

Fundamentals of Investing

Fundamentals of Investing

First Canadian Edition

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Dedicated to
our friends and mentors,
Dr. Lawrence J. Gitman and Michael D. Joehnk,
who trusted us as coauthors and successors of *Fundamentals of Investing*.

SBS

CJZ

To my wife Pooja, and my children—Saanvi and Eshaan.

VKV

To my mother Sabahat Jale Yüce

AY

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her work on foreign direct investments. She has published many papers and books and has contributed chapters to many compilations.

Preface

“Great firms aren’t great investments unless the price is right.” Those words of wisdom come from none other than Warren Buffett, who is, without question, one of the greatest and best-known investors ever. The words of Mr. Buffett sum up very nicely the essence of this text—to help students learn to make informed investment decisions, not only when buying stocks but also when investing in bonds, mutual funds, or any other type of investment.

Solving Teaching and Learning Challenges

The fact is that investing may sound simple, but it’s not. Investors in today’s turbulent financial markets confront many challenges when deciding how to invest their money. This text is designed to help students understand the risks inherent in investing and to give them the tools they need to answer the fundamental questions that help shape a sound investment strategy. For example, here are some things students want to know: What are the best investments for me? Should I buy individual securities, mutual funds, or exchange-traded funds? How do I make judgments about risk? Do I need professional help with my investments, and can I afford it? Clearly, investors need answers to questions like these to make informed decisions.

The language, concepts, and strategies of investing are foreign to many. To become informed investors, students must first become conversant with the many aspects of investing. Building on that foundation, they can learn how to make informed decisions in the highly dynamic investment environment. This first Canadian edition of *Fundamentals of Investing* provides the information and guidance that individual investors need to make such informed decisions and to achieve their investment goals.

This text meets the needs of professors and students in the first investments course offered at colleges and universities, professional certification programs, and continuing education courses. Focusing on both individual securities and portfolios, *Fundamentals of Investing* explains how to develop, implement, and monitor investment goals after considering the risk and return of different types of investments. A conversational tone and the liberal use of examples guide students through the material and demonstrate important points.

Hallmarks of *Fundamentals of Investing*

Using information gathered from academicians and practising investment professionals, as well as feedback from adopters, the first Canadian edition reflects the realities of today’s investment environment. At the same time, the following characteristics provide a structured framework for successful teaching and learning.

CLEAR FOCUS ON THE INDIVIDUAL INVESTOR. The focus of *Fundamentals of Investing* has always been on the individual investor. This focus gives students the information they need to develop, implement, and monitor a successful investment program. It also provides students with a solid foundation in basic concepts, tools, and techniques. Subsequent courses build on that foundation by presenting the advanced concepts, tools, and techniques used by institutional investors and money managers.

COMPREHENSIVE YET FLEXIBLE ORGANIZATION. The text provides a firm foundation for learning by first describing the overall investment environment, including the various investment markets, information, and transactions. Next, it

presents conceptual tools needed by investors—the concepts of return and risk and the basic approaches to portfolio management. It then examines the most popular types of investments—common stocks, bonds, and mutual funds. Following this series of chapters on investments is a chapter on how to construct and administer one’s own portfolio. The final section of the text focuses on derivative securities—options and futures—which require more expertise. Although the first two parts of the text are best covered at the start of the course, instructors can cover particular investment types in just about any sequence. The comprehensive yet flexible nature of the text enables instructors to customize it to their own course structure and teaching objectives.

We have organized each chapter according to a decision-making perspective, and we have always been careful to point out the pros and cons of the various investments and strategies we present. With this information, individual investors can select the investment actions that are most consistent with their objectives. In addition, we have presented the various investments and strategies in such a way that students learn to consider the implications and consequences of each investment action they contemplate.

TIMELY CANADIAN TOPICS. Current events, changing regulations, and other factors constantly reshape financial markets and investments in the Canadian market. Virtually all topics in this text take into account changes in the Canadian investment environment.

