

Investment Banks in India :
ICICI Securities, Edelweiss, Axis
Bank, HSBC.

WEEK #6

Lesson #14

Intermediary b/w you & your investment - Mutual fund mngs, ETF mngs, etc.

* Investment Banks - do not take deposits or give loans, they underwrite shares



manage the process of issuing new shares in companies or issuing debt.

* Bulge bracket firms - big firms that act as investment banks.

e.g. Goldman Sachs, Merrill Lynch

* Investment bankers have a better public image than undertakers.

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- Underwriting of Securities

- issuance of shares & corp. debt.

- consulting firm analogy.

Investment banks - consulting firm w/ resources.

co
\$

Moral Hazard Problem

- Firms have incentive to issue more shares when earnings hit a temporary high.

Investment Banks - 2 kinds of offering

- ① Bought deal - underwriter agrees to buy all shares that are not sold.
- ② Best efforts - underwriter says that if the issue of shares @ a certain price is not sold, deal collapses.

Underwriting Process I

- pre-filing - advise abt choices.
- Agreement among underwriters, syndicate is formed.
- Registration with SEC
- Cooling off period (distribute prelim prospectus)
"Red Herring" - Wall Street

Underwriting spread is the profit

- diff b/w price @ which the issue was bought from the corporation & price @ which issue is sold

Underwriting Process //

- Call prospective clients for indication of interest
- Due Diligence b/w underwriter & co.
- Decide on offering price
- Underwriting agreement.
- Dealer agreement
- Effective date
- Support price in aftermarket (stabilization)

Tendency for underwriters to underprice shares a little bit so that price goes up.

IPO

- can be privately listed previously.
- price ~~at~~ mostly jumps after the IPO.
- hard for new market entrants
- in the long run, IPO prices tend to fall
- avg IPO earns a +16% return on the first day, this return tends to be offset over the next 3 years.

Big Short movie

Charles Ellis - Goldman Sachs.

- ① Money > prestige.
- ② Loyalty to the firm
- ③ Personal Anonymity

John Whitehead - new chairman of Goldman Sachs.

- ① Client's interests first
- ② Assets are people, capital, reputation.
- ③ Determination
- ④ Creativity & Imagination.

Invest. banking - highly coupled w/ trust.

RATING AGENCIES

* grade companies for their integrity. AAA is best rating. Rating Agencies initially would not accept money from the people they rated, but that broke down w/ increasing no. of financial products & complexity.

Glass Steagall Act (1933)

- Started off the concept of investment banks
- Set up FDIC (insurance of bank deposits)
- States that a bank cannot be a commercial bank as well as investment banks - repealed in 1990s.

Volkert Rule - Commercial banks can no longer be allowed to own hedge funds or do prop trading.

Professional Money Managers

- people who take your assets & invest in stocks/bonds or other investable assets in the open mkt.

Assets of US Households

- | | |
|---------------------------|-------------------------------|
| ① Real Estate | ⑥ Mutual Funds |
| ② Pension Funds | ⑦ Consumer Durables (car etc) |
| ③ Equity in non-corp biz. | ⑧ Treasury Securities |
| ④ Deposits | |
| ⑤ Corpories | |

Liabilities:

- 1) Home Mortgages
- 2) Consumer Credit
- 3) Loans & other.

Prudent Person

Investment Managers must be
"prudent persons".

Presently replaced w/ "prudential
standards" in Dodd Frank Act.

- * Financial Advisors - regulated
- * Financial Planners - not regulated

Mutual Funds

Massachusetts Investment Trust
- published portfolio, redeemed
on demand.

To invest in an Mutual Fund,
contact the firm not buy a share.

Exchange Traded Fund

- more liquid
- tends to have lower expense ratios

closed-end fund - buy a share of the fund on the stock exchange to close, sell the shares.
These shares pay dividends.

→ doesn't track value of underlying assets.

ETF = closed-end fund that tracks the value of underlying assets.

