INTRODUCTION TO THE EQUITIES & MONEY MARKETS

(It*'s easier than you think*)

A short introduction for those who want to enter but feel intimidated

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ACKNOWLEDGEMENTS

Writing this Paper was a labour of love for me – an amateur investor with a problem. My problem?! A little word spelt……….

M - O - N - E - Y

or, to be more precise, not enough of it. But what the heck! If I have the intention now maybe I, (AND YOU, TOO) will find the money later.

Seriously though, it was also a labour of love, (or something close to that), for two other people to whom I am deeply indebted. They are Miss Karen Peart, whose typing fingers have nearly been typed off, and Mr. Brian Allen, Financial Analyst and General Manager, M/VL Stockbrokers Ltd., who was kind enough to critique the Document.

Mr. Allen made some very valuable comments/suggestions that have added immeasurably to the outcome but it must be clearly understood that I am completely responsible for any shortcomings that the Paper may contain.

Comment in Nov 2004

I have been tempted to upgrade this Primer but have decided against it for two reasons inter alia. One is that, for my own continuing fascination with The Market, I want to preserve something that speaks directly to what it was at the time of writing.
The other is that, in due time, I hope to write another Essay which, hopefully, will speak more closely to some of the things which have happened since this edition eg, the complete removal of double taxation on dividends over the three year period of 2000 to 2002

That new Essay will also look at the 1993-2002 period which some call Dr. Omar Davies' Decade of Poverty while others call it his Decade of Individual Prosperity. The 'prosperity' part refers to the generous opportunities that the Minister's Policies presented, through sky high interest rates, to create personal wealth by those who could winnow the 'interest income nuggets' from the 'gold dust' of 'mopping up excess liquidity' The two contrasting perspectives present many important lessons. One is that one man's 'worst of times' may very well be another's 'best of times'. But more anon Frequently Asked Questions (FAQs) are here

INTRODUCATION

1. Let's begin at the beginning. What is "the market"?! Is it the same as the "going to the market," i.e. Constant Spring or Coronation Ma rkets in Kingston or that in the square of each town and parish capitals across Jamaica!

2. Yes and no. Yes, because, like at the food markets**,** goods and services (food), are exchanged (bought/sold) for money, and, at the Stock Market goods and services (stocks and shares) are exchanged (bought/sold) for money also. No, because in the food market the buyer (housewife) meets seller face to face and decides on a price, whereas in the stock market buyer and seller don't face and haggle (the best part of going to the food market?!) with each other. Instead, they do their exchange, or trading, through middle people known as Brokers or, more specifically, Stockbrokers.

3. So, what is the Stock Market?! It is like the food market, but people buy and sell stocks instead of food. But what is a stock anyway? NCB Limited is a stock. So are Caribbean Cement Company, Desnoes & Geddes Limited and every other Company that is listed on the Jamaica Stock Exchange. The word "stock" refers to a company and the word "share" refers to the units of ownership that make up that company. To clarify, just think of a house which is built with building blocks. It could be said that the house is made up of, say, 1,000 concrete building blocks. If four (4) brothers bought the blocks, say, 250 blocks each, we could say that each is a block owner, or block-holder in that house.

4. A Business entity, like National Commercial Bank (NCB), or Caribbean Cement Company or Desnoes & Geddes, is similarly made up of "building blocks." At August, 1994, NCB had approximately 692 million of these "building blocks" or shares; Caribbean Cement Company had 281 million and Desnoes & Geddes had 60.8 million. In the Stock market the building blocks of a company are called and known by two interchangeable names – stocks and shares, but to the purists, a share is one unit of stock. Like with the house, many different persons can own these shares by buying them through a Stockbroker. When this happens, the purchaser of these shares/stocks becomes a shareholder or a stockholder in that company. In plain language, he is now a part-owner of that company, even if he only has the very minimum number of shares that any person is allowed to own.

Who Invests in "The Market"

5. The Equities market, through the Jamaica Stock Exchange, came into being, officially, about 1968/69 but, prior to this, shares were traded through what was called the "Kingston Stock Market Committee." This Committee was comprised mainly of branches of overseas Banks and Stock-broking Companies. Up to very recent times, say the mid to late 1980's however, only a few business and professional persons understood and "played" it. Then too, for a variety of reasons, (beyond the scope of this basic primer), the market remained "flat", meaning that the amount of buying and selling of shares was not exactly overwhelming.

6. However, the rank and file of Jamaicans started entering the market with the first phase of wide scale divestments of government controlled companies, such as the NCB, the Caribbean Cement Company and the Caribbean Steel Mill in Spanish Town. This upsurge in market participation was probably engendered by the massive advertising and P.R. campaign, paid for with our taxes, that was launched to help ensure that those "issues" would be successful.

7. It is probably fair to say however, that the "market" is still dominated by a small percentage of the potential and, that this potential is still untapped because many people are still intimidated by the hype that surrounds it, (the market).

8. The important point to make though is that, whereas there are no guarantees in the Equities Market (unlike in the Money Market), and one could lose "his shirt", the potential also exists for him to make very respectable capital appreciation such that he could buy many 'silk' shirts!.

9. Illustration of the latter is the run up of the "Bull Market" between say, 1991 and its peak in February of 1993 when the Market Index soared to 32,340.78 points. At that time, our Market was rated the fastest growing in the so-called Developing World. Result?! Many Jamaicans became millionaires!! These were the informed (or was it luck?!), players whose "timing" was dead on! That is to say, they sold their shares at the peak of the market when prices of individual shares were high. These "players" would have enjoyed significant capital gains (or capital appreciation) since the end of say 1991 when the market index was at a mere 7684.5 points.

10. A good illustration of losing "one's shirt" follows ironically, right after the "killing" that the good "timers" had. Following right on the market peak at February 1993, the market declined to a precipitous 13,099.68 at December 1993 and continued to a "new" low of 10,648.64 (26-01-1994). At the time of writing in August, 1994, it was at 15,484.36 (Thursday August 25), having lost a total of 395.55 points during that week despite indications that our high interest rates are now on their way back down. Timing, that is, when one buys (and at what price), and when he sells, is one of the most important determinants of capital appreciation especially in a volatile market.

11. But, the good news remains intact – over time most stocks tend to appreciate and the market, in general, tends to keep ahead of inflation.

    So who else should invest in the market?! YOU!!

SOME BASIC OPERATIONAL CONCEPTS

12. Every sphere of activity has its own peculiarities and nuances and The Stock Market is no exception. As we progress, many of these nuances will be introduced because, a good grasp of each will facilitate the ease with which we become market players ourselves.

The Capital Market

13. Money and how it is used, is a good place to start. For easy reference, we could say that the Financial or Capital markets can be broken down into two broad categories. These categories are (a) the Money, and (b) the Equities Markets. The essential difference between the two is the ease with which the money in each can be converted into spendable cash. The Money market consists of instruments such as Treasury Bills, Bonds and Commercial Paper, each of which can be converted to cash within short periods of time.

The Equities Market

14. The Equities Market, on the other hand, consists of the other instruments that have a long life span and are not as easily converted to cash especially in distressed markets. Two prime illustrations of these are Common Stock, (or shares) and real estate.

