by both the SEC and the securities exchanges on which they place orders and must follow the ethical guidelines of those bodies.
Although the procedure for executing orders on organized exchanges may differ from that in the OTC market, it starts the same way: An investor places an order with his or her stockbroker. The broker works for a brokerage firm that owns seats on the organized securities exchanges, and members of the securities exchange execute orders that the brokers in the firm’s various sales offices transmit to them. For example, the largest U.S. brokerage firm, Merrill Lynch, transmits orders for listed securities from its offices in most major cities throughout the country to the main office of Merrill Lynch and then to the floor of the stock exchanges (NYSE and AMEX), where Merrill Lynch exchange members execute them. Confirmation of the order goes back to the broker placing the order, who relays it to the customer. This process can take a matter of seconds with the use of sophisticated telecommunications networks and Internet trading.

For an over-the-counter securities transaction, brokerage firms transmit orders to market makers, who are dealers in the OTC market specializing in that security. As we learned in Chapter 2, the Nasdaq system, along with the available information on who makes markets in certain securities, enables brokers to execute orders in OTC securities. Normally, OTC transactions are executed rapidly, because market makers maintain inventories of the securities in which they deal.

Brokerage Services The primary activity of stockbrokers is to execute clients’ purchase and sale transactions at the best possible price. Brokerage firms will hold the client’s security certificates for safekeeping; the stocks kept by the firm in this manner are said to be held in street name. Because the brokerage house issues the securities in its own name and holds them in trust for the client (rather than issuing them in the client’s name), the firm can transfer the securities at the time of sale without the client’s signature. Street name is actually a common way of buying securities, because many investors do not want to be bothered with the handling and safekeeping of stock certificates. In such cases, the brokerage firm records the details of the client’s transaction and keeps track of his or her investments through a series of bookkeeping entries. Dividends and notices received by the broker are forwarded to the client who owns the securities.

Stockbrokers also offer clients a variety of other services. For example, the brokerage firm normally provides free information about investments. Quite often, the firm has a research staff that periodically issues analyses of economic, market, industry, or company behavior and makes recommendations to buy or sell certain securities. As a client of a large brokerage firm, you can expect to receive regular bulletins on market activity and possibly a recommended investment list. You will also receive a statement describing your transactions for the month and showing commission and interest charges, dividends and interest received, and detailed listings of your current holdings.

Today, most brokerage firms will invest surplus cash left in a customer’s account in a money market mutual fund, allowing the customer to earn a reasonable rate of interest on these balances. Such arrangements help the investor earn as much as possible on temporarily idle funds.

Types of Brokerage Firms Just a few years ago, there were three distinct types of brokerage firms: full-service, discount, and online. No longer are the lines between these categories clear-cut. Most brokerage firms, even the most
traditional ones, now offer online services to compete with the increasingly popular online firms. And many discount brokers now offer services, like research reports for clients, that were once available only from a full-service broker.

The traditional broker, or so-called **full-service broker**, in addition to executing clients' transactions, offers investors a full array of brokerage services: providing investment advice and information, holding securities in street name, offering online brokerage services, and extending margin loans. Investors who wish merely to make transactions and are not interested in taking advantage of other services should consider either a discount broker or an online broker.

**Discount brokers** focus primarily on making transactions for customers. They charge low commissions and provide little or no free research information or investment advice. The investor calls a toll-free number or visits the broker's Web site to initiate a transaction, and the discount broker confirms the transaction by phone, e-mail, or regular mail. Discount brokers that charge the lowest commissions and provide virtually no services are commonly referred to as deep discounters. However, brokers like Charles Schwab, the first discount broker, now offer many of the same services that you'd find at a full-commission broker. Other discounters still focus on transactions.

**Online brokers**, also called Internet brokers and electronic brokers, are typically deep-discount brokers through which investors can execute trades electronically online via a commercial service or on the Internet. The investor accesses the online broker's Web site to open an account, review the commission schedule, or see a demonstration of the available transactional services and procedures. Confirmation of electronic trades can take as little as 10 seconds, and most trades occur within 1 minute. Some firms, such as Ameritrade, E*Trade, and Datek Online, operate only online. In response to the rapid growth of online investors, particularly among affluent young investors who enjoy surfing the Web, most brokerage firms now offer online trading.

The rapidly growing volume of business done by discount and online brokers attests to their success. Today, many banks and savings institutions are making discount and online brokerage services available to their depositors who wish to buy stocks, bonds, mutual funds, and other investment vehicles. Some of the major full-service, discount, and online brokers are listed in Table 3.5.

**Selecting a Stockbroker** If you decide to start your investing activities with the assistance of either a full-service or discount stockbroker, select the person you believe best understands your investment goals. Choosing a broker whose disposition toward investing is similar to yours is the best way to establish a solid working relationship. Your broker should also make you aware of investment possibilities that are consistent with your objectives and attitude toward risk.

You should also consider the cost and types of services available from the firm with which the broker is affiliated, to receive the best service at the lowest possible cost to you. The basic discount brokerage service is primarily transactional, and the online brokerage service is purely transactional. Contact with a broker, advice, and research assistance generally are available only at a higher price. Investors must weigh the added commissions they pay a full-service broker against the value of the advice they receive, because the amount of available advice is the only major difference among online, discount, and full-service brokers.
Referrals from friends or business associates are a good way to begin your search for a stockbroker. Don’t forget to consider the investing style and goals of the person making the recommendation. However, it is not important—and often not even advisable—to know your stockbroker personally. And in this age of online brokers, you may never meet your broker face to face! A strictly business relationship eliminates the possibility that social concerns will interfere with the achievement of your investment goals. This does not mean that your broker’s sole interest should be commissions. Responsible brokers do not engage in churning—that is, causing excessive trading of their clients’ accounts to increase commissions. Churning is both illegal and unethical under SEC and exchange rules. However, it is often difficult to prove.

Opening an Account  To open an account, the customer fills out various documents that establish a legal relationship between the customer and the brokerage firm. A signature card and a personal data card provide the information needed to identify the client’s account. The stockbroker must also have a reasonable understanding of a client’s personal financial situation to assess his or her investment goals—and to be sure that the client can pay for the securities purchased. The client also provides the broker with instructions regarding the transfer and custody of securities. Customers who wish to borrow money to make transactions must establish a margin account (described below). If the customer is acting as a custodian, trustee, or executor or is a corporation, the brokerage firm will require additional documents. Investors may have accounts with more than one stockbroker. Many investors establish accounts at different types of firms to obtain the benefit and opinions of a diverse group of brokers and to reduce their overall cost of making purchase and sale transactions. You can even open an account online at some brokerage firms.

Next you must select the type of account best suited to your needs. We will briefly consider several of the more popular types.

Single or Joint  A brokerage account may be either single or joint. Joint accounts are most common between husband and wife or parent and child. The account of a minor (a person less than 18 years of age) is a custodial account, in which a parent or guardian must be part of all transactions. Regardless of the form of the account, the name(s) of the account holder(s) and an account number are used to identify it.

<table>
<thead>
<tr>
<th>TABLE 3.5 Major Full-Service, Discount, and Online Brokers</th>
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<tbody>
<tr>
<td>Type of Broker</td>
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<tr>
<td>Charles Schwab</td>
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<tr>
<td>Merrill Lynch</td>
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<tr>
<td>Morgan Stanley Dean Witter</td>
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<tr>
<td>Prudential Securities</td>
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<tr>
<td>Salomon Smith Barney</td>
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<tr>
<td>UBS PaineWebber</td>
</tr>
</tbody>
</table>

churning  an illegal and unethical practice engaged in by a broker to increase commissions by causing excessive trading of clients’ accounts.

custodial account  the brokerage account of a minor; requires a parent or guardian to be part of all transactions.
Cash or Margin

A cash account, the more common type, is one in which the customer can make only cash transactions. Customers can initiate cash transactions via phone or online and are given 3 business days in which to transmit the cash to the brokerage firm. The firm is likewise given 3 business days in which to deposit the proceeds from the sale of securities in the customer’s cash account.

