

Series 6 Kaplan Financial Education

The Exam

- 100 questions (plus 10 experimental)
- 2¼ hours
- 70% to pass

Session One Securities Markets, Investment Securities, and Economic Factors

Securities and Corporate Capitalization

Securities and Corporate Capitalization

- A. Issue stock
1. Ownership (equity)
 2. Limited liability
 3. Conservative for issuer



Public

Securities and Corporate Capitalization

- B. Issue debt
1. Bonds, notes
 2. Holder of note or bond is creditor of corporation
 - a. Senior to equity securities in the event of liquidation
 3. Conservative for investor



Public

Common Stock



Common Stock

A. Characteristics

1. All corporations issue common stock
2. Most junior security
 - a. Has a residual claim to assets if company goes out of business or liquidates
3. Purchased for
 - a. Growth
 - b. Income
 - c. Growth and income

Common Stock

B. Dates

1. Trade date
2. Settlement date
 - a. Cash—trade date and settlement date on same day
 - b. Regular way—three business days

Common Stock (Dates) (continued)

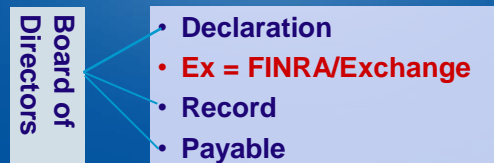
3. Regulation T—FRB
 - a. Credit extended from broker/dealer to customer
 - b. Two business days after settlement date
 - c. Time extension
 - 1.) FINRA or Exchange
 - d. Sell out
 - e. 90-day freeze

Common Stock

C. Privileges of outstanding common stockholders

1. Dividends
 - a. Cash dividends
 - 1.) Dates concerning cash dividends
 - a.) Declaration date
 - b.) Ex-dividend date (set by FINRA or Exchange)
 - c.) Record date
 - d.) Payable date
 - 2.) Buyer is not an owner on the company's books until the settlement date
 - 3.) Selling dividends
 - b. Stock dividends

Common Stock (Privileges of outstanding common stockholders) (continued)



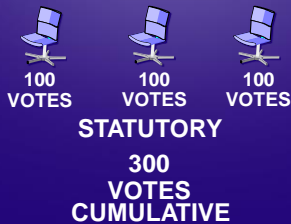
Common Stock (Privileges of outstanding common stockholders) (continued)

S	M	T	W	T	F	S
26	27 Declaration Date	28	29	30	31	1
2	3	4	5	6	7	8
9	10	11	12 Ex-Dividend Date	13	14 Record Date	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31	1	2 Payable Date	3	4	5

Common Stock (Privileges of outstanding common stockholders) (continued)

2. Voting rights
 - a. Crucial corporate decisions
 - b. Board of directors
 - 1.) Shares × vacancies = number of votes
 - 2.) Statutory
 - 3.) Cumulative

Statutory Versus Cumulative



Common Stock

- D. Stock values
 1. Par value
 2. Book value
 3. Market value
- E. Tracking common stock
 1. Trading unit is 100 shares
 2. Priced in points (\$1/share) and 1/100s (cents)

Common Stock (Tracking common stock) (continued)

3. Current yield (dividend yield)
 - a.) Annual dividend ÷ current market value

ABC corporation pays a 0.25 quarterly dividend and has a CMV of \$20. What is the current yield?

$$0.25 \times 4 \text{ quarters} = \$1 \div \$20 = 5\%$$

Preferred Stock



Preferred Stock

- A. Equity security with a fixed/stated dividend
 1. Purchased for income
 2. Behaves like a debt security (pricing)
- B. Preference for
 1. Dividends
 2. Liquidation
- C. Does not have voting privileges

Preferred Stock

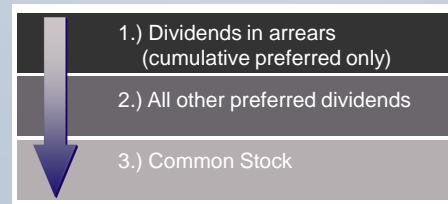
- D. Par value = \$100 (arbitrary number determined by the issuer)
- E. Dividends
 1. Percentage of par
 2. Dollar amount
 3. Dividends not guaranteed and can be missed

