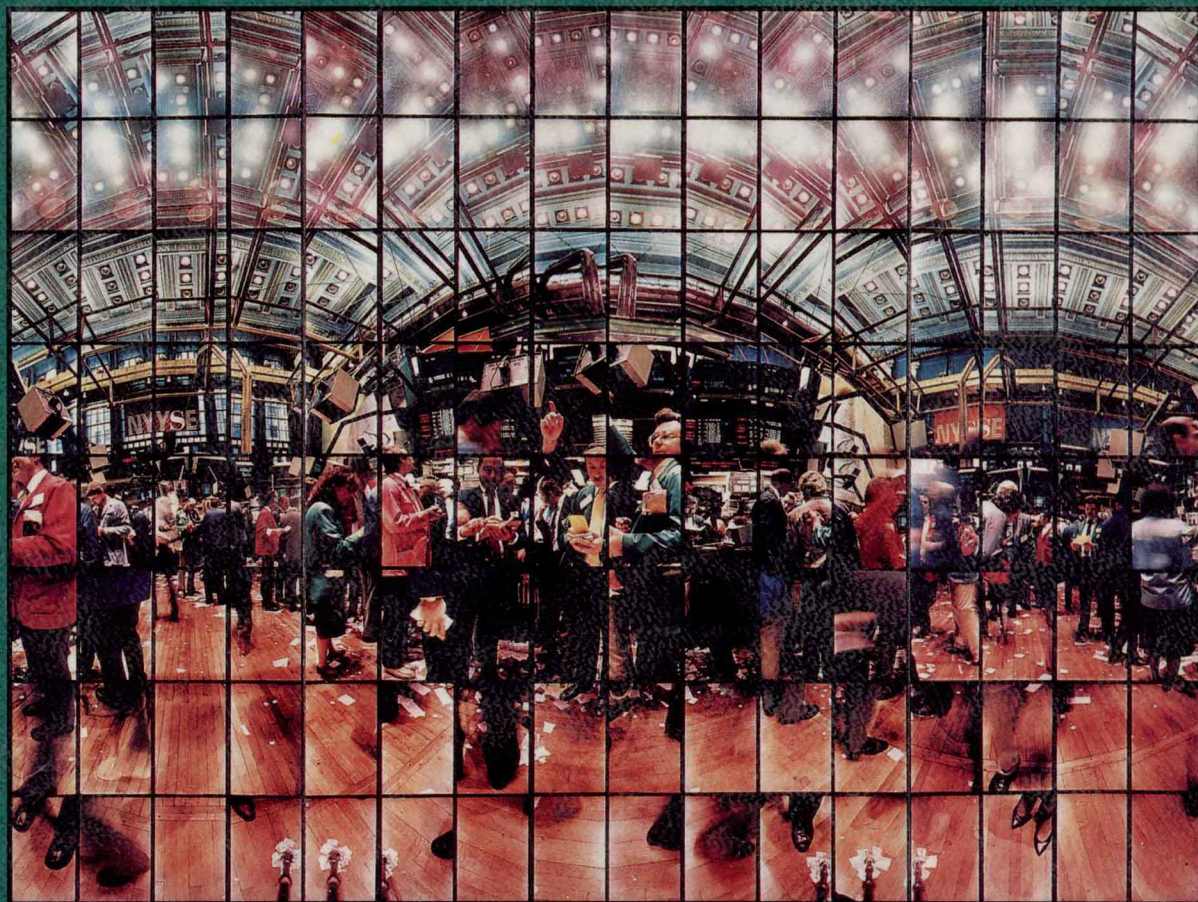


FUNDAMENTALS OF INVESTMENTS



JOHN M. CHENEY

EDWARD A. MOSES

Fundamentals of Investments

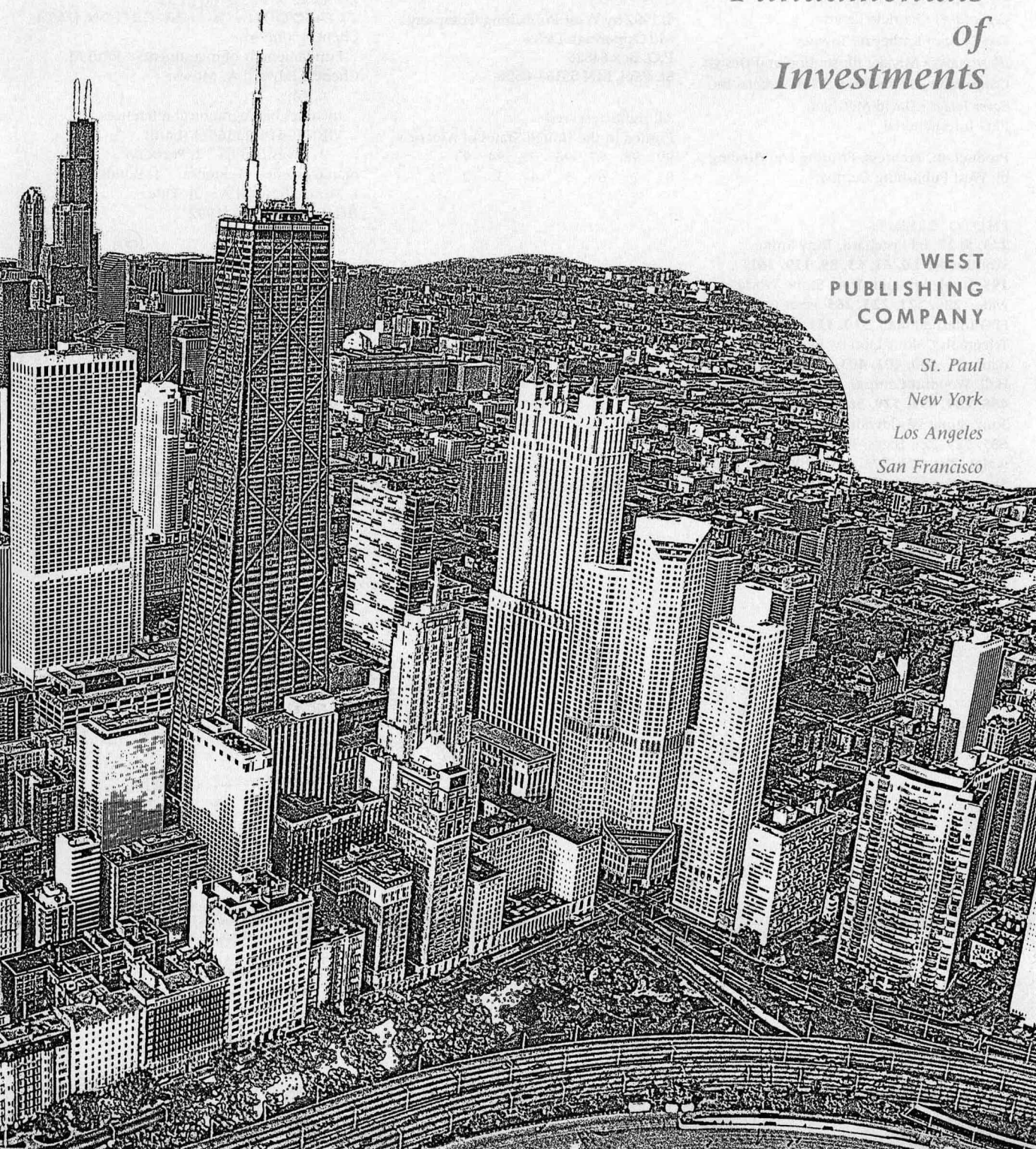
WEST
PUBLISHING
COMPANY

St. Paul

New York

Los Angeles

San Francisco



PRODUCTION CREDITS

Copyediting • Patricia Lewis

Text Design • Katherine Townes

Illustrations • Miyake Illustration and Design

Composition and film • G&S Typesetters, Inc.

Cover Image • David McGlynn,

FPG International

Production, Prepress, Printing and Binding
by West Publishing Company.

PHOTO CREDITS

2, 3, 5, 27 Ed Pritchard, Tony Stone
Worldwide; **60, 61, 63, 89, 119, 161,**
195 Doug Armand, Tony Stone World-
wide; **220, 221, 223, 265** Peter Gridley,
FPG International; **310, 311, 313, 347**
Telegraph Colour Library, FPG Inter-
national; **400, 401, 403, 431, 455** George
Hall, Woodfin Camp & Associates; **iv, v,**
488, 489, 491, 529, 565, 613 Mark Segal,
Tony Stone Worldwide; **644, 645, 647,**
685, 729 Ken Biggs, Tony Stone World-
wide; **770, 771, 773** Jeremy Walker, Tony
Stone Worldwide.