A margin account is an account in which the brokerage firm extends borrowing privileges to a creditworthy customer. By leaving securities with the firm as collateral, the customer can borrow a prespecified proportion of the securities’ purchase price. The brokerage firm will, of course, charge the customer a stated rate of interest on borrowings. (The mechanics of margin trading are covered in Chapter 2.)

Wrap

The wrap account allows brokerage customers with large portfolios (generally $100,000 or more) to shift stock selection decisions conveniently to a professional money manager, either in-house or independent. In return for a flat annual fee equal to between 1% and 3% of the portfolio’s total asset value, the brokerage firm helps the investor select a money manager, pays the manager’s fee, and executes the money manager’s trades. Initially the investor and manager discuss the client’s overall goals. Wrap accounts are appealing for a number of reasons other than convenience. The annual fee in most cases covers commissions on all trades, virtually eliminating the chance of the broker churning the account. In addition, the broker monitors the manager’s performance and provides the investor with detailed reports, typically quarterly.

Odd-Lot or Round-Lot Transactions

Investors can buy stock in either odd or round lots. An odd lot consists of less than 100 shares of a stock. A round lot is a 100-share unit or a multiple thereof. You would be dealing in an odd lot if you bought, say, 25 shares of stock but in a round lot if you bought 200 shares. A trade of 225 shares would be a combination of an odd lot and two round lots.

Transactions in odd lots require either additional processing by the brokerage firm or the assistance of a specialist. For odd lots, an added fee—known as an odd-lot differential—is tacked on to the normal commission charge, driving up the costs of these small trades. Small investors in the early stages of their investment programs are primarily responsible for odd-lot transactions.

Basic Types of Orders

Investors can use different types of orders to make security transactions. The type placed normally depends on the investor’s goals and expectations. The three basic types of orders are the market order, the limit order, and the stop-loss order.

Market Order An order to buy or sell stock at the best price available when the investor places the order is a market order. It is generally the quickest way to fill orders, because market orders are usually executed as soon as they reach the exchange floor or are received by the dealer. Because of the speed with
which market orders are executed, the buyer or seller of a security can be sure that the price at which the order is transacted will be very close to the market price prevailing at the time the order was placed.

**Limit Order** A limit order is an order to buy at or below a specified price or to sell at or above a specified price. When the investor places a limit order, the broker transmits it to a specialist dealing in the security. The specialist notes the number of shares and price of the limit order in his or her book and executes the order as soon as the specified market price (or better) exists. The specialist must first satisfy all other orders with precedence—similar orders received earlier, buy orders at a higher specified price, or sell orders at a lower specified price. Investors can place the limit order in one of the following forms:

1. A fill-or-kill order, which is canceled if not immediately executed.
2. A day order, which if not executed is automatically canceled at the end of the day.
3. A good-til-canceled (GTC) order, which generally remains in effect for 6 months unless executed, canceled, or renewed.

Assume, for example, that you place a limit order to buy, at a limit price of $30, 100 shares of a stock currently selling at $30.50. Once the specialist clears all similar orders received before yours, and once the market price of the stock falls to $30 or less, he or she executes your order. It is possible, of course, that your order might expire (if it is not a GTC order) before the stock price drops to $30.

Although a limit order can be quite effective, it can also keep you from making a transaction. If, for instance, you wish to buy at $30 or less and the stock price moves from its current $30.50 price to $42 while you are waiting, you have missed the opportunity to make a profit of $11.50 per share ($42 – $30.50). If you had placed a market order to buy at the best available price ($30.50), the profit of $11.50 would have been yours. Limit orders for the sale of a stock are also disadvantageous when the stock price closely approaches, but does not attain, the minimum sale price limit before dropping substantially. Generally speaking, limit orders are most effective when the price of a stock fluctuates greatly, because there is then a better chance that the order will be executed.

**Stop-Loss Order** When an investor places a stop-loss order or stop order, the broker tells the specialist to sell a stock when its market price reaches or drops below a specified level. Stop-loss orders are suspended orders placed on stocks; they are activated when and if the stock reaches a certain price. The stop-loss order is placed on the specialist's book and becomes active once the stock reaches the stop price. Like limit orders, stop-loss orders are typically day or GTC orders. When activated, the stop order becomes a market order to sell the security at the best price available. Thus it is possible for the actual price at which the sale is made to be well below the price at which the stop was initiated. Investors use these orders to protect themselves against the adverse effects of a rapid decline in share price.

For example, assume you own 100 shares of Ballard Industries, which is currently selling for $35 per share. Because you believe the stock price could decline rapidly at any time, you place a stop order to sell at $30. If the stock
price does in fact drop to $30, the specialist will sell the 100 shares at the best price available at that time. If the market price declines to $28 by the time your stop-loss order comes up, you will receive less than $30 per share. Of course, if the market price stays above $30 per share, you will have lost nothing as a result of placing the order, because the stop order will never be initiated. Often investors raise the level of the stop as the price of the stock rises. Such action helps to lock in a higher profit when the price is increasing.

Investors can also place stop orders to buy a stock, although buy orders are far less common than sell orders. For example, an investor may place a stop order to buy 100 shares of MJ Enterprises, currently selling for $70 per share, once its price rises to, say, $75 (the stop price). These orders are commonly used either to limit losses on short sales (discussed in Chapter 2) or to buy a stock just as its price begins to rise.

To avoid the risk of the market moving against you when your stop order becomes a market order, you can place a stop-limit order, rather than a plain stop order. This is an order to buy or sell stock at a given price, or better, once a stipulated stop price has been met. For example, in the Ballard Industries example, had a stop-limit order been in effect, then when the market price of Ballard dropped to $30, the broker would have entered a limit order to sell your 100 shares at $30 a share or better. Thus you would have run no risk of getting less than $30 a share for your stock—unless the price of the stock kept right on falling. In that case, as is true for any limit order, you might miss the market altogether and end up with stock worth much less than $30. Even though the stop order to sell was triggered (at $30), the stock will not be sold, with a stop-limit order, if it keeps falling in price.

Online Transactions

The competition for your online business increases daily as more players enter an already crowded arena. Brokerage firms are encouraging customers to trade online and offering a variety of incentives to get their business, including free trades! However, low cost is not the only reason to choose a brokerage firm. As with any financial decision, you must consider your needs and find the firm that best matches them. One investor may want timely information, research, and quick, reliable trades from a firm like Fidelity or Merrill Lynch. Another, who is an active trader, will focus on cost and fast trades rather than research and so will sign up with Ameritrade or Datek. Ease of site navigation is a major factor in finding an online broker. Table 3.6 compares the costs and services of a number of leading brokerage firms, all of which offer online trading of stocks. Some also offer online trading of bonds and mutual funds as well. A good site for objective, in-depth reviews of firms with online brokerage divisions is Gómez Advisors (www.gomez.com). It rates brokers on numerous factors, including response time, ease of use, online resources, and availability of 24-hour customer service.