Preferred Stock

- F. Types
 1. Straight (noncumulative)
 2. Cumulative
 3. Convertible
 4. Callable

Preferred Stock

- G. Priority of dividend payment



Trading Securities

Trading Securities

- A. Securities markets and broker/dealers
 1. Exchanges
 - a. Listed securities
 - b. Auction market



Public → Public

Trading Securities (Securities Markets and Broker/Dealers) (continued)

2. Over-the-counter (OTC)
 - a. Unlisted
 - b. Negotiated market
 - c. Market makers
 - 1.) Dealer/principal (has inventory)
 - d. NASDAQ
 - 1.) Quotation system
3. Third market (NASDAQ Intermarket)
 - a. OTC trading of both listed and unlisted securities
4. Fourth market (Institutional trading)

Trading Securities

B. Market terms

1. Dealer/principal/market maker
 - a. Acts for themselves
 - b. Charges a markup or markdown
2. Spread: Bid Ask
17.00 17.25
 - a. Market maker buys at bid; client sells
 - b. Market maker sells at ask; client buys



Trading Securities

3. Broker/agent
 - a. Acts for others
 - b. Charges a commission
4. Confirmation
 - a. Sent to customer by settlement date

Trading Securities (Market Terms) (continued)

Confirmation of your order:							
Order	No.	Description	Price	Amount	Inter. or Tax	Reg. Fee	Commission
BOT	100	Impression Inc.	28.90	2,890.00	0.00	0.10	40.00
							Net Amount
							2,930.10
Trade Date		1/06/14	Acct. No.	RR No.	RR Name		
Settlement <td>1/09/14</td> <td>453-01245-1</td> <td>27</td> <td colspan="2">C. Monet</td> <td></td>		1/09/14	453-01245-1	27	C. Monet		
Customer Name and Address:			PLEASE NOTE: On odd-lot orders (orders for other than 100 share lots) on all exchanges, purchases are executed at the round-lot price plus a premium (odd lot differential). Sales are executed at the round-lot price less a discount.				
Mr. V. van Gogh 759 Arden Way Chicago, IL 60609-3207			Payment for securities bought and delivery of securities sold are due promptly and in any event on or before the end of the payment period in order to comply with Federal Regulation T and to avoid interest or premium charges.				
ALFA Financial Services, Inc.			Please keep a copy of this confirmation for your records.				

Trading Securities

C. American Depositary Receipts (ADRs)

1. Facilitates the trading of foreign securities in domestic markets
 - a. Foreign company issues stock
 - b. U.S. bank purchases
 - c. Bank issues as an ADR
 - d. Trades in U.S. markets
 - e. No preemptive rights or voting rights for investor
 - f. Investor is subject to currency risk

Debt Securities

Debt Securities

A. Debt financing—bonds

1. Purchased for income, safety
2. Par value—\$1,000
3. Interest paid semiannually

B. Tracking corporate bonds

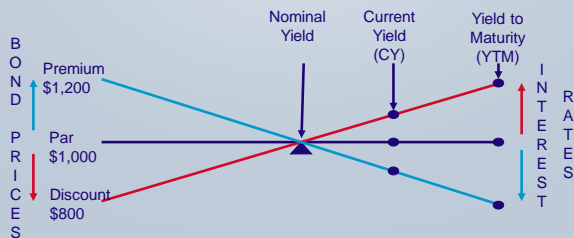
1. Priced in points (1 point = 1% of par or \$10)
 - a. Par = 100 points = \$1,000
 - b. Discount
 - c. Premium

Debt Securities

C. Yields

1. Nominal yield (a.k.a. stated yield, coupon)
Annual interest + par (\$1,000)
2. Current yield (CY)
Annual interest + current market price
3. Yield to maturity (YTM, effective yield)
 - a. Includes annual interest and premium or discount
 - b. Usually the yield quoted in the secondary market

Debt Securities (Yields) (continued)