- Chapter 1 is an up-to-date introduction to the Canadian investment environment, keeping Canadian tax rates of 2020 in mind.
- Chapter 2 offers complete coverage of Canadian securities markets. The various regulatory bodies, SROs, and laws applicable in Canada are introduced, along with subtle difference in terminology and working with other major markets. After introducing the regular IPO process of Shopify Inc., we discuss how securities trading has changed in recent years, and we highlight the Slack direct-listing IPO as a potential threat to the traditional underwriting business of investment banks.
- Chapter 3 introduces the latest sources of investment information and the latest investment tools relevant to Canadian investors, rules related to arbitration in Canada, and the qualifications required for certification as an investment advisor. Because of the changing nature of financial markets, a new investment service called robo-advisors is introduced as well.
- Chapter 4 includes the investment and return-risk characteristics of the Canadian companies Toronto Dominion Bank, WestJet, and Shopify, among others.
- In Chapter 5, we introduce the arbitrage pricing theory. Chapter 5 offers expanded treatment of the concept of correlation, using data derived from real companies to illustrate how correlation affects the performance of a portfolio. These are but a few of the examples of new content found throughout the text.
- Chapter 6 explores a Canada Goose offering and examines the characteristics of Shopify.
- Chapter 7 offers a thorough introduction to analyzing common stocks with reference to IFRS terminologies.
- Chapter 8 introduces interpretation of the average P/E ratio of the S&P/TSX Composite Index of stocks and its relevance to Canadian investors.
- Chapter 9 offers an introduction to behavioural finance with Canadian Tire Corp. Ltd. It also discusses the use of statistics to analyze the breadth of the Canadian market.
- Chapter 10 provides information about Canadian government and provincial debt issues.
- In Chapter 11 we introduce the Canadian yield curve.
- We supply information about Canadian mutual funds and the mutual fund industry in Chapter 12.

- Chapter 13 discusses the holding period return of the portfolio using 2020 Canadian tax rates.
- Chapter 14 introduces the Canadian options market, using the example of Imperial oil. The Canadian stock index options are introduced.
- In Chapter 15 we introduce Canadian commodities and financial futures markets and explain the price settlement convention in Canadian markets.

The first Canadian edition also gives students access to short video clips from professional investment advisors. In these clips, which are carefully integrated into the content of each chapter, professionals share lessons that they have learned through years of experience working as advisors to individual investors.

COMPREHENSIVE, INTEGRATED LEARNING SYSTEM. Each chapter begins with six Learning Objectives, labelled with numbered icons. These goals anchor the most important concepts and techniques to be learned. The Learning Objective icons are then tied to key elements of the chapter, including

- First-level headings
- Summary
- Discussion Questions
- Problems
- Cases

This tightly knit structure provides a clear road map for students—they know what they need to learn, where they can find it, and whether they've mastered it by the end of the chapter.

An **opening story** sets the stage for the content that follows by focusing on an investment situation involving a real company or real event, which is in turn linked to the chapter topics. The opening vignette makes clear the relevance of these topics to the world of investments.

In many cases, an end-of-chapter problem draws students back to the chapter opener and asks them to use the data in the opener to make a calculation or draw a conclusion to demonstrate what they learned in the chapter.

Examples illustrate key concepts and applications and, in this edition, are paired with author-created solution videos (within the eText or Multimedia Library). Students can watch the author videos to increase their understanding of the concept and application being demonstrated by the in-text example and as a guide for the end-of-chapter problems assigned by their professors.

Short video clips offering **An Advisor's Perspective** show professional investment advisors discussing the investment topics covered in each chapter.

Watch Your Behaviour boxes appear in most chapters and highlight investment lessons gleaned from the behavioural finance literature.

Each chapter contains a handful of **Investor Facts**—brief items that cite an interesting statistic or relate an unusual investment experience. These facts add a bit of seasoning to the concepts under review and capture a real-world flavour. The Investor Facts include material focused on topics such as art as an investment and the need to exercise caution when reading analysts' recommendations and media coverage of stocks. One such feature notes that under conditions where relative valuation can be misleading, a simple dividend valuation model can be used as a powerful tool to gauge market sentiments. Another reminds us that the world of finance and investment is changing rapidly, with the increasing use of technology and with new services such as robo-advisors. Still another cautions that investors can sometimes get negative real rates when they invest in T-bills. Other Investor Facts discuss the use of financial statements to detect accounting fraud and the increasing popularity of using options in the Canadian market.