Stocks If you decide that do-it-yourself investing is for you, choose an online broker and open an account. In most cases, you can fill out the application forms online, print and sign them, and mail them with a check to fund your account initially. As soon as you receive confirmation that the funds are in your account, you can start trading. You can place the same types of orders as with a traditional broker.
## TABLE 3.6 Comparison of Costs and Services: Leading Brokerage Firms Offering Online Trading

<table>
<thead>
<tr>
<th>Firm/Web Site</th>
<th>Online Products</th>
<th>Minimum Balance(^1)</th>
<th>Base Stock Commission(^2)</th>
<th>Other Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ameritrade</td>
<td>Stocks, mutual funds, options, bonds (phone only)</td>
<td>$2,000</td>
<td>Online, $8 for market orders, $13 for limit orders; more for phone and broker trades $29.95 per online trade, less for active traders; minimum of $39.95 for broker trades</td>
<td>ATM/debit card, check writing; after-hours trading; alerts; fee for real-time quotes Check writing, ATM/debit card, electronic bill paying; access to stockbrokers; referrals to 3rd-party investment adviser</td>
</tr>
<tr>
<td>(ameritrade.com)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charles Schwab</td>
<td>Stocks, mutual funds, options, bonds (phone only)</td>
<td>$5,000</td>
<td>$29.95 per online trade</td>
<td>ATM/debit card, check writing; electronic bill paying; free real-time quotes; access to stockbrokers and Fidelity consultants</td>
</tr>
<tr>
<td>(<a href="http://www.schwab.com">www.schwab.com</a>)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Datek</td>
<td>Stocks, mutual funds</td>
<td>none</td>
<td>Online, $9.99; Broker-assisted, $25</td>
<td>Check writing; 60-second execution guarantee</td>
</tr>
<tr>
<td>(datek.com)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E*Trade</td>
<td>Stocks, mutual funds, options, bonds (phone only)</td>
<td>$1,000</td>
<td>$14.95 for market orders, $19.95 for Nasdaq stocks, limit orders; more for phone and broker trades</td>
<td>Internet banking, online bill paying, ATM/debit cards; partnership with DirectAdvice.com Check writing, charge/debit card, electronic bill paying; free real-time quotes; access to stockbrokers and Fidelity consultants</td>
</tr>
<tr>
<td>(<a href="http://www.etrade.com">www.etrade.com</a>)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fidelity</td>
<td>Stocks, mutual funds, options, bonds</td>
<td>$2,500</td>
<td>$25 per online trade, less for active traders; considerably more for phone and broker trades</td>
<td>Check writing, ATM/debit card, electronic bill paying; access to stockbrokers and Fidelity consultants Check writing, Merrill Lynch consultants</td>
</tr>
<tr>
<td>(<a href="http://www.fidelity.com">www.fidelity.com</a>)</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>Stocks, mutual funds, options (phone only), bonds</td>
<td>$2,000</td>
<td>Online, $29.95 per trade; also offers unlimited trades for a flat annual fee</td>
<td>Check writing, ATM/credit/debit card, electronic bill paying; access to stockbrokers and Fidelity consultants Check writing, Advisor Direct referral service for large accounts</td>
</tr>
<tr>
<td>(<a href="http://www.ml.com">www.ml.com</a>)</td>
<td>(phone only)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Discount</td>
<td>Stocks, mutual funds, options, bonds (phone only)</td>
<td>none</td>
<td>$14.75 for market orders, $19.75 for limit orders for multiple same-day same side (buy or sell) trades on same stock; more for phone and broker trades</td>
<td>Check writing, ATM/debit card, electronic bill paying and account transfers; Advisor Direct referral service for large accounts</td>
</tr>
<tr>
<td>Brokers</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>(<a href="http://www.ndb.com">www.ndb.com</a>)</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>TD Waterhouse</td>
<td>Stocks, mutual funds, options, bonds (phone only)</td>
<td>$1,000</td>
<td>$12 for market orders, $15 for limit orders</td>
<td>Check writing, ATM/debit card, electronic bill paying and account transfers; Advisor Direct referral service for large accounts</td>
</tr>
<tr>
<td>(<a href="http://www.tdwaterhouse.com">www.tdwaterhouse.com</a>)</td>
<td></td>
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</tbody>
</table>

1For cash account; may be different for retirement account and higher for margin account. These commissions are, of course, subject to change; also, some brokers/dealers may charge more than the indicated commission, others less.

2Some firms add a per-share surcharge after the first 1,000 or 5,000 shares.

Here are the steps in making an online stock purchase transaction at Ameritrade’s Web site. The specifics may vary slightly at other brokerage sites but will follow a similar pattern.

1. Go to your brokerage firm’s Web site and log in with your account number and personal identification number (PIN) to access your account. This takes you to your personal trading homepage.

2. At your personal trading page, you’ll have access to your account information, trade screens, market news, daily market summaries, stock quotes, research, and more. If you have already done your research and know what stock you wish to buy, you move on to the order page.

3. Using the brokerage site’s order form, place your order. Ameritrade has two order tickets: a basic ticket for market, limit, and stop orders and an advanced stock order ticket, shown in Figure 3.10. The advanced order ticket also includes selling short, stop-limit orders, and a place to enter special instructions to set the terms of your trade.

4. After placing your securities order, click to see a preview or confirmation page to review your order before submitting it. If everything is correct, click “Place Order.” Otherwise click “Do Not Place Order” to delete the order information.
5. Clicking on the “Place Order” button takes you to the order-sent page that confirms Ameritrade’s receipt of your order. You can check the status of your order at the “Review Orders” link.

Now you can even invest in non-U.S. stocks online at global trading sites Globeshare.com (www.globeshare.com) and IntlTrader.com (www.intltader.com). IntlTrader.com charges $29.99 per trade; Globeshare commissions vary depending on the country.

See how easy it is? In fact, the ease of Internet investing has created a new type of investor: the compulsive investor, who can’t get enough of investing. The Investing in Action box on page 112 describes the dilemmas of these investment addicts.

Day Trading For some investors, online stock trading is so compelling that they become day traders. The opposite of buy-and-hold investors with a long-term perspective, day traders buy and sell stocks quickly throughout the day. They hope that their stocks will continue to rise in value for the very short time they own them—sometimes just seconds or minutes—so they can make quick profits. Some also sell short, looking for small price decreases. True day traders do not own any stocks overnight—hence the term “day trader”—because they believe that the extreme risk of prices changing radically from day to day will lead to large losses. Day trading is not illegal or unethical, but it is highly risky. To compound their risk, day traders usually buy on margin to use leverage to earn higher profits. But as we saw in Chapter 2, margin trading also increases the risk of large losses.

Until recently, day trading was a little-known activity. Now that the Internet makes investment information and transactions accessible to the masses, it is a dangerously popular one. Day traders watch their computer screens continuously, trying to track numerous ticker quotes and price data to identify market trends. It’s a very difficult task—essentially a very stressful, full-time job. Yet pitches for day trading make it seem like an easy route to quick riches. Quite the reverse is true. Day traders typically incur major financial losses when they start trading. Some never achieve profitability. Day traders also have high expenses for brokerage commissions, training, and computer equipment. By some estimates, they must make a 56% profit annually to break even on fees and commissions alone.

Technical and Service Problems As the number of online investors increases, so do the problems that beset brokerage firms and their customers. The number of complaints about online brokerage services doubled from 1998 to 1999, with technical difficulties the biggest category. Investors who report trading problems are also upset about the lack of response from brokers. And they claim that brokers do not get the best prices for stock orders.

Many online brokerage firms were not prepared for the heavy volume at their Web sites. Victims of their own successful marketing campaigns, the firms had inadequate computer systems and capacity. Software problems have also been to blame in some service outages. The resulting online traffic jams have left customers locked out of brokerage Web sites, unable to view their account information or place trades. Most firms have upgraded their systems to reduce the number of service outages.

The problems go beyond the brokerage sites, though. Once an investor places a trade at a firm’s Web site, it goes through several other parties to be
executed. Most online brokers don’t have their own trading desks and have agreements with other trading firms to execute their orders on the New York Stock Exchange or Nasdaq Stock Market. Slowdowns at any point in the process can create problems confirming trades. Investors, thinking that their trades had not gone through, might place the order again—only to discover later that they have bought the same stock twice. Online investors who don’t get immediate trade execution and confirmation use the telephone when they can’t get through online or to solve other problems with their accounts, and they often face long waiting times on hold.