Common Stock

15. In our reference to the Stock Market, we drew on the similarity (paragraph 3), with the building blocks that are used to construct a house and concluded that those concrete blocks were the units of construction by which a house is built. At paragraph 4, we also concluded that each Business Entity was made up of thousands or millions of these "building blocks", each of which we called a unit of stock or a share.

16. We could now advance this to the next stage and say that these "building blocks" or shares are what are referred to as Common Stock or Common Shares in a company. When one owns common stock in a company, he owns a part of that company, however small, and ownership of these common stocks gives him some basic rights and privileges in that company.

Some of these rights and privileges are:-

a) entitlement to attend and vote at Annual General Meetings

b) entitlement to a proportionate part of the trading surplus of the company which is distributed as dividends

c) entitlement to vote on any special resolutions affecting the management of the company

d) entitlement to a proportionate part of any new stock which is created by way of Bonus Issues or Stock Splits

e) entitlement to proportionate amount of any warrants issued to any holders of common stocks

The conditionalities of common stock investing

17. There are, however, two sides to the coin of ownership of common stock. Whereas one enjoys all the benefits of ownership on the upside, he must also accept the conditionalities on the down-side. One of the main downsides is that there is no guarantee of profits or of profit distribution (dividends) even when there is a profit. Happily however, most companies do make some profit though all profitable companies will not necessarily pay dividends. Instead, they may use all the profits to build up the business and depend on the appreciation in the share price to give value to their shareholders

Preferred Stock

18. Whereas Common Stock is the main building block in the make-up of a company's capital stock, there can be other types of "capital blocks". Two of these are Preferred Shares and Bonds/Debentures

19. A Preferred share is one which confers some special privileges to its owner. This share enjoys some preferential treatment and hence its name. Examples of these preferential treatments are:-

    a) prior claim ahead of common shares for payment of dividend when there is surplus;

    b) the privilege of accumulating any unpaid dividend to a time when the company can pay

    c) privilege to convert these preferred shares into common stock at the election of the owner, (where this arrangement was a part of the preferred package).

20. Like its common stock counterpart though, preferred shares have their own downside. Three of the more important ones are:

    a) their dividend rate is fixed and permanent. This may be good in lean times, but could be a negative in very buoyant times when dividend rate on 'Commons' is way above what is guaranteed to Preferreds.

    b) They can be "taken out of circulation" by the Company if its (the company's) growth rate is running ahead of program and this facility was a part of the package. This process of "taking out of circulation" is known as "calling" the Preferred, or "redeeming" them. To redeem or call these shares, the Company must "buy" them from their owners by paying a price that was also a part of the preferred package.

    c) Preferreds do not participate in Bonus Issues and Stock Splits which are given on common shares.

Bonds (or Loan Financing)

21. A Bond, in simple language, is a "borrows" – a loan. When a Company "issues" Bonds, it means that it borrows money from the persons who take up those "issues" or Bonds. It is a characteristic of the Money and Equities Markets that people don't seem to talk in straight forward language but, with a little effort, we can dispel the mystique and understand what they are saying. Bonds, or debt securities (loan financing) are the third most common financial blocks in the building of a Company's Capital Structure or Financial House. To advance the illustration – we could say that: -

    a) Common Stocks are the foundation, the corners and main uprights

    b) Preferred Stocks make up some of the walls

    c) Bonds/loans are the roof

22. Just as it is possible to build a house completely with just blocks and concrete, i.e. foundation, walls and roof with concrete, so too can a business entity or company get all its financing from common stock.

    Where, however, it is considered desirable, a house builder could have concrete foundations, wooden walls and zinc roofing – three different materials. In a

roughly similar way a Company could "structure" its financial house to include Common Stocks, Preferred Stocks, and Bonds.

23. The most important characteristic of Bonds is that they are LOANS – loans to be paid back, with interest to the loan givers who are called bond-holders. Another major characteristic of Bonds is their long-term nature. These loans are usually for periods of five (50 or ten (10) years or more – with many of these also in the 20-30 year range.

24. When a Company takes these long-term loans, i.e. issues Bonds, they also commit themselves to pay interest at uniform periods be it quarterly, half yearly, or yearly until the end of the loan period when they must repay the loan itself, i.e. the principal.

25. There was a time when each Bond Certificate would have a detachable portion that corresponds with each interest-payment-period. These detachable portions are called "coupons". Hence, a Bond-holder would present his coupons in exchange for his periodic interest payment.

26. A few years ago, the concept of a Bond with no periodic interest payment became very popular. With this kind of Bond all the interest keep on building up, i.e. accrue until the loan principal (Bond) is to be repaid. This kind of Bond is called Zero-coupon Bond. The repayment time for a Bond is called the maturity period.

Advantages of Bond-holders

27. Like Common and Preferred Stocks, Bonds have their own unique advantages. The principal among these is that Bond-holders, being loan givers or creditors, have first priority claim on company surplus. This means that Bonds or Loan interest must be paid FIRST from Company profits before dividends can be paid to anyone else. In order of rank, the payment schedule is:-

    First - Bondholders

    Second - Preferred Stock-holders

    Third - Common Stock-holders

28. In order to sweeten a bond issue, companies sometimes incorporate many incentives. One of the leading incentives is a facility by which a bond-holder can convert his Bond, or loan, into common stock. This might be an attractive option to bond-holders in companies that are doing well and where future growth prospects are good.

PAYING OFF THE LOAN 'BEFORE TIME'

29. In the same way that a bond-holder may get the option to Convert his bond into common stock; the Bond issuer could also retain the opposite option of retiring the Bond, i.e. pay off the loan ahead of the10, 20 or 30 year schedule. Where the Bond issuer has this option, the Bond is said to be callable. When the issuer calls the Bond and pays it off, he is said to have redeemed it and the process is called a "Redemption"

30. The concept of interest rate is a very important one in respect of Bonds when we remember that a Bond is really a loan.

    Every loan is given at a certain rate of interest. Interestingly, if a bondholder runs short on cash he can sell his Bond and get cash ahead of its maturity date. There is a big market in which Bonds can be sold over and over again just like shares.

31. To make a Bond attractive to lenders/investors, it must carry an attractive rate of interest. Suppose 10% was such a rate for a 20 year Bond but, four (4) years after issue, interest rates in the market shoots pass it to say 15%!! This means that investors in this 10% Bond would still be getting the guaranteed 10% when other investors could now get 15% on the new Bond A. Result?!! Bond-holders would want to sell their 10% Bonds and use this money to invest at the now available rate of 15%.

32. But, would anybody buy these 10% Bonds?! The answer is "Yes" Other investors will buy them but only at a reduced price to reflect the fact that its interest rate is lower than that of the market. If a Bond has to be sold after it loses its value like this it will only be bought by other investors at a lower price. This lower price is called a discounted price– less than original cost.

33. If, on the other hand, interest rate in the market had dropped to say 6% four years after the 10% Bond was issued, the reverse situation would apply. That is, the 10% Bond would now be earning way ahead of the new 6% bond and many investors would want to buy that 10% Bond. What price would they now have to pay? One that is higher than the original cost. When this happens, i.e. investors pay a higher price than the original, they are said to pay a premium price.

