

# **Complete Guide to Investing**

---

**8<sup>th</sup> Edition**

Distributed by The CPE Store  
[www.cpestore.com](http://www.cpestore.com), 1-800-910-2755

# Table of Contents

---

<b>Chapter 1 – Getting Started as an Investor .....</b>	<b>1</b>
Learning Objectives .....	1
Introduction.....	1
Investing.....	2
The Sources of Money for Investing.....	2
The Types of Investments.....	2
Features of Bonds .....	3
Features of Common Stocks.....	4
Dividends.....	4
Convertible Securities .....	4
Derivative Products.....	5
The Difference between Common Stocks and Mutual Funds.....	5
Other Types of Investments .....	6
Factors to Consider in Investment Decisions.....	6
Tax Aspects to Consider When Investing .....	7
Drawbacks and Benefits of Buying Municipal Bonds .....	7
Retirement.....	8
Capital Losses Treatment .....	8
The Relationship between Risk and Return.....	8
The Difference between a Marketable Investment and a Liquid Investment.....	9
How Interest Rates Affect the Market Value of Your Investment.....	9
Expenses Associated with Investments.....	9
Aggressive vs. Conservative Investing .....	9
Steps in Investment Planning .....	10
Review Questions.....	11
Review Answers .....	12
<b>Chapter 2 – Financial Markets and Investment Processes.....</b>	<b>13</b>
Learning Objectives .....	13
Introduction.....	13
Capital Markets.....	13
Major Exchanges .....	13
The Futures Market?.....	14
Transactions.....	14
Security Transactions .....	14
Types of Securities Transactions .....	15
Various Kinds of Orders .....	16
Settlement Date.....	16
Brokerage Firms .....	17
Stock Splits and Stock Dividends .....	17
Cash Dividends .....	17
Dividend Reinvestment and Cash Option Plans .....	18
Buying Stock on Margin (Margin Trading).....	18
Selling a Stock Short.....	19
Review Questions.....	20
Review Answers .....	21
<b>Chapter 3 – Return and Risk.....</b>	<b>23</b>
Learning Objectives .....	23
Introduction.....	23
Investment Return .....	23
Return .....	23
Measuring the Return Over Time .....	24
Effective Annual Yield .....	25

## Table of Contents

Compute the Expected Rate of Return.....	26
Measuring Risk.....	26
Investment Risks .....	27
Different Risks .....	27
Reducing Risk .....	28
Risk Tolerance.....	28
The Risk-Return Trade-Off.....	29
Beta.....	30
How Do Investment Alternatives Affect the Risk-Return Trade-Off?.....	32
Review Questions.....	33
Review Answers .....	35
<b>Chapter 4 – Fundamental Analysis.....</b>	<b>39</b>
Learning Objectives .....	39
Introduction.....	39
Fundamental Analysis.....	40
Risk Analysis .....	40
Political Uncertainties.....	42
Industry Analysis.....	42
Analyzing Financial Statements .....	43
Financial Statement Analysis .....	43
Horizontal and Vertical Analyses.....	43
Working with Financial Ratios .....	46
Evaluating a Company's Liquidity.....	46
Measuring How a Company Utilizes Assets .....	48
Business Solvency.....	49
Measuring Profitability.....	51
Relation between Company Earnings and Market Value .....	52
Overall, Would You Invest in This Company?.....	54
Bankruptcy Prediction Model.....	56
A Systematic Approach for Stock Picking.....	56
Review Questions.....	58
Review Answers .....	59
<b>Chapter 5 – Technical Analysis .....</b>	<b>61</b>
Learning Objectives .....	61
Introduction.....	61
Technical Analysis .....	61
Tools for Technical Analysis.....	62
The Dow Theory.....	62
Charting.....	63
Types of Charts .....	63
Moving Averages .....	65
Support and Resistance Levels.....	65
Relative Strength Analysis .....	66
Software Charting .....	67
Key Indicators.....	68
Price-Trading Volume .....	68
Market Breadth .....	68
Barron's Confidence Index.....	69
Contrarian Indicators.....	69
Cash Held by the Mutual Fund.....	69
Short Interest Ratio.....	69
Short Sales by Specialists.....	70
Odd-Lot Trading Indicator .....	70
Index of Bearish Sentiment .....	71
Puts and Calls .....	71