Tips for Successful Online Trades Successful online investors take additional precautions before submitting their orders. Here are some tips to protect yourself from common problems:

- Know how to place and confirm your order before you begin trading. This simple step can keep you from having problems later.
- Verify the stock symbol of the security you wish to buy. Two very different companies can have similar symbols. Some investors have bought the wrong stock because they didn’t check before placing their order.
• Use limit orders. The order you see on your computer screen may not be the one you get. With a limit order, you avoid getting burned in fast-moving markets. Although limit orders cost more, they can save you thousands of dollars. For example, customers eager to get shares of a hot IPO stock placed market orders. Instead of buying the stock near the offering price of $9, some were shocked to find that their orders were filled at prices as high as $90 during the stock’s first trading day. Investors who were aware of the price run-up tried to cancel orders but couldn’t get through to brokers. Charles Schwab and ETrade accept only limit orders for online IPO purchases on the first day of trading.

• Don’t ignore the online reminders that ask you to check and recheck. It’s easy to make a typo that adds an extra digit to a purchase amount.

• Don’t get carried away. It’s easy to churn your own account. In fact, new online investors trade about twice as much as they did before they went online. To control impulse trading, have a strategy and stick to it.

• Open accounts with two brokers. This protects you if your online brokerage’s computer system crashes. It also gives you an alternative if one brokerage is blocked with heavy trading volume.

• Double-check orders for accuracy. Make sure each trade was completed according to your instructions. It’s very easy to make typos or use the wrong stock symbol, so review the confirmation notice to verify that the right number of shares was bought or sold and that the price and commissions or fees are as quoted. Check your account for “unauthorized” trades.

**Bonds**  Electronic bond trading accounts for about 6% of the overall trading volume, and only 1% is from individual investors. Few fully automated online bond transactions systems are available to individual investors. Typically, you must find the information at Web sites like the ones mentioned earlier in the chapter and then phone your broker to fill the order. At ETrade’s Bond Center, investors can research various types of bonds to learn the price, yield, and maturity dates, although they must still place their orders by telephone. Some firms let customers place e-mail orders but then execute the order in the traditional way. TradeWeb ([www.tradeweb.com](http://www.tradeweb.com)) is one site where individuals can trade U.S. government securities.

It won’t be long, however, before individual investors can trade bonds online much as they do stocks. Many firms are developing online bond-trading capabilities in response to customer demand for full-service online investing. In June 2000, leading investment banks Goldman Sachs, Merrill Lynch, Morgan Stanley Dean Witter, Salomon Smith Barney, and Deutsche bank announced plans to establish BondBook ([www.bondbook.com](http://www.bondbook.com)), a live central exchange for new and existing corporate, high-yield, and municipal bonds. Although it will be limited to institutional investors, it should improve the overall efficiency of the bond market.

**Mutual Funds**  As we noted earlier in this chapter, the Internet is a big time-saver when it comes to sorting through thousands of mutual funds. Many sites offer descriptions of funds, what they invest in, and their track records, as well as screening tools to find funds that meet specific needs or goals.
You can buy and sell funds online at fund company or brokerage firm Web sites. You can also transfer your investment from one fund to another. As with stocks, you must first open an account and have a signature on file. You may be able to download and print a sign-up form and mail in a check either to the fund itself for direct transactions or to the brokerage firm. Once you fund your account, making online transactions is fairly easy.

Brokerage sites like Charles Schwab offer fund supermarkets where investors can buy funds from many different fund companies, instead of having to go from fund family site to fund family site to compare and then purchase them. However, some brokerage firms charge commissions on purchases of funds that you can buy without an initial sales charge if you purchase them directly from the fund family. Availability and commissions differ from one brokerage firm to another, so be sure you understand the fee structure before executing an order. Fund transactions are made through a major stock exchange or Nasdaq; there is no open public market for traditional mutual funds although, as explained in Chapter 12, exchange-traded funds are a new type of publicly traded fund.

Transaction Costs

Making transactions through brokers or dealers is considerably easier for investors than it would be to negotiate directly, trying to find someone who wants to buy that which they want to sell (or vice versa). To compensate the broker for executing the transaction, investors pay transaction costs, which are usually levied on both the purchase and the sale of securities. When making investment decisions, you must consider the structure and magnitude of transaction costs, because they affect returns.

Since the passage of the Securities Acts Amendments of 1975, brokers have been permitted to charge whatever brokerage commissions they deem appropriate. Most firms have established fixed-commission schedules that apply to small transactions, the ones most often made by individual investors. On large institutional transactions, the client and broker may arrange a negotiated commission—commissions to which both parties agree. Negotiated commissions are also available to individual investors who maintain large accounts, typically above $50,000.

The commission structure varies with the type of security and the type of broker. We'll describe the basic commission structures for various types of securities in subsequent chapters. Because of the way brokerage firms charge commissions on stock trades, it is difficult to compare prices precisely. Traditional brokers generally charge on the basis of number of shares and the price of the stock at the time of the transaction. Internet brokers usually charge flat rates, often for transactions up to 1,000 shares, with additional fees for larger or more complicated orders. However, many traditional brokerage firms have reduced their commissions on broker-assisted trades and have instituted annual flat fees set as a specified percentage of the value of the assets in the account. Unless you are a very active trader, you will probably be better off paying commissions on a per-transaction basis.

Obviously, discount and online brokers charge substantially less than full-service brokers for the same transaction. However, most discounters charge a minimum fee to discourage small orders. For example, Charles Schwab, the largest online broker, charges a minimum fee of about $40 for a broker-
assisted order and $30 for an online stock transaction. The savings from the discounter are substantial: Depending on the size and type of transaction, discount and online brokers can typically save investors between 30% and 80% of the commission charged by the full-service broker.

**Investor Protection: SIPC and Arbitration**

Although most investment transactions take place safely, it is important for you to know what protection you have if things don’t go smoothly. As a client, you are protected against the loss of the securities or cash held by your broker. The **Securities Investor Protection Corporation (SIPC)**, a nonprofit membership corporation, was authorized by the Securities Investor Protection Act of 1970 to protect customer accounts against the consequences of financial failure of the brokerage firm. The SIPC currently insures each customer’s account for up to $500,000, with claims for cash limited to $100,000 per customer. Note that SIPC insurance does not guarantee that the investor will recover the dollar value of the securities; it guarantees only that the securities themselves will be returned. Some brokerage firms also insure certain customer accounts for amounts in excess of $500,000. Certainly, in light of the diversity and quality of services available among brokerage firms, this may be an additional service you should consider when you select a firm and an individual broker.

The SIPC provides protection in case your brokerage firm fails. But what happens if your broker gave you bad advice and, as a result, you lost a lot of money on an investment? Or what if you feel your broker is churning your account, the illegal but difficult-to-prove practice of causing excessive trading to increase commissions? In either case, the SIPC won’t help. It’s not intended to insure you against bad investment advice or churning. Instead, if you have a dispute with your broker, the first thing you should do is discuss the situation with the managing officer at the branch where you do business. If that doesn’t do any good, then contact the firm’s compliance officer and the securities regulator in your home state.

If you still don’t get any satisfaction, you can use litigation (judicial methods in the courts) to resolve the dispute. Alternative dispute resolution processes that may avoid litigation include mediation and arbitration. **Mediation** is an informal, voluntary approach in which you and the broker agree to a mediator, who facilitates negotiations between the two of you to resolve the case. The mediator does not impose a solution on you and the broker. The NASD and securities-related organizations encourage investors to mediate disputes rather than arbitrate them, because mediation can reduce costs and time for both investors and brokers.