34. Based on the above two illustrations, it was shown that when interest rates rise in relation to that of an existing Bond, the value of the Bond falls. Alternatively, when interest rates fall in relation to that of an existing Bond, the value of the Bond rises. Investment dealers use a standard formula to determine what the discount (lower) and premium (higher) price should be.

DEBENTURES

(Pronounced Debenchers)

35. A Bond is a heavily documented corporate loan instrument which must usually be backed by collateral. There are some companies though, who, like some individuals, do get loans purely on the strength of their personal word and commitment. Companies in this respected category are called Blue Chip companies. Usually, because of their financial strength and the integrity of their management, these companies can get short-term loans without pledging specific collateral. When they get this un-backed loan, the loan is called a Debenture. Its repayment is backed or guaranteed only by the good name and credit rating of the Company that gets it. These loan periods are usually measured in days (30 – 180), rather than years. They are usually short-term or bridging loans.

DIVIDENDS

36. When a company is doing well, it will generate surplus cash each year. After meeting contractual (Bond Interest), and statutory obligations (taxes, etc.), it will likely:

a) retain some of the surplus for its on-going needs

b) distribute some among its Preferred and Common Stock-holders.

This distribution among Stock-holders is called Dividend Distribution. Each payment reflects the number of stock units that each stock-holder has.

37. **NOTE:** Dividend payments in most countries are fraught with what is called double taxation because, the Company is taxed on it is profits and, when it distributes some of it as dividends, these dividends are again taxed "in the hands" of the Share-holders. In actual practice, this tax is taken by the company on behalf of the revenue authorities so that what the stock-holder gets is a net payment.

Current taxation rates are:

NOTE: At time of writing in 1994/5, th tax Rate on dividends were
Corporate profit - 33 1/3%
Individual dividend - 25%
However, over the three (3) year period of 2000-2002, this tax on dividends was progressively removed to zero percent (o%)

Dividend Yield (or Current Yield)

38. Investors sometimes like to compare the dividend on stocks with the interest on Bonds and other debt securities. To do this, they have to calculate what is called the Dividend Yield. This Yield is a measure of how much dividend a stock is paying compared with its current price. The formula for computing it is dividend (cents) divided by share price (also expressed in cents) multiplied by 100. Therefore, every time a dividend is paid, whether this is quarterly, half yearly or yearly, investors compare the amount of dividend payment with the price of the stock and compute a new yield which is called Current Yield Percentage. For example, following its 1994 half yearly report as at March 31, the NCB Group declared a dividend of 6 cents per stock unit, payable to everyone who owned shares on May 27, 1994, (called Record Date)

39. Earlier in its trading year, (October – September), the Bank had also paid an interim dividend of 8 cents. When combined, both payments add up to 14 cents Y.T.D. Since at trading on Thursday, August 25, 1994, the price of a NCB share was $5.25 and since the dividend payment is the same 14 cents, it means that the current yield is 14 cents divided by 525 x 100 = 2.7%. The significance of current yield (in relation to stocks), is that it tells a share-holder how much of the price of the stock he is getting each year as dividend. This, by extension also tells him how many years it will take him to get back his purchase price through dividend payments.

HOW COMPANIES ARE FINANCED

40. There are two basic ways to finance a company start-up and these two can be combined to form a third way. When an individual wants to start or expand a business, the two basic ways of getting capital are:

a) take it from his own savings or that of his friends or family

b) borrow it from a bank, his friends or family

41. Method 40(a) is called Equity Financing because the organizers put in their own hard cash or equity. Method 40(b) is called Debt Financing because the business organizers borrow the capital to start it. It is never advisable and, no bank would lend 100% financing to start a company anyway so, a third method is to combine 40(a) and 40(b) to effect a joint debt/equity financing.

42. In practical business situations, the Equity financing of a company could be:-

a) Common Stock - total or major portion

b) Preferred Stock - minor portion

43. In respect of debt financing, the break-out could be:-

a) Bank loan

b) Bonds and Debentures

c) Commercial Paper

<u>NOTE:</u> Essentially, commercial paper is short term loans between blue chip companies versus getting these loans from banks.

44. In respect of the combined financing method it could be any combination of debt and equity.

WHO GETS THE MONEY WHEN ONE BUYS STOCKS/SHARES

45. In broad terms, one can buy stocks or shares at one or both of two times:

a) when the stock is coming on the market for the very first time as part of the capitalization of a company, or,

b) after the shares have been bought by other "players" in the market

46. In the case of 45(a) (see at How Companies are Financed), one is dealing with what the trade calls an I.P.O. – meaning Initial Public Offering. When an investor buys shares at this initial offering, the purchase money goes directly to the company that floats the issue. Since the advent of the Jamaican Stock Market in 1969, more than $3 billion have been raised by companies who have gone to the capital market in search of funding for their start up operations.

47. For example, when Caribbean Cement Company went to the market in 1987, it sold about 125 million shares to the public at $2.00 per share. Since this was an initial sale by the company itself, the total sales price of approximately $250 million went directly into the coffers of the Cement Company as revenue for its management to use as it saw fit. This initial selling of shares is referred to as the Primary Market for shares. In this Primary Market, the purchase price of shares goes to the company that sells them.

48. Since then, every Cement Company stock-holder has been free to sell his shares whenever he wishes and at whatever price he could get (through his Stock-broker). When the holder of a stock sells that stock, the purchase price goes to him after paying his Broker and other mandated fees. Similarly, when he, or anyone else, buys stock that is owned by another shareholder, the purchase price goes to the seller minus Broker and other mandated fees. This subsequent buying and selling of shares after the initial public offering is called the secondary market. In this secondary market, nothing whatever goes to the company whose shares are being bought and sold between willing traders.

WHAT IS THE STOCK MARKET AND WHAT IS ITS IMPORTANCE?

49. The Stock Market is not necessarily a specific identifiable location. However, for better logistical operation, it makes sense to have a specific geographical location In general, though, the phrase refers, in generic terms, to the availability of stocks to be traded and a facility through which trading can take place. This facility could be located anywhere that is convenient for sellers and buyers of stock to meet.

50. In practical terms, the facility for trading is called the Stock Exchange and the place where sellers and buyers meet in Jamaica to exchange stocks, i.e. buy and sell, is the "floor" of the Jamaica Stock Exchange, presently located in the Bank of Jamaica Building. In America, an equivalent place of trading is 'the floor' of the New York Stock Exchange.

WHAT IS THE STOCK MARKET INDEX?

51. Once a Stock Market comes into operation, a way has to be found to measure the trading activity and **value** of the stocks traded. To do this, the managers of Exchanges have devised a way to give a numerical value to this trading activity. This numerical value is the Trading Index. In practical terms, it is the addition of the **value** of all the stocks that are traded and then this total value is divided by the **number** of stocks traded. In recent times however, some Exchangers have refined their divisor to a figure other than the exact number of stocks traded to suit the peculiarities of their own situation.