Characteristics of Corporate Bonds

Characteristics of Corporate Bonds

A. Secured bonds

1. Mortgage bond
2. Collateral trust certificate
3. Equipment trust certificate



Characteristics of Corporate Bonds

B. Unsecured bonds

1. Debentures
2. Subordinated debentures



Characteristics of Corporate Bonds

C. Convertible bonds

1. Can be exchanged for common stock
 - a. Advantages for issuer
 - 1.) Bond is more marketable
 - 2.) Issuer reduces the cost of debt
 - 3.) If bond is converted, debt obligation disappears

Characteristics of Corporate Bonds (Convertible Bonds) (continued)

- b. Advantages for purchaser
 - 1.) Bond pays a fixed rate of interest
 - 2.) Convertible bondholders get paid prior to stockholders in the event of liquidation
 - 3.) Can convert to take advantage of capital appreciation of the common stock
 - c. Disadvantage for purchaser
 - 1.) Lower coupon rate
2. Parity exists when the value of the bond equals the value of the conversion

Characteristics of Corporate Bonds

D. Redemption

1. Principal and last semi-annual interest payment returned upon maturity

E. Zero-coupon bonds

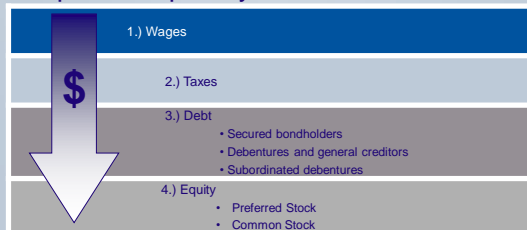
1. All interest paid at maturity
2. Interest taxed annually

F. Interest taxed at all levels

1. Federal, state, and local

Characteristics of Corporate Bonds

G. Liquidation priority



U.S. Government Securities

U.S. Government Securities

A. Marketable government debt (negotiable)

1. T-bills

- a. Maturities—one year or less: 4, 13, 26, and 52 weeks
- b. Priced at discount by auction—mature at par; no periodic interest

U.S. Government Securities (Marketable Government Debt) (Negotiable) (continued)

2. T-notes
 - a. Maturities: 2–10 years
 - b. Semiannual interest
3. T-bonds
 - a. Maturities: greater than 10 years
 - b. Semiannual interest
4. Treasury Inflation Protection Securities (TIPS)
 - a. Semiannual adjustment to principal based on CPI

U.S. Government Securities (Marketable Government Debt) (Negotiable) (continued)

B. Taxation of U.S. Government securities

1. Interest taxed at the federal level
2. Interest tax-exempt at the state and local level

Agency Issues

Agency Issues

A. Government National Mortgage Association (Ginnie Mae)

1. Actual government agency
2. Only agency directly backed by U.S. Government



Backed in Full by U.S. Government



Mortgage-Backed Pass-Through Securities



Monthly Principal and Interest

Agency Issues

B. Quasi-agency issues

1. Federal National Mortgage Association (Fannie Mae/FNMA)
2. Federal Home Loan Mortgage Corporation (Freddie Mac/FHLMC)
3. Backed by own issuing authority
4. Semiannual principal and interest

Agency Issues

C. Taxation of GNMA, FNMA, FHLMC

1. Interest taxable at all levels

Municipal Bonds



Municipal Bonds

A. Types

1. General obligation (GO)
 - a. Backed by full faith and credit of issuer
 - b. Funded by state or local taxes
 - c. Voter approval required
2. Revenue bonds
 - a. Backed by user fees
 - b. IDRs backed by corporate credit

Municipal Bonds

B. Taxation

1. Interest is tax-exempt at the federal level
2. Interest may be tax-exempt at the state and local level
 - a. If purchaser is a resident of the state in which the bond is issued

If an investor is looking for income and is in a high federal tax bracket; the purchase of municipal bonds may be appropriate

Municipal Bonds

C. Tax-equivalent yield and tax-free equivalent yield

A client whose tax bracket is 30% considers a

10% corporate bond	or	7% municipal bond
\$100 interest/year		\$70 interest/year
– \$30 tax		– \$0 tax
\$70 after tax		\$70