If mediation is not pursued or if it fails, you may have no choice but to take the case to **arbitration**, a formal process whereby you and your broker present the two sides of the argument before an arbitration panel. The panel then decides the case. Many brokerage firms require you to resolve disputes by binding arbitration; in this case, you don’t have the option to sue. You must accept the arbitrator’s decision, and in most cases you cannot go to court to review your case. Before you open an account, check whether the brokerage agreement contains a binding-arbitration clause.
Settling securities disputes through mediation or arbitration rather than litigation has advantages and disadvantages. Mediation and arbitration proceedings typically cost less and are resolved more quickly than litigation. Recent legislation has given many investors the option of using either securities industry panels or independent arbitration panels such as those sponsored by the American Arbitration Association (AAA). Independent panels are considered more sympathetic toward investors. In addition, only one of the three arbitrators on a panel can be connected with the securities industry. However, the average arbitration award is about 60% of the original investment, before deducting any fees.

Probably the best thing you can do to avoid the need to mediate, arbitrate, or litigate with your broker is to select him or her carefully, understand the financial risks involved in the broker’s recommendations, thoroughly evaluate the advice he or she offers, and continuously monitor the volume of transactions that he or she recommends and executes. Clearly, it is much less costly to choose the right broker initially than to incur later the financial and emotional costs of having chosen a bad one.

If you have a problem with an online trade, immediately file a written—not e-mail—complaint with the broker. Cite dates, times, and amounts of trades, and include all supporting documentation. File a copy with the NASD regulatory arm Web site (www.nasdr.com) and with your state securities regulator. If you can’t resolve the problems with the broker, you can try mediation and then resort to arbitration, litigation being the last resort.

IN REVIEW

3.14 Describe the types of services offered by brokerage firms, and discuss the criteria for selecting a suitable stockbroker.

3.15 Briefly differentiate among the following types of brokerage accounts:
   a. Single or joint.
   b. Custodial.
   c. Cash.
   d. Margin.
   e. Wrap.

3.16 Differentiate among market orders, limit orders, and stop-loss orders. What is the rationale for using a stop-loss order rather than a limit order?

3.17 In what two ways, based on the number of shares transacted, do brokers typically charge for executing their clients’ transactions? Differentiate between the services and costs associated with full-service, discount, and online brokers.

3.18 Summarize the steps you would take to make an online stock transaction. What is day trading, and why is it risky?

3.19 Based on the Investing in Action box on page 112, do you believe that compulsive investing is the same as gambling? What steps can an investor take to keep his or her trading habits under control?

3.20 How can you avoid problems as an online trader?

3.21 What capabilities currently exist for buying bonds and mutual funds online?

3.22 What protection does the Securities Investor Protection Corporation (SIPC) provide securities investors? How are mediation and arbitration procedures used to settle disputes between investors and their brokers?
Although financial information is available from numerous sources, many investors have neither the time nor the expertise to analyze it and make decisions on their own. Instead, they turn to an investment adviser, which is an individual or firm that provides investment advice, typically for a fee. Alternatively, some small investors join investment clubs. Here we will discuss using an investment adviser and then briefly cover the key aspects of investment clubs.

Using an Investment Adviser

The “product” provided by an investment adviser ranges from broad, general advice to detailed, specific analyses and recommendations. The most general form of advice is a newsletter published by the adviser. These letters comment on the economy, current events, market behavior, and specific securities. Investment advisers also provide complete individualized investment evaluation, recommendation, and management services.

Regulation of Advisers

As we noted in Chapter 2, the Investment Advisers Act of 1940 ensures that investment advisers make full disclosure of information about their backgrounds, about conflicts of interest, and so on. The act requires professional advisers to register and file periodic reports with the SEC. A 1960 amendment permits the SEC to inspect the records of investment advisers and to revoke the registration of those who violate the act’s provisions. However, financial planners, stockbrokers, bankers, lawyers, and accountants who provide investment advice in addition to their main professional activity are not regulated by the act. Many states have also passed similar legislation, requiring investment advisers to register and to abide by the guidelines established by the state law.

Be aware that the federal and state laws regulating the activities of professional investment advisers do not guarantee competence. Rather, they are intended to protect the investor against fraudulent and unethical practices. It is important to recognize that, at present, no law or regulatory body controls entrance into the field. Therefore, investment advisers range from highly informed professionals to totally incompetent amateurs. Advisers who possess a professional designation are usually preferred because they have completed academic courses in areas directly or peripherally related to the investment process. Such designations include CFA (Chartered Financial Analyst), CIC (Chartered Investment Counselor), CFP (Certified Financial Planner), ChFC (Chartered Financial Consultant), CLU (Chartered Life Underwriter), and CPA (Certified Public Accountant).

Online Investment Advice

You can also find financial advice online. Whether it’s a retirement planning tool or advice on how to diversify your assets, automated financial advisers may be able to help you. If your needs are specific rather than comprehensive, you can find good advice at other sites. For example, T. Rowe Price has an excellent college planning section (www.troweprice.com/college). Financial Engines (www.financialengines.com), AdviceAmerica.com (www.adviceamerica.com), and DirectAdvice.com (www.directadvice.com) are among several independent advice sites that offer
broader planning capabilities. Many mutual fund family Web sites have online financial advisers. For example, Vanguard (www.vanguard.com) has a financial planning section that helps you choose funds for specific investment objectives, such as retirement or financing a college education. Table 3.7 compares the features and capabilities of several investment advice sites.

### The Cost and Use of Investment Advice

Professional investment advice typically costs, annually, between 0.25% and 3% of the dollar amount of money being managed. For large portfolios, the fee is typically in the range of 0.25% to 0.75%. For small portfolios (less than $100,000), an annual fee ranging from 2% to 3% of the dollar amount of funds managed would not be unusual. These fees generally cover complete management of a client’s money, excluding any purchase or sale commissions. The cost of periodic investment advice not provided as part of a subscription service could be based on a fixed-fee schedule or quoted as an hourly charge for consultation. Online advisers are much less expensive; they either are free or charge an annual fee.

Whether you choose a traditional investment advisory service or decide to try an online service, some are better than others. More expensive services do not necessarily provide better advice. It is best to study carefully the track record and overall reputation of an investment adviser before purchasing his or her services. Not only should the adviser have a good performance record, but he or she also should be responsive to the investor’s personal goals.

How good is the advice from online advisers? It’s very hard to judge. Their suggested plans are only as good as the input. Beginning investors may not have sufficient knowledge to make wise assumptions on future savings, tax, or inflation rates or to analyze results thoroughly. A good personal financial planner will ask lots of questions to assess your investing expertise and explain

### Online Investment Advisers

<table>
<thead>
<tr>
<th>Web Site</th>
<th>Description</th>
<th>Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>AdviceAmerica (<a href="http://www.adviceamerica.com">www.adviceamerica.com</a>)</td>
<td>Comprehensive Web-based financial planning advice on mutual funds; evaluates outcomes of various investment choices; makes asset allocation recommendations.</td>
<td>$29 per quarter; $99 per year</td>
</tr>
<tr>
<td>DirectAdvice (<a href="http://www.directadvice.com">www.directadvice.com</a>)</td>
<td>Develops investment strategy based on goals; recommends specific stock, bond, and money market mutual funds for maximum diversification. Online interview to assess goals, income, and investments. Fast data entry; easy to navigate and run “what-if” scenarios. College savings, retirement, and investing plans.</td>
<td>$75 per year</td>
</tr>
<tr>
<td>Financial Engines (<a href="http://www.financialengines.com">www.financialengines.com</a>)</td>
<td>Independent site. Retirement planning focus. Data input is easy. Powerful forecasting tools run hundreds of possible economic scenarios to analyze current portfolio performance and show probability of achieving goals. Subscription service offers specific buy and sell suggestions for mutual funds for tax-deferred accounts keyed to retirement date, expected income in retirement, savings rate, return assumptions, and risk tolerance.</td>
<td>Forecast free; portfolio recommendations $55 a year ($150 for multiple accounts)</td>
</tr>
<tr>
<td>Vanguard Funds (<a href="http://www.vanguard.com">www.vanguard.com</a>)</td>
<td>Vanguard Online Planner offers advice on allocating assets among stock, bond, and cash investments. Suggests appropriate Vanguard funds based on risk tolerance and personal financial situation. Helps choose investments for a total financial plan or just for college, retirement, investment, or estate planning.</td>
<td>Free; must be customer to save data</td>
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</tbody>
</table>
what you don’t know. These early-stage automated tools may take too narrow a focus and not consider other parts of your investment portfolio. For many investors, online advisers lack what leads them to get help in the first place—the human touch. They want hand-holding, reassurance, and gentle nudging to follow through on their plans.