52. The higher the individual price of the stocks goes on an Exchange, the higher is the Stock Market Index likely to go above its base or starting point. The shares of different companies, even if they were to sell at the same price, would however, have different impacts on the Exchange's index. The variable in this case would be the relative number of shares that each company has. The greater the number of shares of company X, the greater is the impact of a price variation of its shares on the value of the Index. At the time of writing (1994/5) , on the Jamaica Stock Exchange, the three companies with the biggest potential impact on the Index would be :-

T.O.J.	3, 862,735	shares at August 1994
B.N.S.	731,808	shares at August 1994
N.C.B.	691,604	shares at August 1994

53. The base year for the Jamaica Stock Exchange is 1969 and the base Index was 100 points. Since then the Index has seen very good and very bad times. Following are some illustrations of where the Index has been:

DATE	**INDEX**
January 21, 1988	1,572.09
September 29, 1988	1,295.73
January 09, 1990	2,075.85
February 27, 1990	1,897.95 (low point)
December 29, 1990	2,539.39 (high point)
January 1992	7,681.50
December 31, 1992	25,745.88 (highest value to that point 235% increase in the year See at paragraph 9 for the Current record of 32,340.78 at February 1993.

WHAT IS THE IMPORTANCE OF THE INDEX?

54. Since the Index records the value of each unit of stock and **measures** the **market** value of each company as reflected by the price that buyers pay for its shares, it follows that the Index is a very valuable market indicator of how traders see or perceive the market which, roughly translated, really means the Economy.

A rising Index (indicating what is called a Bull Market), says that traders have confidence in the future prospects for dividends on shares while they keep them, and capital appreciation if they elect to sell them. Also, the Index gives an immediate value of each listed company through the simple expedient of multiplying each of its shares by the value at which traders buy and sell those shares at any particular time.

HOW DOES ONE MAKE MONEY IN THE STOCK MARKET?

55. The number one attraction of the Stock Market, if one is an Entrepreneur, is the potential to raise capital to finance his business operation. If one is an investor, that number one attraction is the potential to multiply the value of his investment. In "How Companies are Financed" (paragraph 40), we dealt with the former.

56. With respect to the latter there are five basic ways to make money in the market. Each of the five is related to the others but, for clarity, these are through :

a) Dividend payments (earn income)

b) Appreciation in share value (get capital gains)

c) Bonus issues which increase the number of shares and simultaneously, company capitalisation

d) Stock splits which also increase the number of shares but without simultaneously increasing company capitalisation

e) Exercise of warrant/options/rights which can also increase one's number of shares and company capitalisation

57. Some companies have the ability to pay dividends on a very regular basis. Two, namely Bank of Nova Scotia Jamaica Limited, and Grace Kennedy Company Limited, pay on a quarterly and half yearly basis respectively. Bank of Nova Scotia, for example, paid about 80 cents per share during the 1993 financial year.

This means that a Shareholder with, say 10,000 shares would have grossed a total of $8,000 for that year and still has his 10,000 shares to sell any time he wishes. Retired persons like good dividend paying stocks because of the income these dividends provide

58. Probably the fastest way to make (and lose) money in The Stock Market is through appreciation (and depreciation) of the value of individual stocks. The following list illustrates this:

Stock	High Price in 1992 ($)	Low Price in 1988 ($)	% Gain
BNS	34.00	6.20	448.4
Island Life	80.10	6.75	1085.2
Carrears	41.50	2.95	1306.8

Cement Co.	20.10	1.38	1356.5
Pegasus Hotel	90.00	1.67	5289.2

The persons who bought Pegasus Hotel at its low price of $1.67 in 1988 and sold it at $90.00/share in 1992 would have made 5289.2% on their investment over four (4) years. This is 1,322.3% per year over the period – more than an excellent investment return.

This is an illustration of the Stock Market at its bountiful best. Of course, The Market is not always this bullish and this is why the concept of timing (knowing when to buy and/or sell) is so important when one wants to maximize his profit-taking opportunities.

59. The third way to make money in the Market is through the issue of Bonus Shares. Bonus Shares, as the name suggests, are additional shares that a Company creates and distributes among its shareholders, without those shareholders taking money from their pockets to pay for them. Once these bonus shares are issued they also rank pari passu with previously existing shares in respect of subsequent dividend distribution. Additionally, if he so wishes, the owner of these new shares could sell them. That sales price would be pure profit. Of course, if a 1 for 1 bonus was given on a $10.00 share that 1 for 1 bonus would now become two shares and the original $10 price for one would now become $5.00 for each of the two "new" shares. The issuing of bonus shares is one way to build up a company's capital base (through the re-investing of operating surplus versus paying it out as dividend) and market capitalization (especially if investors react positively by pushing up the individual value of the increased number of shares.

60. Between 1990 and December 1992, many companies gave bonus shares to their shareholders. Some of these are Bank of Nova Scotia, Carib Steel, Carreas, CIBC, Jamaica Producers, Jamaica Pegasus Hotel, Seprod and Trafalgar Development Bank. In the case of the Jamaica Pegasus, it was all of 9 bonus shares for every one held! Talk about how money is made in The Market!

61. A good illustration of how bonus issues can make money for a stockholder is given by the case of CIBC (Canadian Imperial Bank of Commerce). At its Initial Public Offering in 1988, $5,000 was used to buy 1,918 shares at $2.40 each. Between 1990 and June 1993 the company gave bonus shares a total of five (5) times with the result that the initial 1,918 units of stocks grew to 12,783 units.

62. If, at the Stock's 1993 high point of $44 these stocks were sold, they would have grossed a total of $562,452 for the initial investment of $5,000, the impact of inflation not withstanding.

WHAT ARE STOCK SPLITS?

63. There are times when the price of a stock can go through the roof. There are two sides to the coin when this happens. On one side, it is a good sign to the eyes of a company, because it means that investors are impressed with it, think a lot of its future prospects, and are therefore willing to pay a premium price for it.

64. On the other side, a very high price puts a stock unit 'out of the reach' of many investors especially if they are not attuned to buying value stocks at high price versus 'affordable' stock which might even be of questionable value. The psychology is that $100 can only buy one share if its price is $100, but fifty (50) shares if the price is at $2.00. Hence, when stock prices get out of the reach of the rank and file investor, companies "correct" the situation by splitting or dividing one big share into smaller, meaning cheaper replicas of itself. The basic objective is to encourage a higher volume of trading because, the more trading a stock enjoys, the greater is the likelihood of appreciation in its market value. Many

formulae are used to estimate the value of a stock in relation to its price. One of the most widely used is called the Price/Earnings ratio. See at para # 84

65. This introduces the concept of the par value of a share. In simple language, when a company is structuring itself, i.e. packaging it's financing, it usually gives a money value to each share that is created. This value can be almost anything – the choice is really arbitrary. For some companies, it is $1.00 but, for others, it is either more, say $2.00, or less, say $0.50.

66. Many of our listed companies did stock splits in the flagship year 1992. Some of them were:

Carib Steel (pre-divestment)	I share divided into 5
Goodyear	1share divided into 5
Island Life	1 share divided into5

When a company issues bonus shares, this doesn't affect the par price or par value of that share. If it was $1.00 **before** the bonus, it continues to remain at $1.00 **after** the bonus. However, when a company splits its stock it also splits the par value in tandem.

