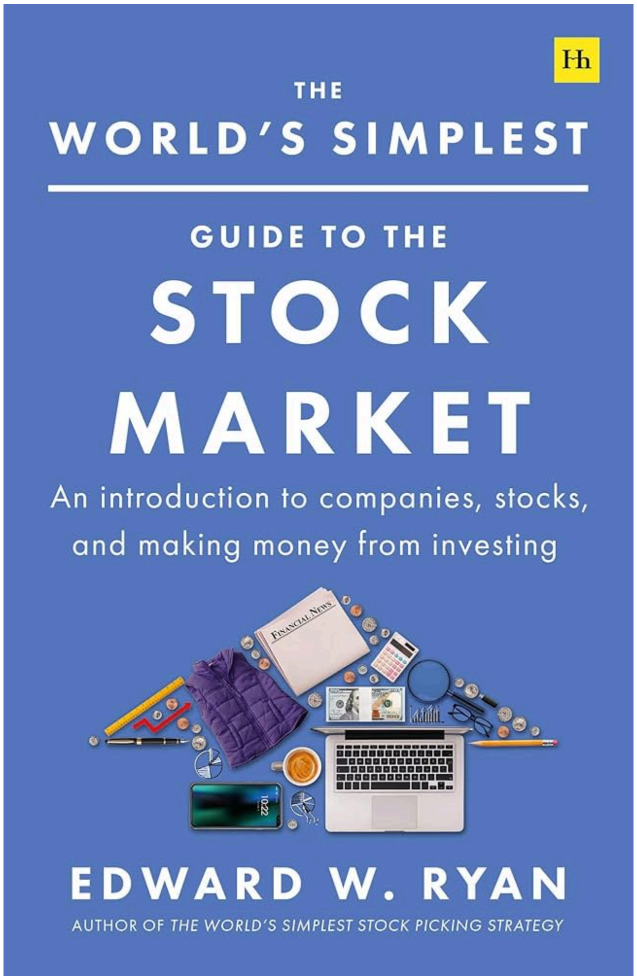
The World's Simplest Guide to the Stock Market

Takeaways

- Publicly traded companies release three financial documents that "tell their story".
    - Income statement
        - Revenue/Expenses
    - Balance sheet
        - Assets/Liabilities
        - Could be categorized as current assets and long-term assets.
    - Cash flow statement
        - summarizes the amount of cash and cash equivalents entering and leaving a company. The CFS highlights a company's cash management, including how well it generates cash. This financial statement complements the balance sheet and the income statement.
- Most large companies usually choose from both sources of capital:
    - Debt
    - Equity
- The way how buying stocks works is as follows:
    - There are broker companies and you create a brokerage account there.
    - You pay these companies (e.g. Fidelity) for the stock you want to buy, and they buy the share & parcel out the share to you as their client.
    - Some organizations protect you and offer coverage from potential fraud from these broker companies.
    - This process is through something called "street name", The name that appears on the stock or bond certificate is that of the broker, but the person who paid for the securities retains ownership rights.
- One rule of thumb for stock valuation is the price-to-earnings ratio, also known as a P/E ratio or multiple. If a share of Nike sells for $100, and the company's most recent annual earnings per share was $4, then the P/E ratio is 25. Or, put another way, an investor pays $25 for $1 of earnings.
- To extend this analogy, a Nike investor would look at a similar stock to see how it's valued. Say, for instance, Under Armour shows a multiple of 20, indicating a slightly lower valuation. From there, it's up to an individual investor to determine what story the P/E ratios show. Maybe Nike is overvalued. Or perhaps Under Armour has stronger prospects for future growth. Either way, deciding which stock is the better buy requires some subjectivity.

- The process, known as an IPO (Initial Public Offering), allows companies to raise money by selling shares on the open market.
    - **Role of Investment Banks:**
        - Companies hire investment banks for their expertise in managing IPOs. These banks act as intermediaries, connecting the company with investors and ensuring the process is properly executed.
    - **Marketing the Shares (Roadshow):**
        - The **Roadshow** is a critical promotional phase where executives pitch their company's value, vision, and financial health to attract institutional investors.
        - It resembles a corporate version of **Shark Tank**, where investors evaluate the business's potential before committing funds.
    - **Institutional Investors:**
        - Large investors like hedge funds and mutual funds are targeted during the IPO because they can invest significant amounts, providing the bulk of the IPO capital.
    - **Finalizing and Trading:**
        - After generating interest and ensuring no major issues arise, the shares are listed on a stock exchange, and public trading begins.
- Once a company becomes public, its shares trade on a stock exchange, the formal market where shares are bought and sold. In the United States, the two dominant platforms are the New York Stock Exchange (**NYSE**) and the **Nasdaq Stock Market**. The NYSE is the home of traditional financial companies such as JPMorgan Chase and industrial firms such as Caterpillar and ExxonMobil.
- The **"Pink Sheets"** refers to the companies that are not listed on major stock exchanges like the NYSE or NASDAQ. It is an over-the-counter (OTC) marketplace where smaller, less-regulated, and often riskier companies' stocks are traded. The name "Pink Sheets" originated because stock quotes were historically printed on pink-colored paper before digital systems became common.
- Most of the major brokerages charge no to little commissions on trades, although there might be some additional costs like not getting the best deal.
- Two Common ways to buy stocks is as follows:
    - Market order - agreeing to buy the stock at whatever the asking price is at the moment of your trade.
    - Limit order - setting a price to buy the stock at if it falls to that. If it doesn't that day, your order would be canceled.
- As I've mentioned in another book summary, index funds are simplified ways for individual investors to buy the performance of a major index, such as Dow Jones or S&P 500.

Resources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An introduction to companies, stocks,
and making money from investing
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