Chapter 12 Summary

People save and make funds available, businesses borrow these savings to make new goods and services

* Makes economic growth possible

Financial assets: claims on the property and income of the borrower

* Property that has value
* Representative claims on the borrower because they specify the amount loaned and terms which loan was made

5 nonbank financial intermediaries in American economy:

1. Depository institutions
2. Insurance companies
3. Pension funds
4. Credit Unions
5. Finance companies

4 considerations important to investors:

1. Risk and Return
2. Investor’s personal investment goals
3. Avoiding some types of investments
4. Consistency of investing

401 (k) plan: tax-deferred investment and savings plan that acts as a person pension for employees

* Employees authorize payroll deductions
  + Invested in mutual funds or other investments approved by their companies
    - Contributing to the plan lowers your taxable income because you don’t have to pay income taxes on money you contribute until you withdrawal money from it
* More than 80% of employers match an employee’s contribution
  + Popular because it provides a simple, consistent and relatively safe way for employees to save : can make a 401 (k) with you if you change jobs
    - Can borrow against money before you retire at a substantially reduced rate
      * Will have to pay taxes on earnings when you withdrawal the money at retirement

Current yield is computed: annual interest ÷ purchase price

4 types of bonds that are commonly traded in America:

1. Corporate bonds: long-term investments
   1. Can be liquidated or quickly sold
      1. IRS considers – interest, coupons, payments on corporate bonds as tax income
2. Municipal bonds: (“munis”) bonds issued by state and local governments
   1. Finance highways, state buildings, some public works
      1. Tax exempt: federal government does not tax interest paid to investors
3. Government Savings Bonds: low-denomination, nontransferable bonds issued by the U.S. government usually through pay roll savings plans
   1. Generates financial assets when it sells savings bonds
   2. Easy to obtain and there is virtually no risk of default
   3. Most investors tend to hold long-term savings bonds, treats them as automatic savings
4. Treasury Notes and Bonds
   1. Treasury Notes: U.S. government obligations with a maturity of 2 – 10 years
   2. Treasury Bonds: maturities range from 10 + years – 30 years
      1. Only collateral that secures both is the faith and credit of U.S. government
      2. Come in denominations of $1,000 so small investors can afford to buy them
      3. Investors can purchase these directly from U.S. treasury

Efficient Market Hypothesis (EMH) means the argument that stocks are always priced about right and that bargains are hard to find because they are followed closely by some investors

* Used to help explain the pricing of equities

NYSE (New York Stock Exchange)

* Oldest, largest, most prestigious (Wall Street)
* 1,400 seats (memberships
  + Allow access to trading floor
  + Members may pay several mill. $ for seats
  + Members can elect their own directors and vote on rules and regulations that govern the exchange
  + Firms must meet requirement related to profitability and size
    - Guarantees companies will be among the largest and most profitable publicly held companies

Over –The-Counter Market (OTC): electronic marketplace for securities that are not traded on an organized trade

* Listed in National Market System (NMS)
* Members belong to National Association of Security Dealers (NASD)

A futures contract is an agreement to buy or sell at a specific date in the future at a predetermined price. Options contracts are contracts that provide the right to purchase or sell commodities or financial assets at some point in the future at a price agreed upon today.

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| Dow-Jones Industrial Average | Similarities | Standard and Poor’s 500 |
| Measures in percentages | Popular stock market performance | 500 reports on stocks listed on NYSE, AMEX, OTC markets |
| Changed the system from points to percentages | Both are used | Measures in index numbers |
| Coverage expands to 30 stocks | Both are important in stock market | 500 representative stocks as an indicator of overall market performance |