

Contents

Dedication	v
Preface	vii
About the Authors	xi
About the Cover	xiii
1. The Challenge: Can You Attain Wealth in Today's Investment Environment?	1
INTRODUCTION	1
THE NATURE OF INVESTMENT MANAGEMENT	3
INVESTMENT MEDIA AND THE ENVIRONMENT	5
CAN YOU MAKE MONEY IN THE STOCK MARKET?	6
THE STOCK MARKET AS A SPECULATIVE INSTITUTION	8
FINANCIAL INFORMATION	13
THE SECURITIES MARKETS	15
TRADING SECURITIES	18
REGULATION OF SECURITIES MARKETS	20
MARGIN PURCHASES	22
INSIDER TRADING	23
SHORT SELLING	26
STOCK MARKET INDICATORS	27

THE 1929 CRASH	30
SUMMARY	32
REFERENCES	35
 2. Financial Mathematics	37
INTRODUCTION	37
Axiom of Value	38
Axiom of Time	38
Axiom of Time Value of Money (TVOM)	40
FUTURE AND PRESENT VALUE	41
Simple and Compound Interest	41
Continuous Compounding	42
Annuity Values	43
Present Value and Discounting	44
Capitalization of an Income Stream	46
FINANCIAL RETURNS	46
Gross Returns	47
Incremental Returns	49
Summary Measures	51
SUMMARY	56
PROBLEMS	57
REFERENCES	58
 3. The Securities Markets and Macroeconomics	59
THE SECURITIES MARKETS	59
Securities of the U.S. Government	60
Municipal Securities	61
Bankers' Acceptances	62
Negotiable Certificates of Deposit and Commercial Paper	63
Eurodollars and Non-U.S. Money-Market Instruments	64
THE CAPITAL MARKET	65
Long-Term Debt Instruments	67
Equity Securities	73

MACROECONOMIC INFLUENCES UPON THE MONEY AND CAPITAL MARKETS	74
Investment and Saving Equilibrium	78
THE NEOCLASSICAL MONETARIST VIEW	85
INTEREST RATE TERM STRUCTURE	91
Example	95
Term Structure Theory: Other Hypotheses and Implications	96
Examples	99
SUMMARY	100
PROBLEMS	101
REFERENCES	107
 4. Financial Statement Analysis	109
RATIO ANALYSIS	109
FINANCIAL STATEMENTS	111
Group I — Liquidity	114
Group II — Profit Ratios	115
Group III — Turnover Ratios	116
Group IV — Return on Investment Ratios	117
Group V — Leverage and Capital Structure Ratios	118
Group VI — Asset-Relation Ratios	120
Group VII — Common Stock Security Ratios	121
Group VIII — Yield and Price Ratios	122
Common Size Analysis	123
ADJUSTMENTS TO FINANCIAL STATEMENTS	132
FINANCIAL STATEMENTS AND ACCOUNTING DATA	138
FINANCIAL ANALYSIS FOR MERGERS AND ACQUISITIONS	139
DEAL STRUCTURE	140
INSTALLMENT SALES ANALYSIS	140
CORPORATE STRUCTURE FOR MERGERS AND ACQUISITIONS	144
ACCOUNTING FOR MERGERS AND ACQUISITIONS	150

SPECIAL INDUSTRY RATIOS	151
Railroads	151
Regulated (Public) Utilities	152
Airlines	153
Commercial Banks	153
Life Insurance Companies	154
Property and Casualty Companies	154
Mutual Funds	155
SUMMARY	157
PROBLEMS	160
REFERENCES	168
 5. Forecasting Techniques	 171
INTRODUCTION TO FORECASTING	171
FORECAST ACCURACY MEASURES	172
NAÏVE FORECASTS	173
SMOOTHING TECHNIQUES	177
STOCHASTIC MODELING	179
TIME SERIES ANALYSIS	185
REGRESSION AND CORRELATION ANALYSIS	186
Examples	187
INDEPENDENT VARIABLES AND SENSITIVITY	
ANALYSIS	188
SUMMARY	191
PROBLEMS	193
REFERENCES	194
 6. Analysis of Fixed Income Securities	 195
FORECASTS AND BOND ANALYSIS	195
COVERAGE RATIOS AND INCOME SECURITY	200
PROTECTION IN CASE OF FINANCIAL	
DIFFICULTY	203
THE RISK STRUCTURE OF INTEREST RATES	208