Hence, Carib Steel which had an original par value of 50 cents now has a new par value of 50 cents divided by 5 = 10 cents; Goodyear which was previously at $1.00 is now 20 cents. The same applies to the Island Life split. This latter stock was split when the market price for its $1.00 par value stock soared to $80.00 per unit.

67. When there is either a bonus issue or a stock split this fact will eventually be reflected in the market price of that stock. For example, if the price of a stock was say $50 per share before a bonus, and the bonus was, say, 1 for 1, this would mean that there would now be two shares of stock for $50 where previously it was only one. A simple division of $50/2 would now give the new price of $25 per share for each of the two shares. Of course this price would not remain fixed. The market, based on demand and supply, would either push it up or pull it down.

68. A similar rationale applies with a stock split. Since the market price of Island Life's shares was $80 at the time of the split, the new price immediately after would be $80/5 or $16 per unit but The Market (meaning investors generally) could eventually push that price either up or down.

WHAT ARE WARRANT OPTIONS & RIGHTS?

69. A warrant is an authority to exercise an option to buy at a particular price within a particular time especially where it is anticipated that a share price will appreciate. In the market, this option could be the right to acquire shares in a particular company under given conditions. For example, when the Caribbean Cement Company went public in 1987, it gave a warrant to existing shareholders to buy one (1) additional share for every five (5) shares that each purchaser bought. This right of purchase, at the stipulated price of $2.30, was to be exercised by December 31, 1988.

70. Against the expectation that the share price would have appreciated significantly, many persons bought many of these Warrants (which are tradeable just like shares), when the price of each dropped as low as 10 cents for a share originally priced at $2.30

71. As it happened however, the Cement shares, (along with the rest of the market), took a dive and were cheaper on the open market than the price at which they were slated to be sold under the terms of the Warrants. In effect, therefore, these particular Warrants became useless. It would however, be the opposite story if the market and the Cement shares, were booming in December 1988 or, at the extended expiry date of December 31, 1989.

72. If, say, the market price of Cement shares had risen to say $10 each, warrant holders, (<u>who had the right to buy more shares FROM THE COMPSNY at $2.30/share</u> could either take up_these_extra shares at a "basement price" of $2.30 or, sell them (the warrants) to whoever would buy them at any price the market would bear.

For example;

If market price of Cement shares was	$10.00
But Warrant holders could buy at	<u>$ 2.30</u>
Price Difference	$ 7.50
	======

Warrant holders could exercise their purchase option, buy these shares at a massive $7.50 discount, and immediately re-sell their shares at market price, i.e. $10, and earn a capital gain of 235%. Similar reasoning would apply to other investors who bought these Warrants from the original holders. Of course, the capital gain here would be lower, reflecting the additional price of the option itself.

FOUR COMPONENTS FOR A SUCCESSFUL SOJOURN THROUGH THE EQUITIES MARKET

73. Playing the Stock Market needs the same mindset that is brought to every serious pursuit i.e. one of purposeful involvement with specific objectives. In the case of the Stock Market these pre-requisites could probably be identified as:

a) a commitment to "learn and play the game"

b) an investment objective to pursue

c) a strategy to find investable funds

d) a sense of the importance of time and timing ie when to buy and when to sell

74. If playing the Stock Market does not come naturally, (it doesn't for many people), the commitment will have to be cultivated. This will take some discipline as one builds up the level of interest and expertise through self-education activities such as subscription to financial and investment magazines, reading financial reports and commentaries, listening to investment discussions, going to investment seminars and talking with people who are already involved, and who can share personal and business investment insights. Maybe the best way to cultivate this commitment, however, is to link one's involvement in the market with some specific personal, family, or business objectives.

AN INVESTMENT OBJECTIVE TO PURSUE

75. Playing the Stock Market is about making money. To illustrate this, let's quote form John Jackson, a leading stock market investment guru, who demonstrated some outstanding capital gains in his Investor's Choice magazine. Writing in the November 1991 issue, he cited the growth of the following ten (10) stocks over the

period 1969-1991. He said that if investors had invested $1,000 in each stock in 1969, the returns in 1991 would have been:

Lascelles DeMercado	-	$799,000 - growth increase of 79,900%
Jamaica Producers	-	311,290 - growth increase of 31,129%
Carreras Limited	-	261,244 - growth increase of 26,024%
Goodyear Ja. Ltd.	-	134,435 - growth increase of 13,336%
Pan Jamaica	-	103,615 - growth increase of 10,262%
BNS Jamaica Ltd.	-	80,880 - growth increase of 8,088%
Desnoes & Geddes	-	65,300 - growth increase of 6,530%
Jam. Citizen's Bank	-	60,520 - growth increase of 6,052%
Gleaner Co. Ltd.	-	54,761 – growth increase of 5,476%

76. See other illustrations at paragraph 58. Each person will need to have his own reason for playing the market, but some basic ones may be to:

a) buy (or help buy) a house

b) pay children's school fee or university expenses

c) raise seed money to start one's own business

d) pay (or help pay) for the new car

e) get spending money

f) save for one's rainy day i.e. build a retirement nest egg

A STRATEGY TO FIND INVESTABLE FUNDS

77. When people have a good enough reason to do something they will do it – even where doing it imposes or demands some sacrifice. Many people will invest for no greater reason than the fact that they have "free" money to do so. For many others however, they will have to define a strategy to get the money to pursue their investment objective.

In this respect, it is important to re-state two points that are eluding many people. The first is that one does not need a large number of dollars to start his investment program. It would be nice to start with say, $100,000 but, one tenth or even one twentieth of that will do. The second point is that we must always remember that the most important thing in matters of money is not how much of it you and I make, or are paid, but how much of it we keep and invest in, and for, ourselves. A prudent saver and money manager on $50,000/year could easily out-save another making $100,000 if the latter devotes all his higher income to finance his cost of high living.

78. Some strategies worth pursuing in the search for investable funds) are:

a) Learn to "pay" yourself first from every dollar that you earn and from every source through strategies such as salary deduction and post dated cheques

b) Invest at least a part of all unexpected money that you receive

c) invest at least a part of all employment incentive and bonus payments

d) invest at least a part of all redundancy and termination payments

e) invest at least a part of all pension refunds when one changes jobs in situations where the portability of pensions is not enforced

f) give post-dated cheques (PDC) of a similar amount to your Investment Counsellor, Stockbroker or Unit Trust Company to invest for you on a regular periodic basis. This investment technique is called dollar cost averaging

79. These are all common sense strategies but, we many times overlook them. For example, in respect of the use of the PDC in the case of say a $500,000/year person, he could tell himself that, come hell or high water (or anything in between), he is committing to investing 1/10 or even 1/20th of that income-flow or $25,000 each year.

And, if this was to be done uniformly over 12 months, he could underline his commitment by writing 12 Post Dated Cheques to the value of $2,084 and giving them to his Financial Counsellor to invest each month.