For this investor:

The municipal bond's tax equivalent yield is 10%
 The corporate bond's tax-free equivalent yield is 7%

Municipal Bonds

D. Summary: taxation of interest

Debt Instrument	Federal Tax	State/Local Tax
U.S. government direct debt	Yes	No
Municipal debt	No	May be taxable
U.S. territories	No	No
Corporate and agencies	Yes	Yes

The Money Market



The Money Market

- A. Definition
 - 1. High-quality debt instruments with one year or less to maturity
- B. T-bills
 - 1. High quality
 - 2. 52 weeks or less to maturity
- C. Banker's Acceptances (BAs)
 - 1. Facilitate foreign trade (import/export)
 - 2. 270 days maximum maturity to be exempt from registration

The Money Market

- D. Commercial paper
 - 1. Unsecured promissory note
 - 2. 270 days maximum maturity to be exempt from registration
- E. Negotiable (jumbo) CDs—minimum \$100,000

Economic Factors

Economic Factors

- A. Gross Domestic Product (GDP)
 - 1. Annual national output of goods and services
 - 2. Includes federal spending and exports
- B. Consumer Price Index (CPI)
 - 1. Price of a representative market-basket of goods
 - 2. Normalized to a constant dollar
 - 3. Increases with inflation; decreases with deflation

Economic Factors

- C. The 4-phase business cycle
 - 1. Expansion—GDP rises
 - 2. Peak—GDP does not rise (Prosperity)
 - 3. Contraction (Decline)—GDP falls
 - a. Two consecutive quarters = recession
 - b. Six consecutive quarters = depression
 - 4. Trough and recovery

Economic Factors

D. Business cycle



*Recession: Two Quarters Depression: Six Quarters

Economic Factors

- E. Government economic policy
 - 1. Fiscal (President and Congress)
 - a. Taxation
 - b. Spending
 - 2. Monetary (Federal Reserve)—three tools used to fight inflation
 - a. Reserve requirement
 - 1.) Determining the minimum each bank must keep on reserve with the FED
 - 2.) Least used method

Economic Factors (Government Economic Policy) (continued)

- b. Discount rate
 - 1.) Lowering lowers interest rates generally
 - 2.) Raising raises interest rates generally
- c. Federal open market operations
 - 1.) Buy treasuries to lower interest rates
 - 2.) Sell treasuries to raise interest rates
 - 3.) Most frequently used

Economic Factors (Government Economic Policy) (continued)

- 3. Effects on economy and investors
 - a. Raising interest rates or tightening money supply
 - 1.) Contracts the economy
 - 2.) Bearish for the stock market
 - 3.) Fights inflation
 - b. Lowering interest rates or loosening money supply
 - 1.) Expands the economy
 - 2.) Bullish for the stock market
 - 3.) Risks inflation

Economic Factors

- G. U.S. money rates (interest rates)
 - 1. Federal funds rate
 - 2. Discount rate
 - 3. Broker call loan rate
 - 4. Prime rate

Test Prep Question #1

When trading common stock, either at an exchange or over the counter, the standard size of the trading unit is

- A. 10 shares
- B. 50 shares
- C. 100 shares
- D. There is no standard unit

Test Prep Question #2

A company currently has earnings of \$4 and pays a \$.50 quarterly dividend. If the market price is \$40, what is the current yield?

- A. 1.25%
- B. 5%
- C. 10%
- D. 15%

Test Prep Question #3

The over-the-counter market could be characterized as what type of market?

- A. Negotiated
- B. Exchange
- C. Auction
- D. Primary

Test Prep Question #4

What is the term used to describe the condition when the market price of the bond is equal to the value of the stock upon conversion?

- A. Arbitrage
- B. Equality
- C. Parity
- D. Subordinated

Test Prep Question #5

Which of the following interest rates is directly set by the Federal Reserve?

- A. The discount rate
- B. The federal funds rate
- C. The broker call loan rate
- D. The prime rate

Test Prep Answers

1. C
2. B
3. A
4. C
5. A