

Lecture 3: Equity Markets

ECON435: Financial Markets and the Macroeconomy

Anton Korinek

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Review

Fixed-Income Markets:

- *money markets*: maturity up to 1 year
examples: T-bills, certificates of deposit, commercial paper, ...
 - *bond markets*: higher maturity
examples: Treasury notes and bonds, agency bonds, corporate bonds, ...
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Equity Markets

Equities (or common stocks, shares):

- represent ownership rights:
 - right to vote in annual meeting, e.g. vote for board of directors
 - right to residual profits after all other claimants have been paid (dividends)
 - are subject to limited liability
 - can be traded on stock exchanges: NYSE, NASDAQ, ...
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Equity Markets

Stocks are often represented by a "ticker":
GOOG, AAPL, YHOO, SBUX, WMT, C

Internet resources about stocks:

- <http://finance.google.com>
 - <http://finance.yahoo.com>
 - <http://www.bloomberg.com>
 - <http://www.marketwatch.com>
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Equity Markets

Agency problems:

- management: supposed to represent interests of shareholders
 - in practice, management has considerable power to act in its own interest:
 - myopic management
 - large, unjustified pay packages
 - board of directors: supposed to oversee managers
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Categories of Stock

- Preferred stock:
 - promises a fixed annual dividend
 - has priority over common stock
 - may be *redeemable* or *convertible*
 - does not have voting rights
 - somewhere in between debt and equity
 - Common stock:
 - receives dividend only after all promised dividends on preferred stock have been paid
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Stock Market Indexes

Indexes are benchmarks for the performance of a market

Dow Jones Industrial Average (DJIA):

- calculated since 1896
- includes 30 large corporations (blue chips)
- price-weighted index: represents a portfolio with 1 stock of each company in the index
→ high price stocks have larger weight

Stock Market Indexes

Standard & Poor's Composite 500 (S&P 500):

- includes 500 largest US corporations
- market-value-weighted index: represents change in total market value of all 500 companies
→ larger companies have larger weight

Other indexes:

- NASDAQ
- Wilshire 5000: includes almost all US stocks

Main US Stock Indexes