COPYRIGHT

© 1992 by West Publishing Company

610 Opperman Drive

P.O. Box 64526

St. Paul, MN 55164-0526

All rights reserved

Printed in the United States of America

99 98 97 96 95 94 93

8 7 6 5 4 3 2 1

LIBRARY OF CONGRESS

CATALOGING-IN-PUBLICATION DATA

Cheney, John M.

Fundamentals of investments / John M.

Cheney, Edward A. Moses,

p. cm.

Includes bibliographical references.

ISBN 0-314-93360-3 (hard)

1. Investments. 2. Portfolio
management. 3. Stocks. 4. Bonds.

I. Moses, Edward A. II. Title.

HG4521.C45354 1992

332.6—dc20



91-35170

CIP

Preface

Students usually begin their first course in investments with great expectations and are excited and interested in the subject matter. It is the responsibility of the professor and the selected textbook not to disappoint the student. Our overriding objective in writing *Fundamentals of Investments* was to provide the student and professor with a comprehensive book that is readable, presents complex concepts in an understandable manner, incorporates the latest advances in theory and practice, and is organized in such a way that the student's expectations of gaining insightful and usable investment information are met.

The dramatic changes the securities markets have undergone in recent years have added significantly to the complexities of personal and institutional investment management. As a result of what is known as financial engineering, new investment products have proliferated. In addition, specialized mutual funds, innovative insurance products, and the emergence of international financial markets have made new alternatives available to the individual investor. Increasing volatility in the securities markets and the continuing changes in the tax code are examples of additional factors investors must consider in developing and implementing investment strategies.

Accompanying these changes has been the ongoing development and empirical testing of investment theories and techniques. These include hypothesis related to the efficiency of financial markets, portfolio and capital market theory, arbitrage pricing theory, option pricing models, program trading, and portfolio insurance to name just a few. The necessity to cover these developments, along with the need to provide investors with an understanding of investment basics, creates quite a challenge for the student of investments, the professor, and, we might add, the authors of investment books.

The purpose of this book is to provide information and procedures that will enable individual investors to make informed investment decisions. The strategies of practicing investment professionals as well as results from theoretical and empirical research are used to introduce students to the practical aspects of investing. The techniques and procedures for active investment strategies presented in this book recognize that there is strong evidence that financial markets are efficient. An underlying proposition throughout the book is that investors should appreciate the pitfalls and complications that occur in pursuing an active investment strategy in an efficient market.

Fundamentals of Investments is intended for use in a first course in investments. While the topics are covered in a comprehensive fashion, the book presents material requiring quantitative analysis in an easily understandable

manner. The intended prerequisite for an investments course using this book is the introductory managerial finance course.

DISTINGUISHING PEDAGOGICAL FEATURES

The book has been designed to make the study of investments a meaningful and interesting learning experience for the student. To achieve this goal, we have included a number of pedagogical features, including a somewhat distinctive and flexible organization, the most up-to-date information available, knowledge-level objectives for each chapter, Interest and Research Boxes, numerous examples, tables, and figures, a rich set of end-of-chapter materials, a Glossary of Key Terms, and some very helpful appendixes.

• Organization

Careful consideration was given to the sequencing of chapters in the book, while at the same time allowing the professor flexibility in the design of the course. An examination of the Contents reveals the logic of the organization. This text begins with a discussion of investment fundamentals, including a case example that outlines the challenges facing the individual investor, and an introduction to risk and return. The next two parts examine the investment environment and introduce valuation concepts and analysis. The next three parts present the fundamental analysis of bonds, preferred and common stocks, and alternative investments. The seventh part explores portfolio and capital market theory in detail as well as the analysis of portfolio performance and market efficiency. The book concludes with a separate section on personal investment management that reexamines the personal investment case study presented in Chapter 1.

Several aspects of the organization deserve special mention. The early presentation of risk and return in Chapter 2 includes an overview of portfolio and capital market theory. This overview is sufficient to enable students to understand the use of these concepts in the ensuing chapters. Professors who desire a more detailed treatment of these topics may wish to assign Chapters 19 and 20 early on in the course.

