Module 5 Article

Indicators To Know & Use

Indicators Are Important For Traders

By looking at a company's fundamentals and an array of indicators, we can better benchmark a company against their peers. These indicators include:

Earnings Per Share (EPS)

This is a way to break down the earnings of a company to a smaller more manageable number. It also correlates the stock to its share of the company's total profits. To calculate EPS you divide the company's total profit for the year and divide by the outstanding shares.

EXAMPLE: If a company's profit is $100 million and there are 10 million shares, the EPS is $10.

EPS is a very good measure at looking at how a company is performing year over year. You are able to analyze the EPS and see how it has grown over the years and if it is steadily growing that is a good sign of a healthy company. However, if it is super volatile then the company may not be the best to invest in.

Price to Earnings (P/E) Ratio

This ratio looks at the relationship between a company's stock price and the earnings of the company. To calculate it you divide the current share price by that company's earnings per share.

EXAMPLE: A company's stock currently sells for $100 per share and its earnings per share are $10. That means it has a P/E ratio of 10 ($100 divided by $10).

A P/E ratio can tell you whether a company' stock is priced too high or low compared to its earnings, however, not all investors agree on what it exactly shows. Some investors believe a company with a high P/E to be overvalued, however, some companies with high P/E's are the best performers. This is why investors look at multiple indicators to determine where a stock will move.

Price to Earnings Ratio to Growth Ratio (PEG)

This ratio helps further dive into the P/E ratio and use it. This is calculated by dividing the price to earnings ratio by the expected company growth percentage.

EXAMPLE: A stock with a P/E of 100 and projected earnings growth next year of 10% would have a PEG of 10 (100 divided by 10). A stock with a P/E of 10 but projected earnings growth of 10% will have PEG of 1 (10 divided by 10).

PEG can be a good indicator of if the stock you are looking at is a good value. A low PEG means that it is cheaper to get in on the action and a share of the company's profit. A large PEG means that it will be costly to access the company's profits.

Price to Book Value Ratio (P/B)
This measure looks at the value that the market puts on a company compared to the financially stated value on the company's books. To calculate this they divide the current share price by the book value per share. To find the book value it is the current equity of a company.

Usually, a low P/B is better. This is because you are paying less for more book value. These stocks typically have the potential to grow rapidly because they are primed for growth.

Dividend Payout Ratio (DPR)
The measure determines the ratio between dividends of a company and earnings per share of a stock. It is calculated by dividing the dividends of a stock by the earnings per share.

EXAMPLE: If a company paid out $10 per share in dividends and had an EPS of $100, the DPR would be 10% (10 divided by 100).

The DPR is good at evaluating how much of a company's earnings are going towards dividends. With a high DPR it shows that the company is distributing its earnings rather than keeping them. This typically happens with more mature companies that are not growing as much. Smaller companies that are growing typically have very small earnings and/or dividends, which means they usually have lower DPR.

Dividend Yield
This number measures the size of a dividend paid by a company by comparing it with its share price. The number is calculated by dividing the dividend by the share price and expressing it as a percentage.

EXAMPLE: You have 2 stocks which each pay an annual dividend of $1 per share. Company 1's stock is trading at $100 a share, but Company 2's stock is only trading at $10 a share. Company A has a dividend yield of 1% (1 divided by 100), while Company B's is 10% (1 divided by 10).

This yield percentage gives you an estimate of how much of a return you are getting on the share in the form of dividends. Having a higher dividend yield means you are getting more bang for your buck.

The Bottom Line
Indicators can help you assess the value of a stock and its growth potential. But there are many other factors affecting stock prices that can't be easily measured. The indicators illustrated above are all derived from a Company's Financial Statements, so they provide a much more detailed perspective of a company within their industry and the broader market, however, they do not inform investors about short-term volatility and momentum.

There are lots of other external factors that can and do affect stock prices that can't be measured as easily. In addition most of these indicators rely on the financial statements published by the company so be careful to look at other businesses in the industry to compare financials and indicators.