METHODS OF PRINCIPAL REPAYMENT	217
PREDICTION OF FUTURE DEFAULT	221
HOLDING PERIOD RISKS	223
BOND TABLES AND BOND-RATING AGENCIES	226
ANALYSIS OF MUNICIPAL BONDS	232
ANALYSIS OF PREFERRED STOCK	234
CONTINUING THE ANALYSIS OF AMERICAN FUNERAL SUPPLIES	236
SUMMARY	246
PROBLEMS	248
REFERENCES	259
7. Analysis of Common Stocks	261
COMMON STOCK BASICS	261
Determining Capital Outlays and Future Financing	263
Common Stock Valuation Models	268
Holding-Period Returns	272
The Dividend Stream — Earnings Multiplier Model	274
An Illustration of Estimating Common Stock Returns	277
GROWTH AND RISK ANALYSIS	279
MERGERS AND GROWTH	287
After-Tax Returns and Growth	292
RISKINESS OF STOCKS	294
RISK MEASURES FOR COMMON STOCK RETURNS	300
Growth-Rate Equations for the Levered Firm	305
Common Stocks: Further Considerations	308
Example	310
STOCK PRICES AND THE ISSUANCE OF NEW SHARES	312
Example	314
Example	318
FINANCIAL ANALYSIS AND ACCOUNTING DATA	319

CONVERTIBLE SECURITIES	321
SUMMARY	330
PROBLEMS	338
REFERENCES	357
8. Futures and Options	359
INTRODUCTION	359
A Famous Example	361
Futures	363
WARRANTS	368
Common Stock Subscription Rights	380
Example	382
Warrants, Convertibles, and Dilution	383
Options	384
SUMMARY	388
PROBLEMS	391
REFERENCES	395
9. Risk, Uncertainty, Utility and Portfolio Theory	397
UTILITY THEORY	397
VON NEUMANN-MORGENSTERN UTILITY	403
INDIFFERENCE CURVES	406
PORTFOLIO THEORY	415
Example	434
SUMMARY	435
PROBLEMS	438
REFERENCES	443
10. Capital Market Theory, Efficiency, and Imperfections	445
CAPITAL MARKET THEORY	445
THE CAPITAL MARKET LINE (CML)	450
THE SECURITY MARKET LINE (SML)	452

PORTFOLIO EVALUATION	455
ADDITIONAL TOPICS IN PORTFOLIO MANAGEMENT	461
CAPITAL MARKETS: EFFICIENCY AND IMPERFECTIONS	477
CAPITAL MARKETS AND THE REAL WORLD	482
EXPECTATIONS, CONVERGENCE, AND THE EFFICIENT MARKET HYPOTHESIS	485
Example: AFS, A Graham & Dodd Approach	492
CAPITAL ALLOCATION EFFECTS	499
SUMMARY	502
PROBLEMS	504
REFERENCES	508
 Appendix A. Time Value of Money	511
PRESENT AND FUTURE VALUE FACTORS	511
INTERNAL RATE OF RETURN (IRR) CALCULATION	513
PROBLEMS	518
 Appendix B. Financial Statistics	521
PROBABILITY, RANDOM VARIABLES, AND MEASURES OF LOCATION, DISPERSION AND SHAPE	521
Examples	525
THE NORMAL DISTRIBUTION	527
Examples	529
SAMPLING AND THE <i>t</i> -DISTRIBUTION	529
Examples	530
COVARIANCE	532
REGRESSION AND CORRELATION ANALYSIS	534
CONDITIONAL PROBABILITY DISTRIBUTIONS	541
EXPECTED VALUES AND VARIANCES OF TWO OR MORE RANDOM VARIABLES	543
PROBLEMS	545
REFERENCES	551

Appendix C. Company Data	553
IMPORTANCE OF REAL WORLD DATA	553
SERVICE CORPORATION INTERNATIONAL (SCI)	553
Appendix D. Selected Snapshot Data	583
SELECTED SNAPSHOT DATA	583
Index	593