## Table of Contents

What Does the Chicago Board Options Exchange Volatility Index (VIX) represent?.....	71
A Caveat.....	72
Review Questions.....	73
Review Answers .....	74
<b>Chapter 6 – Common Stocks and Preferred Stocks .....</b>	<b>75</b>
Learning Objectives .....	75
Introduction.....	75
Common Stock .....	75
Characteristics of Common Stock .....	76
Types of Stocks .....	77
Yield on Common Stock Investments.....	78
Preferred Stock.....	79
Rating Preferred Stock.....	80
Calculating Expected Return from Preferred Stock.....	80
Types of Preferred Stock .....	81
Investing in Money Market Preferred Stock .....	82
Review Questions.....	83
Review Answers .....	84
<b>Chapter 7 –Common Stock Valuation.....</b>	<b>85</b>
Learning Objectives .....	85
Introduction.....	85
The Time Value of Money .....	85
Future Value of \$1 .....	85
Future Value of an Annuity of \$1.....	86
Present Value of \$1 .....	87
Present Value of an Annuity of \$1 .....	88
The Fundamental Value of Common Stock .....	90
Determining the Required Rate of Return.....	92
Price/Earnings Ratio Approaches.....	93
A Caveat about P/E Ratios .....	95
Other Stock Valuation Techniques .....	96
The Price-Sales (P/S) Ratio .....	96
The Price-Free Cash Flow .....	96
The Price-Dividends (P/D) Ratio .....	97
The Price-Book (P/B) Ratio .....	97
Stock Valuation.....	97
The Bottom Line .....	98
Review Questions.....	99
Review Answers .....	100
<b>Chapter 8 – Fixed Income Securities.....</b>	<b>101</b>
Learning Objectives .....	101
Introduction.....	101
Bonds .....	101
Characteristics of Bonds .....	102
Bond Yields, Interest Rates, and Bond Prices .....	102
The Yield Curve.....	102
Types of Bonds.....	102
Selecting a Bond.....	104
Determining Interest Rate Risk.....	105
Macaulay's Duration Coefficient .....	105
Interest Rate Elasticity .....	106
Computing the Effective Rate on a Bond .....	106
Municipal Bonds .....	108
Trading in Municipal Bonds .....	108

## Table of Contents

Government Bonds.....	109
Treasury Bills.....	109
Treasury Notes.....	110
Treasury Bonds .....	110
Treasury STRIPS (Separate Trading of Registered Interest and Principal of Securities) .....	110
Buying Treasuries.....	110
Government Agency Bonds .....	110
Other Fixed Income Securities .....	111
Investing In Savings Bonds .....	112
I and EE Savings Bond Comparison .....	113
Investing in a Bond Fund or ETF.....	113
Unit Investment Trusts .....	114
Investing in Municipal Bonds: Three Approaches .....	114
Investing in Mortgage-Backed Securities.....	115
Review Questions.....	116
Review Answers .....	118
<b>Chapter 9 – Investing in Options .....</b>	<b>121</b>
Learning Objectives .....	121
Introduction.....	121
Options.....	121
Stock Rights .....	121
The Value of Right.....	122
Stock Warrants .....	122
Return on a Warrant .....	123
The Value of a Warrant.....	123
Leverage Effect of a Warrant .....	124
Calls and Puts .....	125
In-the-Money and Out-of-the-Money Call Options.....	126
In-the-Money and Out-of-the-Money Put Options .....	126
Calls .....	127
Puts.....	128
Call and Put Investment Strategies .....	128
Option Writing.....	130
Naked or Covered Options.....	130
Review Questions.....	131
Review Answers .....	132
<b>Chapter 10 – Futures Contracts.....</b>	<b>133</b>
Learning Objectives .....	133
Introduction.....	133
Futures Contracts .....	133
Futures Contract.....	133
The Difference between a Long and Short Position.....	134
How Futures Contracts Are Traded.....	134
Futures Trading Risk.....	135
Commodities Futures.....	135
Returns and Risks for Futures Contracts .....	135
Using Futures .....	136
Ways to Minimize Risks .....	136
Financial Futures .....	137
Interest Rate Futures .....	137
Currency Futures .....	137
Stock Index Futures Contract.....	137
Review Questions.....	139
Review Answers .....	140