In Part II, The Investment Environment, we have included separate chapters on mutual funds and investing internationally. We feel these topics are important to the individual investor and deserve their location and emphasis in the book. These topics are also further examined throughout the book in appropriate chapters.

A separate chapter on investment strategies is also presented in Part II. This chapter describes the different investment approaches an investor can employ and provides an anchor point for assessing how the different investment alternatives can fit into an individualized investment strategy.

Finally, because the book is written with the investment decision-making process of the individual investor in mind, personal investment management is treated as a separate part at the end of the book.

- **Timeliness**

Advances in investment theory, practice, and products are occurring at an almost dizzying pace. Although theory precedes practice by a considerable interval of time (sometimes forever) in many disciplines, this is not the case in the area of investments. With the so-called rocket scientists with strong academic credentials in heavy demand on Wall Street, the distinction between theory and practice is not so clear. We have made every effort to include the most up-to-date information possible in the book. The currency of the material is reflected in the examples, tables, and figures throughout the book as well as in the Interest Boxes, Research Boxes, and references at the end of the chapters.

- **Knowledge-Level Objectives**

Each chapter begins with a list of knowledge-level objectives. This pedagogical feature is designed to give the student an immediate awareness of the important concepts presented in the chapter as well as an overview of the contents of the chapter.

- **Interest Boxes**

The Interest Boxes discuss contemporary, real-world situations or events relevant to the surrounding text. These boxes, which are sometimes humorous as well as informative, can be assigned at the option of the professor.

- **Research Boxes**

The Research Boxes present the results of interesting research on a particular topic discussed in the surrounding text. We have carefully selected and summarized this material to provide students with additional information on topics of special interest. These boxes can be assigned at the option of the professor.

- **Examples, Tables, and Figures**

We have used numerous examples, tables, and figures throughout the book. These illustrations have been selected to enhance the student's understanding of a particular topic. Whenever possible, we have used real-world data to make the illustrations as realistic as possible.

- **End-of-Chapter Features**

A number of important pedagogical features are included in the end-of-chapter material. These features should help students test their understanding of the chapter material and assist them in applying the investment concepts presented in the chapter.

- *Summary.* Each chapter contains a summary that briefly discusses the key concepts presented in the chapter. Reading the chapter summary and the knowledge-level objectives prior to reading the chapter will provide the student with a complete overview of the chapter's contents.
- *Key terms.* The key terms, which are set in boldface type when they are introduced in a chapter, are also listed in alphabetical order at the end of the chapter. The Glossary of Key Terms at the end of the book contains definitions of these terms.
- *Concept applications.* Consistent with the applications orientation of the book, this feature lists the important investment concepts presented in the chapter and explains how the individual investor can apply each concept.
- *Questions and problems.* Each chapter contains a number of questions and problems that can be assigned by the professor. These questions and problems are designed to test the students' understanding of the concepts and applications presented in the chapter. In many instances, the problems employ data and situations from publicly traded companies.
- *Key to the Investment Analysis Software.* This feature summarizes the access procedures for performing the calculations in a chapter using the *Investment Analysis Software (IAS)* that accompanies this book. Each of the calculations for which a template is available in IAS is indicated by a computer symbol (as shown to the left) in the text preceding the equation for the calculation. This section also includes a page reference to Appendix A-1, The Investment Analysis Software, which provides a detailed description of the access procedures for a particular calculation. IAS can be helpful in solving many of the end-of-chapter problems.
- *End-of-chapter references.* We have provided the interested student and professor with a broad selection of references at the end of each chapter. These references range from academic journals to the more popular investment-related periodicals. They include "classic" academic articles as well as recent articles from publications such as *Barron's*, the *Wall Street Journal*, *Fortune*, the *Journal of Portfolio Management*, and *Financial Analysts Journal*, to name just a few.



• End-of-Chapter Appendixes

At the end of several chapters we have included material in an appendix. While this practice is not widespread throughout the book, we felt that professors might wish to exclude certain topics from the assigned readings. Thus, placing this material in an appendix adds to the flexibility of the book.