Famous Failures in Finance boxes consist of short, self-contained discussions of real-life scenarios in the investment world, many of which focus on ethics. These boxes appear in selected chapters and on the text's website. Many of them include a Critical Thinking Question for class discussion, with answer guidelines given in the Instructor's Manual.

Key Equations are highlighted throughout the text to help readers identify the most important mathematical relationships.

Many chapters provide **Excel Screenshots** showing completed Excel models designed to solve in-chapter examples. The Excel icon indicates that student versions of these screenshots are available.

At appropriate spots in the text, students will find **Calculator Keystrokes** sections on the use of financial calculators, with calculator graphics that show the inputs and functions to be used. The financial calculator callout in the text indicates that the reader can use the financial calculator tool in MyLab Finance to find the solution for an example by inputting the keystrokes shown in the calculator screenshot.

Concepts in Review questions appear at the end of each section of each chapter. These review questions enable students to test their understanding of each section before moving on to the next. Answers to these questions can be found by reviewing the immediately preceding material.

The **end-of-chapter summary** makes *Fundamentals of Investing* an efficient study tool by integrating chapter contents with online Study Plans. A thorough summary of the key concepts—What You Should Know—is directly linked to the text and online resources—Where to Practise.

A **Learning Objective** icon precedes each summary item, which begins with a boldfaced restatement of the learning objective.

Discussion Questions, keyed to the Learning Objectives, guide students in integrating, investigating, and analyzing the key concepts presented in the chapter. Many questions require that students apply the tools and techniques of the chapter to investment information they have obtained and then make a recommendation with regard to a specific investment strategy or vehicle. These project-type questions are far broader than the Concepts in Review questions within the chapter. Answers to the Discussion Questions are provided in the Instructor's Manual.

Expanded and Revised Problem Sets offer additional review and homework opportunities and are keyed to the Learning Objectives. Answers/solutions are provided in the Instructor's Manual.

For many end-of-chapter problems, Excel templates (indicated by the Excel icon) are available. These templates do not solve problems for students; rather, they help students reach a solution faster by inputting data for them or by organizing facts presented in problems in a logical way. In this edition we provide electronic Excel-based versions of many in-text tables, so students can see how the calculations in the tables work. They can also alter the baseline assumption in the printed tables to see how changing the assumptions affects the main results of each table.

Two **Case Problems** in each chapter encourage students to use higher-level critical thinking skills: to apply techniques presented in the chapter, to evaluate alternatives, and to recommend how an investor might solve a specific problem. Again, these problems are keyed to the Learning Objectives to point out the chapter topics that each problem illustrates.

CFA Exam Questions from the 2010 Level One Curriculum and the *CFA Candidate Study Notes, Level 1, Volume 4*, are included at the end of each part of the text. Because of the nature of the material in some of the early chapters, the CFA questions for Parts One and Two are combined and appear at the end of Part Two. These questions give students an opportunity to test their investment knowledge against that required for the CFA Level I exam.

Also available are three **Sample CFA Exams**. Each of these exams is patterned after the CFA Level I exam and comes with detailed answer guideline. The exams deal

only with topics that are actually covered in the first Canadian edition of *Fundamentals of Investing* and are meant to replicate as closely as possible the types of questions that appear on the standard Level I Exam. The Sample CFA Exams come in three lengths: 30 questions, 40 questions, and 50 questions. Each exam is unique and consists of a different set of questions, so students can take any one of the exams, or all of them, without running into any duplicate questions. Answers are included for immediate reinforcement.

Each chapter has questions that students can use **StockTrak** to answer. As users of this text, students are entitled to discounted access to StockTrak's Global Portfolio Simulations. When a StockTrak account is established, each student will receive a virtual \$500,000 to manage a portfolio of global stocks, options, bonds, futures, mutual funds, commodities, and currencies. Once a link is set up for the course, students may use the following coupon to receive their discount.