<u>NOTE:</u> This is not to suggest that any Stockbroker would be enamored by a $2,000 monthly order but, a Unit Trust company would gladly accept it.

TIME AND TIMING – IT'S AS IMPORTANT AS THE MONEY TO BE INVESTED

80. The concept of a Time horizon– short, medium and long term, is central to the discipline of investing. In unusual times, it is possible to "make a killing" or (lose one's shirt) almost overnight. But, this would be an aberration. Usually, the Equities Market is a medium to long term phenomenon. So one should not go into the market expecting to see an immediate appreciation in the value of stock that he has just bought. This might very well happen if the market suddenly finds some important reasons to do so but, one should not put one's "pot on the fire" waiting for this to happen. Again, the likely situations are those referred to at paragraph 56.

81. The concept of timing is very important and is not to be misunderstood. For the uninitiated, the idea revolves around "knowing" when to buy and when to sell stocks. Crudely put, the central theme is that one should buy <u>good stocks</u> when everybody else is running from the market and sell those stocks when every one else is scrambling back into it! The reasons for this seemingly contrary posture are impeccable! Stock prices are usually lowest when investors are running out of the market. This is the time to buy some value stocks. On the other hand, prices usually are at their highest when everybody who ran out 'the last time' are now running back in! From this perspective, there is <u>absolutely</u> no substitute for "good timing" in the making of profit from the stock market.

82. A good illustration of this is the remark about the value of the CIBC shares at paragraph 61. Now that the market is in the doldrums, those same $44 shares are now (August 26, 1994) worth only $12.95. If sold at this low price they would only fetch $165,540 vs. the $562,452 that was possible in February 1993, a very big difference of $396,912!! This, unfortunately, is where most new investors would sell, out of fright, instead of waiting it out until the crowd is rushing in again and will pay good money for good (and many bad) stocks.

83. All of this however, is history. The challenge now is:

a) how to spot and buy stocks which could appreciate significantly in the medium to long-term, and

b) having bought, how to determine when to sell it before it recedes from its peak value

84. Experienced investors use a variety of valuation and monitoring techniques to pursue these two objectives. While most of these are beyond the scope of this manual, there are three indicators that the new investor can use to get a feel of how and where the wind is blowing. These indicators are:

a) happenings on the monetary landscape

b) industry/company news

c) industry vs. company P/E ratios

85. The general trend of the economy will affect all business transactions including the value, and the buying and selling of shares. One of the biggest indicators in any economy is the interest rate. This interest rate is determined by what the economists call the monetary policies of Governments. This monetary policy can dictate if interest rate will rise or fall in the medium to long-term. Generally speaking, when the indication is for interest rate to rise, it is also usually a good time to sell stock and switch the fund resulting from the sale into what is called Fixed Interest Securities, i.e. Bonds and Money Market Funds.

86. There is a very basic and good reason for this “switch”. There are no guarantees on equity investments. The price of a share can go up or down according to market conditions and outlook. On the other hand, interest rates on Bonds and other debt instruments are usually fixed and guaranteed. Hence, in a market where interest rates are high and rising, conventional wisdom suggests that one moves his money (investment) from an unguaranteed to a guaranteed place. Consequently, there is usually an inverse relationship between interest rates and the market index.

87. But, good news can be “bad news” and bad news can be “good news” in respect to the buying and selling of shares and, the people who hear and evaluate this news first can usually gain benefit ahead of the crowd. Investors should therefore keep their “ears to the ground” The news, for example, that a company is modernizing its operation could mean, under normal circumstances, that its operation will become more cost effective and profitable in the medium to long-term. This news should be a signal to buy that company’s stock, all other things being equal.

88. There are times, however, when a good stock could suffer a temporary setback. On these occasions, investors with short term horizons will usually sell because they see this dislocation as bad news. However, where other things are equal, the long term wisdom of the market is that this could be a good signal to buy this stock when others are selling it – usually at a good buyer’s price i.e. a heavy discount. This is when “bad news” can become “good news” to the long-term investor.

89. Industry and individual company P/E ratios sometimes give good clues about whether or not to buy or sell particular shares. See at paragraphs 107-117(b) for a fuller treatment of this indicator.

WHERE AND HOW TO ENTER THE MARKET

90. There are many ways to enter the Equities Market. Some of these are through:

a) Equity-linked insurance policies

b) Mutual Funds, which we call Unit Trusts here in Jamaica and incorporating Index Funds….a variant of Mutual Funds

c) Investment advisors and portfolio managers who will tell you what to do, i.e. where to invest.

d) Stockbrokers, who are licensed to **trade** for you, i.e. buy or sell shares according to your instruction.

e) Yourself as your own advisor but executing your trades through a stockbroker.

91. Each of these methods has its own advantage and disadvantage, but a key advantage with those at 90(a) – (c) is that they have professional management to manage your funds on your behalf and their track records here in Jamaica are reasonably impressive. For example, in the case of Jamaica's first equity-linked insurance policy (Mutual Life's Blue Chip), $1,000 invested in 1970 would today (at May 1994) be worth in excess of $61,400! This represents an increase in value of nearly 6,042% and the Unit Trust could probably boast results in the same general region.

92. But, when one goes into the market, he usually wants to try his own skills at stock selection and this means benefiting from the advice and experience of the professional money managers but, making one's own selections. In practical terms, of course, one might elect to enter the market from all five (5) entry points at paragraph 90. The whole purpose of this little manual, though, is to get you to call some of the shots yourself and enjoy the ecstasy of capital gains (as well as the agony of lost opportunities). The reality is that there will be some wrong calls. The challenge is to have many right calls for every wrong one. This is the formula for success in the stock market

HOW TO PREPARE ONESELF TO ENTER THE MARKET

93. There are some commonsense steps to take in preparing oneself to enter the market. All these steps are designed to educate the prospective investor about it (the market). Maybe the most basic and important of these is reading. The interesting thing is that the newspapers, radio and television are usually overflowing with FREE INFORMATION! All one has to do is tap into it and try to get a grasp of what the news is saying.

94. Some specific sources of information on the market are:

a) financial sections of all newspapers

b) periodicals dedicated to financial and investing matters

c) radio and television programmes focused on the market

d) seminars dealing with money, investing and the stock market

e) annual reports of listed companies

f) stock exchange year books

If one starts accessing any or all of these information sources, he will find that before long he will amass enough information and confidence to go and talk with a stockbroker. Once the initial step is taken, one can progress at his own pace to where he starts picking his own stocks, sometimes even against the advice of his stockbroker.

BUSINESS CYCLE AND ITS IMPACT ON THE MARKET

95. By now, everyone is familiar with the fact (even if we do not always fully understand why), that "The Market" comes and goes - ebbs and flows. All kinds of factors are credited with the responsibility for causing these goings-on but the only one of interest here is INTEREST RATE, (no pun intended).

96. There are always many competing interests for people's investible funds. Prominent among these are the Stock Market and what are called Fixed Interest Securities. This is another fancy name for lending out one's money and getting guaranteed rates of interest on it (via Government Bonds, Debentures and other debt instruments).