• End-of-Book Appendixes

Five appendixes that should be quite useful to the student appear at the end of the book. Appendix A-1 contains a complete description of the Investment Analysis Software that accompanies the book. The appendix provides a step-

by-step guide for the use of the software. Appendix A-2 contains a brief review of analytical techniques used in the book. This summary of analytical techniques provides a quick refresher for statistical and other analytical calculations. Appendix A-3 presents the mathematical terms, symbols, and key formulas used in the book. It provides a quick reference for the student who has forgotten the meaning of a previously defined term or symbol or the equation for a particular calculation. Appendixes A-4 and A-5 contain the compound value and present value financial tables as well as tables for the standard normal cumulative probability distribution and a table for the student *t* distribution for hypothesis testing.

EDUCATIONAL AIDS AND SUPPLEMENTS

Fundamentals of Investments and its ancillary materials are designed to maximize the learning experience of the student and assist the professor in using the book.

- **Study Guide**

The *Study Guide to Accompany Fundamentals of Investments*, written by Phillip T. Kolbe of Memphis State University, and the authors of the book, is designed to enrich the student's learning experience. The study guide contains a chapter outline and a discussion of the key points in the outline. In addition, multiple-choice and true-false tests, with answers, enable the student to assess his or her knowledge. Further, the study guide contains problems with solutions as well as a matching exercise involving the key terms.

- **The Investment Analysis Software**

The Investment Analysis Software that accompanies the book was written specifically for *Fundamentals of Investments* by Carol J. Billingham of Central Michigan University. It is designed for IBM personal computers and compatibles. The software, using Lotus 1-2-3 templates, may be run from either a floppy disk drive or a hard disk drive.

All equations in the book preceded with a computer symbol are included in the software. In addition, the Investment Analysis Software contains Personal Financial Planning and Analysis programs that can be used for preparing personal financial statements, maintaining records for analyzing personal portfolios, and performing a rent-versus-buy analysis for a personal residence.

- **Instructor's Manual**

The Instructor's Manual, written by the authors, is designed to help professors prepare and teach a course in investments using *Fundamentals of Investments*. The manual contains suggested syllabi for courses taught in both the quarter



and semester systems. Outlines for possible class projects on economic, industry, and security analysis are also included. Each chapter in the Instructor's Manual includes a detailed outline for the corresponding chapter in the book, teaching suggestions with appropriate class discussion questions, suggested answers to end-of-chapter questions, and solutions to end-of-chapter problems. The manual also contains a test bank consisting of true-false and multiple-choice questions and problems.

• Transparency Masters

A separate pack of transparency masters of key tables and figures in the book is available on a complimentary basis to adopters of the book.

ACKNOWLEDGMENTS

The authors gratefully acknowledge the significant efforts of the many contributors to this book. Without their expertise, suggestions, and support, this book would not have been possible.

Working from first draft to final manuscript requires the help of reviewers who not only have expertise in the area of investments but also have the classroom experience to improve the clarity of the presentation. We are deeply indebted for the excellent reviews of a portion or all of the manuscript provided by the following individuals:

Carol J. Billingham, Central Michigan University; Paul J. Bolster, Northeastern University; Carroll Broome, DePaul University; Richard A. DeFusco, University of Nebraska, Lincoln; Richard J. Dowen, Northern Illinois University; Hassan B. Ehsani, Suffolk University; Thomas H. Eyssell, University of Missouri, St. Louis; James F. Feller, Middle Tennessee State University; George L. Granger, East Tennessee State University; Robert T. Kleiman, Oakland University; Phillip T. Kolbe, Memphis State University; Steven T. Mann, University of South Carolina; Joel Morse, University of Baltimore; Philip Pfaff, Canisius College; Grady Perdue, University of Houston, Clear Lake; Richard PonArul, California State University, Chico; Gary E. Powell, American University; Thomas V. Schwarz, Southern Illinois University at Carbondale; Howard E. Van Auken, Iowa State University; Herbert J. Weinraub, University of Toledo; Richard E. Williams, Wright State University; Tony R. Wingler, University of North Carolina, Greensboro.

A book such as *Fundamentals of Investments* covers a wide range of topics. In order to ensure that we covered the topics accurately and completely, we used the expertise of a number of our colleagues. We would like to thank Stan Atkinson, Wallace Reiff, and Sharon Graham of the University of Central Florida; Jeff Madura of Florida Atlantic University; and Richard White and Charles Jones of the University of North Florida.