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The **Study Plan** gives personalized recommendations for each student, based on his or her ability to master the Learning Objectives in your course. This allows students to focus their study time by pinpointing the precise areas they need to review and enables them to use customized practice and learning aids to help them stay on track.

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Students can access a fully functional **Financial Calculator** inside MyLab Finance, as well as a financial calculator app that they can download to their iPhone®, iPad®, or Android device, so that they can perform financial calculations and complete assignments, all in the same place.

Question Help consists of homework and practice questions to give students unlimited opportunities to master concepts. If students get stuck, learning aids like Help Me Solve This, View an Example, eText Pages, and a Financial Calculator walk

them through the problem and show them helpful info in the text—giving them assistance when they need it most.

Worked Out Solutions are available to students when they are reviewing their submitted and graded homework. These solutions provide step-by-step explanations of how to solve the problem, using the exact numbers and data presented in the original problem. Instructors have access to Worked Out Solutions in preview and review modes.

Developing Employability Skills

For students to succeed in a rapidly changing job market, they should be aware of their career options and how to go about developing skills that prepare them to pursue those career opportunities. In this text, we focus on developing these skills in a variety of ways.

Excel modelling skills—Each chapter offers students opportunities to work with Excel spreadsheets and build Excel models to solve investment problems. Many chapters provide Excel screenshots that show completed models designed to solve in-chapter examples.

Ethical reasoning skills—The Famous Failures in Finance boxes that appear in each chapter often highlight ethical problems arising in the investment context, as well as the potential consequences of unethical actions by investment professionals. These boxes will help students recognize the ethical temptations they are likely to face while pursuing a career in investments or as they invest their own money.

Critical thinking skills—Nearly every significant investment decision involves critical thinking, because making optimal decisions means weighing tradeoffs among alternatives, such as the risk/reward tradeoff inherent in making any investment. To weigh these tradeoffs, students must first learn how to quantify them. Nearly every chapter in this text talks about the quantitative benefits and costs of different investments, and students who master this content will be in a strong position to make better investment decisions on behalf of their clients and themselves.

Data analysis skills—Investment is all about data. Analysts have to identify the data that are relevant for a particular investment problem, and they must know how to process those data in a way that leads to a good investment decision. In-chapter examples and end-of-chapter problems require students to sort out relevant from irrelevant data and to use the data that are available to make clear recommendations about what course of action an investor should take.

Stock analysis skills—One of the important aspects of learning about investment is application. Each chapter has a detailed StockTrak exercise that is tied to the main learning objective of the chapter. These StockTrak exercises enable students to apply their learning in a real-world setting via simulated trading. They come with step-by-step instructions.

Instructor Teaching Resources

We recognize the key role of a complete and creative package of materials to supplement a basic text. We believe that the following materials, offered with the first Canadian edition of *Fundamentals of Investing*, will enrich the investments course for both students and instructors.

Features of the Supplement

Instructor's Manual

- Teaching outlines
- Chapter summaries
- Key concepts
- Chapter overviews
- Solutions to all questions and problems in the text

(continued)

Features of the Supplement	
Test Bank	<p>More than 1,800 multiple-choice, true/false, short-answer, and graphing questions with these annotations:</p> <ul style="list-style-type: none">• Type (multiple-choice, true/false, short-answer, essay)• Topic (the term or concept that the question supports)• Learning outcome• AACSB learning standard (written and oral communication; ethical understanding and reasoning; analytical thinking; information technology; interpersonal relations and teamwork; diverse and multicultural work; reflective thinking; application of knowledge)
Computerized TestGen	<p>TestGen allows instructors to</p> <ul style="list-style-type: none">• Customize, save, and generate classroom tests• Edit, add questions, or delete questions from the test item files• Analyze test results• Organize a database of tests and student results
PowerPoints	<p>PowerPoints include lecture notes, key equations, and figures and tables from the text. These slides meet accessibility standards for students with disabilities. Their features include but are not limited to</p> <ul style="list-style-type: none">• Keyboard and screen reader access• Alternative text for images• High colour contrast between background and foreground colours

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