97. As we know, the returns on stock market investment, i.e. buying and selling of shares can be really impressive but these investments in stocks have no guarantees whatever. One could lose his shirt just as easily if certain conditions prevail. On the other hand, investments in fixed interest securities (called <u>fixed income securities</u> in the trade) are guaranteed. When one lends his money to whoever, he gets written confirmation about two things; how much interest his money will earn each year for the period of the loan and, when he will get back the amount (principal) that was loaned. Once this is finalized, the lender could go to sleep for all he cares – he knows exactly how much he will get at the end of the loan period and neither continuous rain, continuous drought nor anything in between, will affect that arrangement.

98. Not surprisingly, therefore, when interest rates are very high, and or trending high, people usually switch their savings from the uncertainties of the Stock Market to the certainties of Fixed Income Securities. This is what has been happening since the Government initiated its tight money management program in 1993. With interest rates of as high as 25% on Treasury Bills (loans to Government), nearly everybody ran from the Equities to the Money Market.

99. But who are the people who borrow the millions of dollars that are usually invested in Fixed Income Securities? There are three broad groups as follows:

    a) Governments

    b) Business, and

    c) Individual people

    Governments effect their borrowing through a range of instruments over the short, medium and long term cycles. Three of the main ones are Treasury Bills (Short Term), Local Registered Stock/Bonds (Medium Term) and Longer Bonds (Long Term). A variety of fancy terms are used in association with these three instruments but, they are all loans just like the loan that an individual gets from his own commercial bank. The rates that governments pay on Treasury Bills (short-term loans), are used by the financial community to set the general level of interest rate for commercial transactions in a country as a whole.

COMMSENSE STOCK SELECTION STRATEGIES

100. By now, if you seriously want to "take the jump" into the stock market, you would start to:

a) prepare yourself through reading and seminars

b) devise a strategy to find investible funds, and

c) take tentative steps about how to enter.

So far, so good. At paragraph 90, mention was made of four (4) ways by which you could **ENTER** and benefit from the expertise of the professional money managers in each category from 90(a) – (d). Now we want to look at how **YOU** can actively pursue your investment objectives **by getting involved in stock selection.**

101. One alternative to giving your total investment dollar to these experts is to **share** it with them! This way, some could go to the Stockbroker who could do a mix of individual stocks and/or put your funds into a portfolio of investments. Some could go to the other categories of experts at paragraph 90 and the rest would be for you to invest on your own.

102. Since you are not likely to become an expert overnight, we will need to find some tentative steps at stock selection. I recommend the following four (4) initiatives at STEP I:

a) look for an industry that is central to the economic activity of the country e.g. banking, and cement manufacturing

b) look for an industry that earns foreign exchange e.g. agriculture and tourism (to hedge against devaluation)

c) look for a monopoly or service industry that either has tax exemption or whose return on equity is guaranteed by whatever arrangement egg Telecommunications of Jamaica which is guaranteed a return on equity of 20% ;

d) look for an industry that has been doing well for a long time, e.g. food and drink distribution

Of course, instead of using these headings at STEP I you could use the alternative used in the Financial Gleaner, which lists the companies under headings of Banking, Communications, Conglomerates, Insurance, Manufacturing, Tourism, Trading and others. At STEP 2, having selected one's preferred industries, the next step is to short-list the companies within that industry and go for the top one or two performers in it.

103. Where money is not a problem, you could invest in all these companies and, in fact, this is what many Fund Managers do to protect their flanks or hedge against the possibility of any particular stock going sour. For our purposes, though, we need to be more selective since we might not initially have enough funds to make meaningful purchases everywhere.

FINE TUNING THE SELECTION OF STOCKS

104. At STEP 3, the experts use one or the other or a combination of three techniques to help fine tune the selection. These they call:

a) Fundamental Analysis

b) Technical Analysis

c) Modern Portfolio and Asset Pricing Theory

The good thing for us is that we will (or should) get the benefit of these techniques since they, the experts, will invest some of our funds for us. At STEP 4, for our commonsense selection techniques, I recommend the following yardsticks:

d) Dividend payment history over the years

e) Growth in stock price over the years

f) Bonus distribution of shares over the years

g) Price/Earnings ratio (P/E ratio)

h) Future outlook

105. Each of these fine tuning "techniques" can be used without complex formulae or what the experts call financial modeling. If a company pays a good dividend consistently, it means that it is making profit consistently. Bank of Nova Scotia, Grace Kennedy and Carrears jump to mind immediately. Similar situation applies where the price of a stock keeps going up. For example, the price of Grace Kennedy stock went from $7.20 to $11.40 to $34.50 at January 1991, 1992 and 1993 respectively. This upward movement (or appreciation in price) is usually a reflection of many positives. Two of these are continuing profitable operation and consequent demand for the stock. Sometimes, this demand can even push the price so high that some companies decide to split it up into more shares to make the stock more easily available to a demanding market. Illustrations of these splits were given at paragraphs 63-66.

106. A usually sure sign that a company is doing well is when it not only pays regular dividends but also has profits left over to transform into capital by the creation/distribution of bonus shares. Many of our listed companies fall into this Blue-chip category. Some of these were identified at paragraphs 59-61. Others can be found in Stock Exchange Year books going back to the beginning of the Stock Exchange in 1969. A classic illustration is Life of Jamaica. The demand for its stock was so strong in 1991 that each original stock was transformed into 40 new ones first by a 10 for 1 stock split and then by a 4 for 1 bonus issue!

107. Nobody talks about the Stock Market without also talking the "Gospel according to Price/Earning Ratio" or P/E ratio for short. But what is the P/E Ratio and what gives it its importance in the selection of stocks? The 'P' stands for 'price' of a share at a particular time, the 'E' for earnings on a per share basis at the same time. When 'P' is divided by 'E' and multiplied by 100, the result is the P/E ratio. Many things can be said about this ratio. Four of them are:

    a) It gives an indication of how investors value the total market as a whole
    b) It does the same thing for individual companies within the market
    c) This means it compares the relative value of different companies within the market
    d) It gives an idea of how long it will take for an investor to get back his investment from each company in the market, all other things remaining the same

The following Table is taken from the Trading Summary prepared by one of our stockbrokers and published in the Financial Gleaner of Friday, August 25, 1994.

Trading Summary Table

108. Using Bank of Nova Scotia for illustration, the three important columns in this Table are:

a) EPS Projected i.e. 166.7 cents

b) Last price at which the stocks was sold i.e. $10.95

c) P/E Projected i.e. 6.6 times or multiples

A little calculation will show that the Price/Earnings multiple of 6.6 times was derived by dividing the last price at which the stock was sold ($10.95) or 1095 cents), by the amount of profits the company is expected to make on each unit of stock i.e. 166.7 cents

In essence, therefore, the Price/Earnings ratio is really a figure that tells how many times or multiples of earnings the market will pay for a particular stock. In this case, it will pay a price that is equal to 6.6 times or 6.6 multiples of anticipated earnings for this particular stock.

109. The importance of Price/Earnings ratios can probably be expressed by saying that the market feeds on itself and vice versa. Every market (Kingston, London, New York, Tokyo) tends to have its own optimal Price/Earning ratio and anything way above or way below is then either good (below the optimal) or bad (above it). The generally accepted optimal ratio for our market is probably a multiple of 10 at this time.