We are deeply appreciative of the expertise and loving care for details demonstrated by Florence Rendulic in typing the entire manuscript. Sue Crabill's help in typing the appendixes for the book and the Instructor's Manual is

*To my wife Anne and
my daughter Cheryl—JMC*

*To my wife Susan and
my children, Lynne
and Daniel—EAM*

Brief Contents

Preface xxii

PART I *Investment Fundamentals 2*

- 1 • An Overview of Investments 5**
- 2 • Investment Risk and Return 27**

PART II *The Investment Environment 60*

- 3 • Security Markets: Operations and Regulations 63**
- 4 • Investment Information 89**
- 5 • Investing in Mutual Funds 119**
- 6 • Investing Internationally 161**
- 7 • Investment Strategies 195**

PART III *Valuation Concepts and Analysis 220*

- 8 • Economic, Market, and Industry Analysis 223**
- 9 • Analyzing Financial Statements 265**

PART IV *Fundamental Analysis of Bonds 310*

- 10 • Bond Fundamentals 313**
- 11 • Bond Analysis: Returns, Risk, and Strategies 347**

PART V *Fundamental Analysis of Preferred and Common Stocks 400*

- 12 • Preferred and Common Stock Basics 403**
- 13 • Analyzing and Forecasting Company Earnings 431**
- 14 • Preferred and Common Stock Valuation 455**

PART VI *Analysis of Alternative Investments 488*

- 15 • Options 491**
- 16 • Convertibles and Warrants 529**

- 17 • Commodity and Financial Futures 565**
- 18 • Precious Metals, Real Estate, and Collectibles 613**

PART VII *Portfolio Theory and Analysis* 644

- 19 • Portfolio Theory 647**
- 20 • Capital Market and Arbitrage Pricing Theories 685**
- 21 • Analysis of Portfolio Performance and Market Efficiency 729**

PART VIII *Individual Investment Decision Making* 770

- 22 • Personal Investment Management 773**

Appendixes

- A-1 • The Investment Analysis Software A-2**
- A-2 • Review of Analytical Techniques A-15**
- A-3 • Mathematical Terms, Symbols, and Key Formulas A-24**
- A-4 • Compound and Present Value Tables A-31**
- A-5 • Standard Normal Cumulative Probability Distribution and Student
t Distribution A-40**

Glossary G-1

Corporation and Organization Name Index I-1

Name Index I-5

Subject Index I-11

Contents

Preface xxii

PART I

***Investment Fundamentals* 2**

1 • *An Overview of Investments* 5

- Introduction 6
- The Decision to Invest: A Case Study 6
- Overview of Investment Alternatives 8
- Factors to Consider in Choosing among Investment Alternatives 13
 - Investment Objective 13
 - Rate of Return 14
 - Risk 15
 - Taxes 16
 - Investment Horizon 16
 - Investment Strategies 17
- The Evolution of the Investment Environment and Process 21
 - The 1950s and 1960s 21
 - The 1970s 21
 - The 1980s 22
 - The 1990s 23
- Organization and Features of the Book 24
- Summary 25
- Key Terms 26
- Questions 26

2 • *Investment Risk and Return* 27

- Introduction 28
- Investment Return 30
 - Single-Period Measure of Return 30
 - Measures of Return over Several Periods 31
 - Annualized Holding Period Returns 31

Required Rate of Return 33

Expected Rate of Return 34

Investment Risk 38

Sources of Investment Risk 38

Measures of Investment Risk 40

Coefficient of Variation 41

Beta: Another Measure of Investment Risk 43

Relating Beta and the Required Return 46

Application: The Young Investors 49

Summary 52

Concept Applications 53

Key Terms 54

Questions 54

Key to the Investment Analysis Software 55

Problems 56

References 58

PART II

***The Investment Environment* 60**

3 • *Security Markets: Operations and Regulations* 63

- Introduction 64
- Primary Markets 64
 - Role of the Investment Banker 65
 - Investment Bankers and Banking in the 1980s: A Decade of Innovations and Ethical Problems 69
 - Investment Banking in the 1990s 71
- Secondary Markets 72
 - New York Stock Exchange 72
 - American Stock Exchange 74
 - Regional Exchanges 76