**Investment Clubs**

Another way to obtain investment advice and experience is to join an investment club. This route can be especially useful for those of moderate means who do not want to incur the cost of an investment adviser. An investment club is a legal partnership binding a group of investors (partners) to a specified organizational structure, operating procedures, and purpose. The goal of most clubs is to earn favorable long-term returns by making investments in vehicles of moderate risk.

Individuals with similar goals usually form investment clubs to pool their knowledge and money to create a jointly owned and managed portfolio. Certain members are responsible for obtaining and analyzing data on a specific investment vehicle or strategy. At periodic meetings, the members present their findings and recommendations for discussion and further analysis by the membership. The group decides whether to pursue the proposed vehicle or strategy. Most clubs require members to make scheduled contributions to the club’s treasury, thereby regularly increasing the pool of investable funds. Although most clubs concentrate on investments in stocks and bonds, some may concentrate on specialized investments such as options or futures.

Membership in an investment club provides an excellent way for the novice investor to learn the key aspects of portfolio construction and investment management, while (one hopes) earning a favorable return on his or her funds. In fact, many investment clubs regularly earn returns above the market and even above professional money managers. The reason? Investment clubs typically buy stocks for the long term, rather than trying to make the quick buck.

As you might expect, investment clubs have also joined the online investing movement. By tapping into the Internet, clubs are freed from geographical restrictions. Now investors around the world, many who have never met, can form a club and discuss investing strategies and stock picks just as easily as if they gathered in person. Finding a time or place to meet is no longer an issue. Some clubs are formed by friends; others are strangers who have similar investing philosophies and may have met online. Online clubs conduct business via e-mail or set up a private Web site.

Members of the National Association of Investors Corporation (NAIC), a not-for-profit organization, qualify for a site at Yahoo! that includes meeting rooms, investment tools, and other investment features. Other portals offer sites for nonmembers.

NAIC, which has over 730,000 individual and club investors and 37,000 regular and online investment clubs, publishes a variety of useful materials and also sponsors regional and national meetings. (To learn how to start an investment club, visit the NAIC Web site at [www.better-investing.org](http://www.better-investing.org). Or order an
IN REVIEW

3.23 Describe the services that professional investment advisers perform, how they are regulated, online investment advisers, and the cost of investment advice.

3.24 What benefits does an investment club offer the small investor? Why do investment clubs regularly outperform the market and the pros? Would you prefer to join a regular or an online club, and why?

Discuss the growth in online investing, including educational sites and investment tools, and the effective use of the Internet. The Internet has empowered individual investors by providing information and tools formerly available only to investing professionals and by simplifying the investing process. The savings it provides in time and money are huge. Investors get the most current information, including real-time stock price quotes, market activity data, research reports, educational articles, and discussion forums. Tools such as financial planning calculators, stock-screening programs, charting, and stock quotes and portfolio tracking are free at many sites. Buying and selling securities online is convenient, relatively simple, inexpensive, and fast.

Identify the major types and sources of traditional and online investment information. Investment information, descriptive or analytical, includes information about the economy and current events, industries and companies, and alternative investment vehicles, as well as price information and personal investment strategies. It can be obtained from financial journals, general newspapers, institutional news, business periodicals, government publications, special subscription services, stockholders' reports, comparative data sources, subscription services, brokerage reports, investment letters, price quotations, and electronic and online sources. Most print publications also have Web sites with access to all or part of their content. Financial portals bring together a variety of financial information online. Investors will also find specialized sites for bond, mutual fund, and international information, as well as message boards that discuss individual securities and investment strategies. Because it is hard to know the qualifications of those who make postings on message boards, participants must do their own homework before acting on an online tip.

Explain the characteristics, interpretation, and uses of the commonly cited stock and bond market averages and indexes. Investors commonly rely on stock market averages and indexes to stay abreast of market behavior. The most often cited are the Dow Jones averages, which include the Dow Jones Industrial Average (DJIA). Also widely followed are the Standard & Poor's indexes, the NYSE composite index, the AMEX composite index, the Nasdaq indexes, and the Value Line indexes. Numerous other averages and indexes, including a number of global and foreign market indexes, are regularly reported in financial publications.

Bond market indicators are most often reported in terms of average bond yields and average prices. The Dow Jones bond averages are among the most popular. A
wealth of return and price index data is also available for various types of bonds and various domestic and foreign markets. Both stock and bond market statistics are published daily in the Wall Street Journal and summarized weekly in Barron’s.

Review the roles of traditional and online stockbrokers, including the services they provide, selection of a stockbroker, opening an account, and transaction basics. Stockbrokers facilitate transactions among buyers and sellers of securities, and they provide a variety of other client services. An investor should select a stockbroker who has a compatible disposition toward investing and whose firm offers the desired services at competitive costs. Today the distinctions among traditional, discount, and online brokers is blurring. Most brokers now offer online trading capabilities, and many no-frills brokers are expanding their services to include research and advice. Investors can open a variety of types of brokerage accounts, such as single, joint, custodial, cash, margin, and wrap. An investor can make odd-lot transactions (less than 100 shares) or round-lot transactions (100 shares or multiples thereof). An added fee is typically charged on odd-lot transactions.

Describe the basic types of orders (market, limit, and stop-loss), online transactions, transaction costs, and the legal aspects of investor protection. A market order is an order to buy or sell stock at the best price available. A limit order is an order to buy at a specified price or below or to sell at a specified price or above. Stop-loss orders become market orders as soon as the minimum sell price or the maximum buy price is hit. Limit and stop-loss orders can be placed as fill-or-kill orders, day orders, or good-till-cancelled (GTC) orders.

On small transactions, most brokers have fixed-commission schedules; on larger transactions, they will negotiate commissions. Commissions also vary by type of security and type of broker: full-service, discount, or online broker. The Securities Investor Protection Corporation (SIPC) insures customers’ accounts against the brokerage firm’s failure. To avoid litigation, mediation and arbitration procedures are frequently employed to resolve disputes between investor and broker. These disputes typically concern the investor’s belief that the broker either gave bad advice or churned the account.

Discuss the roles of investment advisers and investment clubs. There are a variety of different types of investment advisers, who charge an annual fee ranging from 0.25% to 3% of the dollar amount being managed and are often regulated by federal and state law. Web sites that provide investment advice such as retirement planning, asset diversification, and stock and mutual fund selection, are now available as well. Investment clubs provide individual investors with investment advice and help them gain investing experience. Online clubs have members in various geographical areas and conduct business via e-mail or at a private Web site.

Q3.1 Thomas Weisel, chief executive of a securities firm that bears his name, believes that individual investors already have too much information. “Many lose money by trading excessively on stray data,” he says. Other industry professionals oppose the SEC’s fair disclosure rule for the same reason. The Securities Industry Association’s general counsel expressed concern that the rule will restrict rather than encourage the flow of information. Other securities professionals argue that individual investors aren’t really capable of interpreting much of the information now available to them. Explain why you agree or disagree with these opinions.
Q3.2 Innovative Internet-based bookseller Amazon.com has now expanded into other retail categories. Gather appropriate information from relevant sources to assess the following with an eye toward investing in Amazon.com.
   a. Economic conditions and the key current events during the past 12 months.
   b. Information on the status and growth (past and future) of the bookselling industry and specific information on Amazon.com and its major competitors.
   c. Brokerage reports and analysts’ recommendations with respect to Amazon.com.
   d. A history of the past and recent dividends and price behavior of Amazon.com, which is traded on the Nasdaq National Market.
   e. A recommendation with regard to the advisability of investing in Amazon.com.