## Table of Contents

<b>Chapter 11 – Global Investing.....</b>	<b>141</b>
Learning Objectives .....	141
Introduction.....	141
Global Investing .....	141
Advantages of Global Investing.....	141
Risks in Investing Globally .....	143
Currency (or Foreign Exchange) Risk .....	144
Political (or Sovereign) Risk .....	145
Institutional Obstacles.....	145
The Ways to Invest Globally.....	146
Purchasing Foreign Stock Directly.....	146
American Depository Receipts (ADRs).....	147
Disadvantages of ADRs.....	147
Buying Foreign Bonds.....	148
The Difference between a Eurobond and a Foreign Bond.....	148
Foreign Bonds to U.S. Investors.....	148
The Advantages of Foreign Convertibles.....	148
Yield .....	149
Investing in International Money Markets .....	149
Buying Shares of U.S.-Based Multinational Corporations .....	149
Investing in International Mutual Funds and ETFs .....	150
Global Portfolio Diversification via Mutual and Exchange Traded Funds.....	150
Features of the Various Types of International Funds.....	150
Selecting Mutual Funds and ETFs .....	151
Sources of Information.....	151
Review Questions.....	153
Review Answers .....	154
<b>Chapter 12 – Tax-Advantaged Investments.....</b>	<b>155</b>
Learning Objectives .....	155
Introduction.....	155
Related Tax Rules and Applications .....	155
Tax Advantages of Real Estate .....	156
Limited Partnerships .....	157
Real Estate Investment Trusts (REITs) .....	157
Real Estate Operating Companies (REOC).....	158
Retirement Plans .....	159
Tax Implications .....	159
Keeping Your Eye on Retirement .....	159
Types of Pension Funds .....	160
Retirement Plans: The Basic Rules .....	161
Annuities.....	162
Review Questions.....	166
Review Answers .....	167
<b>Chapter 13 – Investing in Mutual Funds, Index Funds, and ETFs .....</b>	<b>169</b>
Learning Objectives .....	169
Introduction.....	169
Mutual Funds and Other Funds.....	170
Fund Investing .....	170
Fund Attributes .....	170
Common Services Offered by Funds.....	170
The Determination of Net Asset Value.....	170
Mutual Fund Distributions .....	171
Computing the Total Return on a Mutual Fund .....	171
Mutual Funds Fees .....	171
Types of Mutual Funds .....	172

## Table of Contents

The Difference between Open-End and Closed-End Funds.....	172
Fund Categories .....	173
Different Investment Programs with Mutual Funds.....	174
Selecting a Bond (Income) Fund .....	174
Some Guidelines to Follow When Investing in a Bond Fund .....	175
Tax-Exempt Municipal Bond Funds.....	175
Unit Investment Trusts .....	175
Measuring the Performance of a Mutual Fund.....	176
Choosing a Mutual Fund and ETFs .....	177
What Is Performance Benchmarking? .....	178
Risk-Reducing Strategies for Investing in Mutual Funds.....	179
How Does Dollar Cost Averaging Work? .....	179
Investing in Index Funds: No-Brainer Investment Method .....	180
Obtaining Mutual Fund Information and Ratings .....	181
Online Resources .....	181
Investing in Money Market Funds.....	182
Sources of Information for Money Market Funds .....	182
Closed-End Funds .....	182
Advantages and Disadvantages of Closed-End Funds .....	183
Sources of Information and Online Services for Closed-End Funds .....	183
Hedge Funds .....	183
Tax Tips with Funds.....	183
Robo-Advisors .....	184
Review Questions.....	186
Review Answers .....	187
<b>Chapter 14 – Diversification, Portfolio Construction, and Asset Allocation.....</b>	<b>189</b>
Learning Objectives .....	189
Introduction.....	189
Diversification .....	190
How to Allocate Assets with Mutual Funds and ETFs .....	190
Investing In an Asset Allocation Fund.....	191
A Do-It-Yourself Portfolio Construction.....	191
Calculate Your Allocation Mix.....	192
Rebalancing: Fine-Tune Your Asset Mix .....	192
Obtain Help for Constructing an Asset Allocation Portfolio .....	193
Using Beta for Asset Allocation .....	194
Life-Cycle Guide: Recommended Asset Allocation .....	195
How Your Family Situation Affects Your Financial Goals and Investment Conditions? .....	196
Review Questions.....	198
Review Answers .....	199
<b>Glossary.....</b>	<b>201</b>
<b>Index .....</b>	<b>221</b>