Over-the-Counter Market	77
Third and Fourth Markets	78
Trading Mechanics	79
Overview	79
Types of Orders	80
Regulation of Securities Markets	82
Securities Act of 1933	83
Securities Exchange Act of 1934	83
Maloney Act of 1936	85
Insider Trading and Securities Fraud Enforcement Act of 1988	85
Other Regulations	85
Summary	85
Concept Applications	86
Key Terms	87
Questions	87
References	88

4 • *Investment Information* 89

Introduction	90
Analysis of Economic Conditions	91
Industry Analysis	92
Company Information	94
Investment Advisory Services	94
Standard & Poor's Corporation	95
Moody's Investor Service	95
Value Line	100
Investment Newsletter and Chart Services	103
Computerized Data Bases	103
Overview	103
Compustat	104
CRSP	104
ISL	104
Value Line Data Base	104
Compact Disks	104
On-Line Services	105
Market Indexes	105
The Dow Jones Averages	106
Standard & Poor's Stock Indexes	109
New York Stock Exchange Indexes	111
American Stock Exchange Indexes	111
NASDAQ Indexes	111
Value Line Index	111
The Wilshire 5000 Equity Index	112

Comparison of Market Indexes over Time	112
---	-----

Summary	114
Key Terms	115
Questions	115
Problem	116
References	116

5 • *Investing in Mutual Funds* 119

Introduction	120
Closed-End Companies	120
Closed-End Funds	120
Other Types of Closed-End Companies	123
Overview of Mutual Funds	124
Historical Development of Mutual Funds	126
Regulation of Mutual Funds	127
Ex-Post Holding Period Return for Mutual Funds	128
Mutual Fund Characteristics	131
Load versus No-Load Mutual Funds	131
Other Types of Fees and Expenses	132
Investment Objectives of Mutual Funds	135
Investing in Mutual Funds	140
Sources of Information	140
Determining an Investment Objective	143
Services Provided by Mutual Funds	143
Key Decision Variables	145
Investment Strategies for Mutual Funds	149
Passive Strategies	149
Active Strategies	153
Summary	154
Concept Applications	155
Key Terms	156
Questions	156
Key to the Investment Analysis Software	157
Problems	157
References	159

6 • Investing Internationally 161

- Introduction 162
- International Assets and Markets 162
 - The World Investable Market Portfolio 162
 - Background on Financial Markets 162
 - Comparing Risk and Return 166
 - Size of International Companies 167
- Diversifying Internationally 169
 - Evidence on the Benefits of Diversifying Internationally 169
 - Factors Influencing Security Prices Globally 172
 - International Diversification with Floating Exchange Rates 174
- International Investments for the Individual Investor 179
- International Money Market Investments 185
- Concept Applications 189
- Summary 189
- Key Terms 190
- Questions 190
- Key to the Investment Analysis Software 191
- Problems 191
- References 192

7 • Investment Strategies 195

- Introduction 196
 - Speculation versus Investing 196
 - Taxes 197
- Trading Strategies 198
 - Long versus Short Position 198
 - Margin Trading 200
 - Hedging 201
 - Arbitrage 204
- Analysis Strategies 204
 - Technical Analysis 205
 - Fundamental Analysis 205
- Investment Strategies in an Efficient Market 206
 - Passive Strategies 207
 - Active Strategies 208
 - Conclusions 214

- Summary 214
- Key Terms 215
- Questions 215
- Problems 216
- References 217

PART III

Valuation Concepts and Analysis 220

8 • Economic, Market, and Industry Analysis 223

- Introduction 224
 - Stock Prices and the Economy 224
 - The Business Cycle 227
 - Key Economic Variables 228
 - Professional Economic Forecasts 236
 - Relating an Economic Forecast to the Stock Market 240
- Technical Analysis 241
 - Breadth of the Market 241
 - The Confidence Index 242
 - Mutual Funds' Cash Position 242
 - Put-Call Ratio 243
 - Short Interest 243
- Industry Analysis 243
 - Importance of Industry Analysis 249
 - Key Industry Fundamentals 250
 - Industry Selection 253
 - Illustration of an Industry Analysis 255
- Summary 255
- Key Terms 255
- Concept Applications 256
- Questions 256
- Key to the Investment Analysis Software 257
- Problems 258
- References 260
- Appendix 8A: Illustration of Basic Industry Analysis: Automobiles 262