Q3.3 Visit four financial portals or other financial information Web sites listed in Table 3.4. Compare them in terms of ease of use, investment information, investment tools, advisory services, and links to other services. Also catalog the costs, if any, of obtaining these services. Which would you recommend, and why?

Q3.4 Gather and evaluate relevant market averages and indexes over the past 6 months to assess recent stock and bond market conditions. Describe the conditions in each of these markets. Using recent history, coupled with relevant economic and current event data, forecast near-term market conditions. On the basis of your assessment of market conditions, would you recommend investing in stocks, in bonds, or in neither at this time? Explain the reasoning underlying your recommendation.

Q3.5 Prepare a checklist of questions and issues you would use when shopping for a stockbroker. Describe both the ideal broker and the ideal brokerage firm, given your investment goals and disposition. Discuss the pros and cons of using a full-service rather than a discount or online broker. If you plan to trade online, what additional questions would you ask?

Q3.6 Visit the sites of two brokerages listed in Table 3.6 or any others you know. After exploring the sites, compare them for ease of use, quality of information, availability of investing tools, reliability, other services, and any other criteria important to you. Summarize your findings and explain which you would choose if you were to open an account, and why.

Q3.7 Describe how, if at all, a conservative and an aggressive investor might use each of the following types of orders as part of their investment programs. Contrast these two types of investors in view of these preferences.
   b. Limit.
   c. Stop-loss.

Q3.8 Learn more about day trading at sites such as Edgetrade.com (www.edgetrade.com), Daytrading Stocks (www.daytradingstocks.com), Intelligent Speculator (www.intelligentspeculator.com), and Rookie Day trader (www.rookiedaytrader.com). On the basis of your research, summarize how day trading works, some strategies for day traders, the risks, and the rewards. What type of person would make a good day trader?

Q3.9 Differentiate between the financial advice you would receive from a traditional investment adviser and one of the new online planning and advice sites. Which would you personally prefer to use, and why? How could membership in an investment club serve as an alternative to a paid investment adviser?
Problems

P3.1 Bill Shaffer estimates that if he does 10 hours of research using data that will cost $75, there is a good chance that he can improve his expected return on a $10,000, 1-year investment from 8% to 10%. Bill feels that he must earn at least $10 per hour on the time he devotes to his research.

a. Find the cost of Bill's research.

b. By how much (in dollars) will Bill's return increase as a result of the research?

c. On a strict economic basis, should Bill perform the proposed research?

P3.2 Imagine that the Mini-Dow Average (MDA) is based on the closing prices of five stocks. The divisor used in the calculation of the MDA is currently 0.765. The closing prices for each of the five stocks in the MDA today and exactly a year ago, when the divisor was 0.790, are given in the accompanying table.

<table>
<thead>
<tr>
<th>Stock</th>
<th>Closing Price Today</th>
<th>One Year Ago</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ace Computers</td>
<td>$ 65</td>
<td>$74</td>
</tr>
<tr>
<td>Coburn Motor Company</td>
<td>37</td>
<td>34</td>
</tr>
<tr>
<td>National Soap &amp; Cosmetics</td>
<td>110</td>
<td>96</td>
</tr>
<tr>
<td>Ronto Foods</td>
<td>73</td>
<td>72</td>
</tr>
<tr>
<td>Wings Aircraft</td>
<td>96</td>
<td>87</td>
</tr>
</tbody>
</table>

a. Calculate the MDA today and that of a year ago.

b. Compare the values of the MDA calculated in part (a) and describe the apparent market behavior over the last year. Was it a bull or a bear market?

P3.3 The SP-6 index (a fictitious index) is used by many investors to monitor the general behavior of the stock market. It has a base value set equal to 100 at January 1, 1970. In the accompanying table, the closing market values for each of the six stocks included in the index are given for three dates.

<table>
<thead>
<tr>
<th>Stock</th>
<th>Closing Market Value of Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>J une 30, 2002 (Thousands)</td>
</tr>
<tr>
<td>1</td>
<td>$ 430</td>
</tr>
<tr>
<td>2</td>
<td>1,150</td>
</tr>
<tr>
<td>3</td>
<td>980</td>
</tr>
<tr>
<td>4</td>
<td>360</td>
</tr>
<tr>
<td>5</td>
<td>650</td>
</tr>
<tr>
<td>6</td>
<td>290</td>
</tr>
</tbody>
</table>

a. Calculate the value of the SP-6 index on both January 1, 2002, and June 30, 2002, using the data presented here.

b. Compare the values of the SP-6 index calculated in part (a) and relate them to the base index value. Would you describe the general market condition during the 6-month period January 1 to June 30, 2002, as a bull or a bear market?

P3.4 Carla Sanchez wishes to develop an average or index that can be used to measure the general behavior of stock prices over time. She has decided to include six closely followed, high-quality stocks in the average or index. She plans to use August 15, 1978, her birthday, as the base and is interested in measuring the value of the average or index on August 15, 1999, and August 15, 2002. She has found the closing
prices for each of the six stocks, A through F, at each of the three dates and has calculated a divisor that can be used to adjust for any stock splits, company changes, and so on that have occurred since the base year, which has a divisor equal to 1.00.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$46</td>
<td>$40</td>
<td>$50</td>
</tr>
<tr>
<td>B</td>
<td>37</td>
<td>36</td>
<td>10</td>
</tr>
<tr>
<td>C</td>
<td>20</td>
<td>23</td>
<td>7</td>
</tr>
<tr>
<td>D</td>
<td>59</td>
<td>61</td>
<td>26</td>
</tr>
<tr>
<td>E</td>
<td>82</td>
<td>70</td>
<td>45</td>
</tr>
<tr>
<td>F</td>
<td>32</td>
<td>30</td>
<td>32</td>
</tr>
<tr>
<td>Divisor</td>
<td>0.70</td>
<td>0.72</td>
<td>1.00</td>
</tr>
</tbody>
</table>

Note: The number of shares of each stock outstanding has remained unchanged at each of the three dates. Therefore, the closing stock prices will behave identically to the closing market values.

a. Using the data given in the table, calculate the market average, using the same methodology used to calculate the Dow averages, at each of the three dates—the 15th of August 1978, 1999, and 2002.

b. Using the data given in the table and assuming a base index value of 10 on August 15, 1978, calculate the market index, using the same methodology used to calculate the S&P indexes, at each of the three dates.

c. Use your findings in parts (a) and (b) to describe the general market condition—bull or bear—that existed between August 15, 1999, and August 15, 2002.

d. Calculate the percentage changes in the average and index values between August 15, 1999, and August 15, 2002. Why do they differ?

P3.5 Al Cromwell places a market order to buy a round lot of Thomas, Inc., common stock, which is traded on the NYSE and is currently quoted at $50 per share. Ignoring brokerage commissions, how much money would Cromwell probably have to pay? If he had placed a market order to sell, how much money will he probably receive? Explain.

P3.6 Imagine that you have placed a limit order to buy 100 shares of Sallisaw Tool at a price of $38, though the stock is currently selling for $41. Discuss the consequences, if any, of each of the following.
   a. The stock price drops to $39 per share 2 months before cancellation of the limit order.
   b. The stock price drops to $38 per share.
   c. The minimum stock price achieved before cancellation of the limit order was $38.50. When the limit order was canceled, the stock was selling for $47.50 per share.