Consequently, any ratio below this would be generally regarded as a good one, i.e. buy this stock BUT, it must be remembered that this is all relative to what the ratios are for other companies in the same, and other categories in the entire market as a whole. Generally speaking though, the lower a Price/Earning ratio, the stronger is the buy signal, all other things being equal.

110. In summary, the reason for the importance given to the Price/Earning ratio or Price/Earning multiple resides in the fact that this ratio reflects nearly all of the market's sentiments about a stock. Hence, the comment that both market and ratio feed on each other. On the basis of their relative Price/Earnings ratio therefore, the buys, in order of theoretical value, from our Trading Summary, would be:

1st	-	NCB	-	@ 4.8 times
2nd	-	Workers Bank	-	@ 5.2 times
3rd	-	TDB	-	@ 5.4 times
4th	-	BNS & DB&G	-	@ 6.6 times
5th	-	Citizens Bank	-	@ 7.1 times
6th	-	CIBC Jam. Ltd.	-	@10.8 times

The same rationale would apply to all the other companies in all categories listed on the market.

111. As alluded earlier, the P/E formula also allows one to arrive at what might be called a reasonable price for a stock. Let us, for example, agree that, among Commercial Banks, the accepted P/E multiple is 6.7 times (category average as shown on our Trading Summary for week ending August 26, 1994). This means that, on average, the price of each bank stock should be in the range of their projected earning multiplied by 6.7

112. To illustrate with four banks, the price of their stock should be about:-

BNS	166.7c x 6.7 = $11.17
DB&G	35.0c x 6.7 = $ 2.35

NCB 110.0c x 6.7 = $ 7.37

Workers 30.0c x 6.7 = $ 2.01

Instead, each Bank is selling at rates below these values. Put another way, each is selling at the following discounts – BNS 2%; DB&G 2%; NCB 15% and Workers 20% below what each should be selling for based on market expectations. Here, on this basis, Workers, followed by NCB, would be the better buys, all other things being equal (which, in reality, is rarely the case)

WHAT'S IN THE IMMEDIATE FUTURE FOR INDIVIDUAL STOCKS?

113. To a great extent, the Price/Earning ratio already factors n important knowledge or expectation about each stock. This is what the experts do with their various analytical techniques and their knowledge about what each company is planning to achieve in the short to medium term. For example, when Guinness bought D&G, the expectation was that they would expand its export capacity and earn significant foreign exchange. This expectation might not yet be manifested in earnings or price movement. Suffice it to say that "word on the street" is that the company is now retooling expressively for this purpose. Accordingly, it would not surprise anyone to see an early movement in this stock. This is a good illustration of how imminent future happenings can affect a stock price positively.

114. A second illustration on stock selection is a potentially good stock that is going through a rough period. When this is happening, most investors are likely to shun that stock with one result being that its price falls. This is when other investors will "stock up" on this stock because, in a year or two when the rough period is passed, the same disserting investors could come back in droves and drive the price up with their demand for it. This is when those who bought cheap could smile all the way to their Brokers (to instruct them to sell so that they can realize their capital gains!). Workers Bank, now paying off their inherited deficit of approximately $140 million at the time of its purchase, is considered by many to fall into this category. Last trading price on August 24, 1994 was $1.60.

POTENTIAL FOR BONUS SHARES

115. Finally, on the list of commonsense-stock-selection "techniques" is the question of how many of a company's shares are in circulation or, as the trade prefers to say, outstanding.

As asserted in paragraph 56, one of the ways to make money in the market is to get Bonus Shares because, one could easily sell these (at the right time), while retaining his original purchase. How could one use those hoped for bonus units to select stocks?! By assuming that a small profitable company that has a vision for the big time will convert some or all of its profits into share capital by creating bonus units for its shareholders! Where, therefore, the Price/Earning ratio is in the same general ball park (or even if it isn't) one might want to go for this Stock knowing that, or rather anticipating that, over the next few years, his portfolio of this stock will grow (from bonus shares) even if he does not buy another share outright. Recall the story of CIBC and how 1918 units became 12,783?! Therefore, where this potential is adjudged to exit, that might be a good stock to buy, most other things being equal.

CONCLUSION

116. In summary, we could say that when interest rates are high, and climbing, investors move from the Stock Market to the Fixed Income Market (Bonds/Money Market Instruments) and, when rates are low, they reverse the order and move back to stocks. Again, the timing of one's buy/sell transactions is very important.

For best effect, one should aim to be a step or two ahead of the crowd in moving from one phase to the next.

117. In practical terms, being a "step ahead of the crowd" could mean selling equities when the market is at or near its peak (at high price) and transferring the proceeds to a fixed income instrument. This way, one's money would still be earning at premium rate while the Equities Market goes flat. Also, it means that at the onset of reductions in interest rate, one would begin phasing back into Equities while equity prices are still low.

118. This way, one's increased amount of investible funds (from high interest earnings) could be used to buy a greater number of equity units (because they are now relatively cheaper). The real pay off will come when the stocks (bought cheaply) appreciate to 30%, 50% or even better than 100% above cost price. One could then either sell them and use the capital gains to finance his investment objective or, repeat the investment switching process and keep multiplying his investment results to suit other objectives.

119. It is against this background that one can say with confidence that one can start in the Equities/Capital market with almost any amount and make good money. Can't find $100,000 to start? No problem! Any Broker will start you off with one tenth of that and, even if it takes a year to save it, ($10,000) it could turn out to be one of the best decisions and best sacrifices of your life because, give this $10,000 (or even $5,000) time and there is no telling what it could become.

120. Remember the story of the $5,000 of CIBC shares at paragraph 61?! It could also happen to you!! And, if that happens, the objective of writing this "Introduction to the Market" would have been achieved.

121. As an inducement to all Jamaicans and Caribbean Nationals in the Diaspora to get investment-conscious FOR THE LONG-TERM, our Governments have decided not to impose a capital gains tax on the income from the **trading of shares.** This is another reason for you to PERSONALLY get into the Market and benefit from this gift because, normally, Governments do not give away anything. (Capital distribution is however, subject to a 7.5% Transfer Tax).

P.S. This "blanket statement" about no tax is NOT ENTIRELY true. Inland Revenue reserves the right to audit a "player" whose sole means of livelihood is adjudged to be based on earnings from the trading of stocks.

122. Finally, remember that this is an introductory Paper. As such, it could not and does not purport to include EVERYTHING that one needs to know about The Market. Hopefully, though, it contains enough to get you started.

THE LAST TWO WORDS

READERS ARE REFERRD TO THE FREQUENTLY ASKED QUESTIONS (FAQS) WHICH ARE HERE FOR GREATER EXPANSION ON MANY OF THE CONCEPTS IN THIS PRIMER

YOUR OBLIGATION WHEN YOU START MAKING MONEY?

FLY ME IN FROM WHEREVER IN THE WORLD I AM AND TAKE ME TO LUNCH!!

HAPPY INVESTING!!

Lloyd A Vermont Sr.

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