→ "authorized participants"



can create/redeem underlying shares back, or create more ETFs.

this makes sure ETF prices track the underlying price.

Lesson #15

Broker (BOAC) - Brokers act on behalf of Others as their Agent for which they earn a Commission.

Dealers (DHPM) - Dealer always acts for himself, in other words as a Principal in the transaction for which he makes a Markup.

Broker-Dealer - companies that can act as broker as well as dealer
→ analogy to antique dealers real estate - no dealers since in US, dealers would have to pay tax on capital gains on the real estate.

"churning" - encouraging clients to make frequent trades by providing several fin. advice.
→ high commission

EXCHANGES

NASDAQ - computerized system replaced the pink sheets. (would have bid & ask prices printed)

- * Exchanges provide stds & ethics.
- * Markets to Lend Shares - Loan Crowd on NYSE (SLBM in India)
- Chinese Mkt - people tend to invest in locally listed stocks
 - ↳ no info. advantage but there's familiarity bias.

LIMIT ORDER BOOK

electronic comm. n/w (ECN)

- * you can bid/ask by looking at the order book.

HIGH FREQUENCY TRADING

- * Trades can be flashed for a millisecond & only computers will respond. (cancel order soon)
- * Speed of transmission matters
HFT isn't adding value to the mkt, it's siphoning money out.
Viable plan - all orders are executed after a 10s interval.

qty bid ask qty
150 20 20.05 100

It order \$20.02, 50 shares. buy.

PAYMENT FOR ORDER FLOW

* Orders must be given to an executor (broker gives order to an executor that pays them) - still in practice.

* SEC - composite stats on fraction of order flow to diff. executors & order-exec quality (must be published by broker).

Kinds of Orders

① Market Order (best possible price - buy/sell @ current price)

② Limit Order (offer to buy ^{below} some n, or sell above n)

③ Stop Loss Orders - sell @ a price x or below (to set lower limit to loss)

LESSON #16

Govt. Debt & Default

* Repudiation of a debt - govt will never pay, money's gone.

* Odious ~~Def~~ Debt.

* Defaulting - part of money's gone
Govt in danger of debt pay higher interest rate.

* "restructuring" - some value is preserved.

bequest

- * no intl. court of law that handles defaulted govt debts.
- negotiations for restructuring the debt.
- Collective Action clauses: agree to anything voted by the majority of investors.

GOVT. INVOLVEMENT IN CORPORATIONS

- Case Study: TEPCO, Japan - 50% owned by govt, debt that can be converted into preferred shares (so effectively govt - 88%).
- Companies can file for bankruptcy Corporate Tax - to acc. for ltd. liability
 - liquidation/ reorganization
- ch 7 company is shut down. ch 11. company is kept but restructured.

Personal Bankruptcy

- every individual is like a biz with the govt as a partial shareholder bc it allows you to take risks & then declare bankruptcy.

"Govt. as Risk Mgr. of Last Resort"

{ Public Finance is always about
incentivization in a risky world.
people have purposes & fears, & they
choose alt. financing methods to achieve them.

Municipal Finance :

→ debt of cities given
probable population influx
can later be paid via tax
income.

→ prohibition of deficit spending
on current account (can
still run deficit on capital
acc, ie can issue bonds).

Revenue bonds - project that
yields 'improvements'.

* OASDI - Old Age, Survivors & Disability

GOVT. SOCIAL INSURANCE.

it's hard to sell insurance to
the public as private firms.

Progressive Taxes → low income, ~~low tax~~

* For some very low income
households, US has negative tax.

* free public education & services

* Obamacare.

* Insurance that employers must
buy to protect against accidents
(injuries) @ work.

Failure of Income tax:

there's no way of properly
finding wh

| you should have purposes
| beyond making money,
| beyond abstract finance

Withholding of Income Taxes:

* families might not be able to
~~be~~ save up till easy to pay taxes.

Survivor's Insurance:

life insurance but called differently