P3.7 If you place a stop-loss order to sell at $23 on a stock currently selling for $26.50 per share, what is likely to be the minimum loss you will experience on 50 shares if the stock price rapidly declines to $20.50 per share? Explain. What if you had placed a stop-limit order to sell at $23, and the stock price tumbled to $20.50?
Case Problem 3.1

The Perezes’ Good Fortune

Angel and Marie Perez own a small pool hall located in southern New Jersey. They enjoy running the business, which they have owned for nearly 3 years. Angel, a retired professional pool shooter, saved for nearly 10 years to buy this business, which he and his wife own free and clear. The income from the pool hall is adequate to allow Angel, Marie, and their two children, Mary (age 10) and José (age 4), to live comfortably. Although he lacks formal education beyond the tenth grade, Angel has become an avid reader. He enjoys reading about current events and personal finance, particularly investing. He especially likes Money magazine, from which he has gained numerous ideas for better managing the family’s finances. Because of the long hours required to run the business, Angel can devote 3 to 4 hours a day (on the job) to reading.

Recently, Angel and Marie were notified that Marie’s uncle had died and left them a portfolio of stocks and bonds with a current market value of $300,000. They were elated to learn of their good fortune but decided it would be best not to change their lifestyle as a result of this inheritance. Instead, they want their newfound wealth to provide for their children’s college education as well as their own retirement. They decided that, like their uncle, they would keep these funds invested in stocks and bonds. Angel felt that in view of this, he needed to acquaint himself with the securities currently in the portfolio. He knew that to manage the portfolio himself, he would have to stay abreast of the securities markets as well as the economy in general. He also realized that he would need to follow each security in the portfolio and continuously evaluate possible alternative securities that could be substituted as conditions warranted. Because Angel had plenty of time in which to follow the market, he strongly believed that with proper information, he could manage the portfolio. Given the amount of money involved, Angel was not too concerned with the information costs; rather, he wanted the best information he could get at a reasonable price.

Questions

a. Explain what role the Wall Street Journal and/or Barron’s might play in meeting Angel’s needs. What other general sources of economic and current event information would you recommend to Angel? Explain.

b. How might Angel be able to use the services of Standard & Poor’s Corporation, Moody’s Investor Services, and the Value Line Investment Survey to learn about the securities in the portfolio? Indicate which, if any, of these services you would recommend, and why.

c. Recommend some specific online investment information sources and tools to help Angel and Marie manage their investments.

d. Explain to Angel the need to find a good stockbroker and the role the stockbroker could play in providing information and advice. Should he consider hiring a financial adviser to manage the portfolio?

e. Give Angel a summary prescription for obtaining information and advice that will help to ensure the preservation and growth of the family’s newfound wealth.
Case Problem 3.2

Peter and Deborah’s Choices of Brokers and Advisers

Peter Chang and Deborah Barry, friends who work for a large software company, decided to leave the relative security of their employer and join the staff of OnlineSpeed Inc., a 2-year-old company working on new broadband technology for fast Internet access. Peter will be a vice president for new-product development; Deborah will be treasurer. Although they are excited about the potential their new jobs offer, they recognize the need to consider the financial implications of the move. Of immediate concern are their 401(k) retirement plans. On leaving their current employer, each of them will receive a lump-sum settlement of about $75,000 that they must roll over into self-directed, tax-deferred retirement accounts. The friends met over lunch to discuss their options for investing these funds.

Peter is 30 years old and single, with a bachelor’s degree in computer science. He rents an apartment and would like to buy a condominium fairly soon but is in no rush. For now, he is happy using his money on the luxuries of life. He considers himself a bit of a risk taker and has dabbled in the stock market from time to time, using his technology expertise to invest in software and Internet companies. Deborah’s undergraduate degree was in English, followed by an M.B.A. in finance. She is 32, is married, and hopes to start a family very soon. Her husband is a physician in private practice.

Peter is very computer-savvy and likes to pick stocks on the basis of his own Internet research. Although Deborah’s finance background gives her a solid understanding of investing fundamentals, she is more conservative and has thus far stayed with blue chip stocks and mutual funds. Among the topics that come up during their lunchtime conversation are stockbrokers and financial planners. Peter is leaning toward a bare-bones online broker with low cost per trade that is offering free trades for a limited time. Deborah is also cost-conscious but warns Peter that the low costs can be deceptive if you have to pay for other services or find yourself trading more often. She also thinks Peter is too focused on the technology sector and encourages him to seek financial advice to balance his portfolio. They agree to research a number of brokerage firms and investment advisers and meet again to compare notes.

Questions

a. Research at least four different full-service, discount, and online stock brokerage firms, and compare the services and costs. What brokers would suit Peter’s needs best, and why? What brokers would suit Deborah’s needs best, and why? What are some key questions each should ask when interviewing potential brokers?

b. What factors should Peter and Deborah consider before deciding to use a particular broker? Compare the pros and cons of getting the personal attention of a full-service broker with the services provided by an online broker.

c. Do you think that a broker that offers no online trading but focuses on personal attention would be a good choice for either Peter or Deborah?

d. Peter mentioned to Deborah that he had read an article about day trading and wanted to try it. What would you advise Peter about the risks and rewards of this strategy?

e. Prepare a brief overview of the traditional and online sources of investment advice that could help Peter and Deborah create suitable portfolios. Which type of adviser would you recommend for Peter? For Deborah? Explain your reasoning.
W3.1 S&P indexes are available at www.spglobal.com. The S&P 500 is used by 97% of U.S. money managers and pension plan sponsors. More than $1 trillion is indexed to the S&P 500. Click on [S&P Global 1200] and then [Description].
   a. List the six regional indexes.
   b. Now click on [Sector Indices]. Identify the first three sectors.
   c. Go back to the main page and check out the descriptions of a few international indexes.

W3.2 From the main page at www.spglobal.com, click on [U.S. indices], [Supercomp 1500].
   a. Describe the portfolio characteristics of the S&P SuperComposite 1500.
   b. Now click on [S&P 500]. Describe its portfolio characteristics.
   c. What are the differences between the S&P 500 and the SuperComposite 1500?

W3.3 The economy at a glance is shown at stats.bls.gov/eag/eag.map.htm. Check [U.S. Economy at a Glance.] and later [Industry at a Glance]. At the Economy at a Glance site (stats.bls.gov/eag/eag.us.htm), you can see 6 months of data on key economic figures: the unemployment rate, change in payroll employment, consumer price index, producer price index, U.S. import price index, employment cost index, and productivity.
   a. At the Economy at a Glance site, for each economic indicator (such as the unemployment rate), under History you can access both the 10-year historical data and a graph of the data for over a decade. Access either data or graph for Unemployment rate, and describe what happened over the last decade.
   b. Click on your home state to see how the economy is there.
   c. Industry at a Glance contains profiles of the nine major industry groups. Which are the top four industries from the standpoint of employment?

W3.4 Visit the Wall Street Research Net at www.wsrn.com. Go to [Calendars], [Earning Announcements].
   a. List the earnings announcement information (date, time of day, quarter) for any three companies. What impact did the announcement have on the price of the company's stock on that date? Offer an explanation of why the stock price reacted as it did.
   b. At the same site, go to [Economic Calendar]. What is on the calendar for the latest date?
   c. This site has nice links to the Department of Commerce, Economic Research (has several domestic-economics-related links, such as Conference Board Consumer and Business Confidence, Economic Statistics Briefing Room, StatUSA, and Yardeni’s site) and International Research (has links such as Oxford Economic Forecasting, United Nations System of Organizations, and World Bank Group). Check out some links that interest you. Write a brief description of what you found (be sure to include the address of the site) to share with your class.

W3.5 Go to www.quicken.com/investments/charts. This site lets you compare as many as nine stocks and/or indexes on the same chart. Enter the following ticker symbols:
   MRK INTU INTC SLE IBM ADM MSFT AOL F
   a. What companies do these nine ticker symbols stand for?
   b. Compare their 3-year closing prices.