CREATING PROSPERITY BY CONNECTING INVESTMENT OPPORTUNITIES TO INVESTORS

INVESTORS' CORNER

What's in a Stock?

Part 1

"Why not invest your assets in the companies you really like?
As Mae West said, 'Too much of a good thing can be wonderful"
Warren Buffett

Stocks. Shares. Equity. Terms that bounce around in the economics section of the media, but do you truly know much about them? You know that they are related to the stock market, and that they are connected to companies, oh, and that they are or could be fairly risk. The end.
Hold up! There is more. Join me in exploring the fundamentals so that you no longer have to wear that clueless look on your face when the economics section of the news come on.

What is the difference between stocks and shares? Is there a difference? … Yes, there is. But hold your horses, the difference is not of much consequence that using stocks or shares interchangeably is quite acceptable in the investment world! Essentially, stocks or shares are small slices of a company that you can own which gives you rights or a claim to a piece of the company's profits and assets.

Any asset that allows you to have ownership rights is a type of equity investment. Therefore, buying a stock or share is an equity investment that entitles you to ownership rights of the company - to the extent of the number of stocks/shares you own compared to the total number of "shares issued/available". So the more stocks you buy, the larger your slice of the company. For example, if

a company has 1,000 shares of stock outstanding and you own 100 units of those shares, you would own and have claim to 10% of the company's net assets, otherwise known as its book value. If you own shares, then you are referred to as a shareholder.

There are two main types of stocks, common stocks and preferred stocks. Being a common shareholder gives you the right to receive dividends (money paid out of a company's profits or financial reserves to its owners) and the right to vote at shareholders' meetings, either in person or by a proxy if you are unable to attend. On the other hand, preferred stockowners normally are not able to vote at meetings, but they are given preferential treatment – as the name suggests – compared to the common stockholder, which means that they have a preferred right to the company profits and net assets/book value. For example, if a company decides to pay dividend to its owners, preferred stockowners will be paid dividends first. Importantly, if the company goes bankrupt and the net assets are sold and the proceeds are to be paid out to the owners, preferred shareholders would be paid their monies first over common stockholders.

The question then is "why be a common shareholder?" The answer is, because the claim that a preferred shareholder has is fixed, normally they are paid a fixed percentage rate which is agreed to when buying the preference share. So no matter how much profits the company makes, the preferred shareholder claims to the company is capped. However, this is not the case with common stockholders. There is no limit to their claim, so the more the company earns, the more a common stock holders earns. In essence, if the common shareholder is taking all the risk of being paid last then they should be rewarded by getting unlimited claims to the profits, right? It is primarily because of this why common stocks are considered more risky when compared to other assets, like bonds. Therefore, it is important that when you buy a stock you are buying into a company, based on objective criteria and that you are confident it has strong growth prospects with little chance of it going bust!

Join us for the next publication where we will share some tips for trading stocks.

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