9 • Analyzing Financial Statements 265

- Introduction 266
- The First Steps in Company Analysis 268
 - Selecting the Company for Analysis 269
 - Obtaining Company Information 270
- Analysis of Financial Statements 270
 - Return on Equity 271
 - Ratio Analysis and Return on Equity 271
 - Other Ratios 273
 - Interpreting the Ratios 275
- Quality of Financial Statements 278
 - The Impact of Accounting Changes 278
 - Economic versus Accounting Measurement of Income 280
- Other Key Fundamentals in Company Analysis 281
- Illustration of Company Financial Analysis: The Procter & Gamble Company 282
 - Company Background 283
 - Analysis of Procter & Gamble's Financial Statements 283
- Summary 291
- Concept Applications 292
- Key Terms 292
- Questions 293
- Key to the Investment Analysis Software 294
- Problems 294
- References 298
- Appendix 9A: The Procter & Gamble Company and Subsidiaries: Notes to Consolidated Financial Statements 300

PART IV***Fundamental Analysis of Bonds 310*****10 • Bond Fundamentals 313**

- Introduction 314
- Comparing Bonds with Other Types of Investments 314
 - Return Comparison: HPRs 314
 - Risk Comparison 316

Changing Investor Attitudes Toward Bonds 316**Types of Bonds 319**

- U.S. Government Securities 319
- U.S. Savings Bonds 320
- Federal Agency and Miscellaneous Securities 322
- Municipal Securities 323
- Corporate Bonds 326
- Comparison of Yields by Types of Bonds 326

Basic Features of Bond Issues and Individual Bonds 328

- Issuer Characteristics 329
- Bond Characteristics 330
- Bond Ratings 332

Bond Markets 338

- Primary Market 338
- Secondary Market 339
- Quotations 339
- Transaction Costs 339
- Indexes 340

Summary 342**Concept Applications 343****Key Terms 344****Questions 344****Key to the Investment Analysis Software 345****Problems 345****References 346****11 • Bond Analysis: Returns, Risk, and Strategies 347****Bond Valuation 348**

- Basic Equation 348
- Consols, Zeros, OIDs, and LYONs 350
- Investment Decision Making 351

Bond Return Measures 354

- Current Yield 354
- Yield to Maturity 354
- Yield to Maturity for Callable Bonds 356
- Holding Period Return 357
- Expected Rate of Return 358
- An Illustration and Comparison of Return Measures 360

Bond Risk Analysis	361
Systematic Sources of Bond Risk	361
Unsystematic Sources of Bond Risk	366
Empirical Measures of Bond Risk	367
An Illustration and Comparison of Risk Measures	371
Bond Investment Strategies	372
Passive Strategies	373
Active Strategies	374
Bond Portfolio Diversification	383
Naïve Diversification	383
Concept Applications	385
Summary	385
Key Terms	386
Questions	386
Key to the Investment Analysis	
Software	388
Problems	388
References	391
Appendix 11A: Bond Swaps	393
Appendix 11B: Immunization	396
Classical Immunization	396
Contingent Immunization	399

PART V

Fundamental Analysis of Preferred and Common Stocks 400

12 • Preferred and Common Stock Basics 403

Introduction	404
Preferred Stock	404
Debt or Equity?	405
Dividends	406
Taxes	407
Call Feature	408
Convertibility	408
Adjustable Dividend Rates	409
Marketability	410

Common Stock	411
Control	411
Preemptive Right	414
Liquidation Rights	414
Right to Income and Distribution of Additional Shares	415
Common Stock Values	417
Quotations	418
Classifications of Common Stock	419
Blue-Chip Stocks	419
Growth Stocks	420
Income Stocks	420
Cyclical and Defensive Stocks	421
Speculative Stocks	421
Small Stocks	422
Treasury Stock	422
Quality Ratings	422
Summary	423
Concept Applications	424
Key Terms	425
Questions	425
Problems	426
References	428

13 • Analyzing and Forecasting Company Earnings 431

Introduction	432
Definitions of Earnings per Share	432
Earnings Forecasts	434
Difficulty of Forecasting Earnings	434
Professional Earnings Forecasts	436
Accuracy of Earnings Forecasts	437
Methods of Forecasting Earnings	439
Cash Flow per Share	441
Unexpected Earnings	442
An Illustration of Analyzing and Forecasting EPS	445
Summary	448
Concept Applications	449
Key Terms	449
Questions	449