

# Investments: An Introduction



## Chapter **2**: Securities Markets

**Herbert B. Mayo**

## Market Makers - Security Dealers - Specialists

- Offer to buy and sell for their own accounts
- Spread - difference between the bid and ask prices
- Market makers
  - do not set the level of prices
  - facilitate securities transactions

# Securities Markets

- Organized exchanges
  - NYSE and the AMEX
  - the listing of securities

# Securities Markets

- Over-the-counter markets
- Nasdaq stock market
- “Third” and “fourth” markets

# Buying and Selling Securities

- The role of brokers
  - full service brokerage firms
  - discount brokerage firms
- Electronic trading
- Difference between brokers and securities dealers

# Bulls and Bears

- The long (bullish) position
  - anticipating prices rising
- The short (bearish) position
  - anticipating prices falling

# Types of Orders

- Market orders
- Limit orders
- Stop orders

# Settlement

- Confirmation statements
- T + 3: Settlement date
- Delivery versus leaving securities registered in street name

# Cash versus Margin Accounts

- Leveraging the position
- Increased potential percentage return
- Increased risk

# Margin Requirements

- Initial margin requirement
- Maintenance margin
- Margin call

# The Cost of Investing

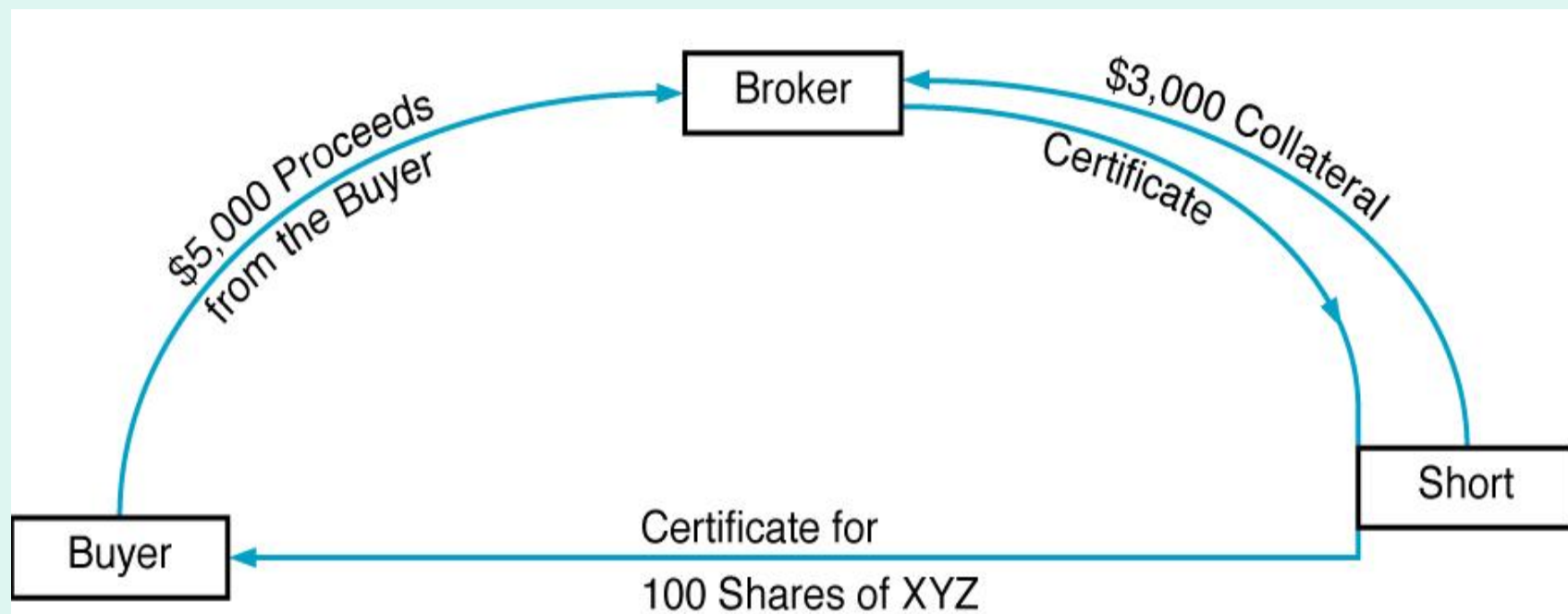
- Commissions
- The spread
- Price concessions

# The Short Sale

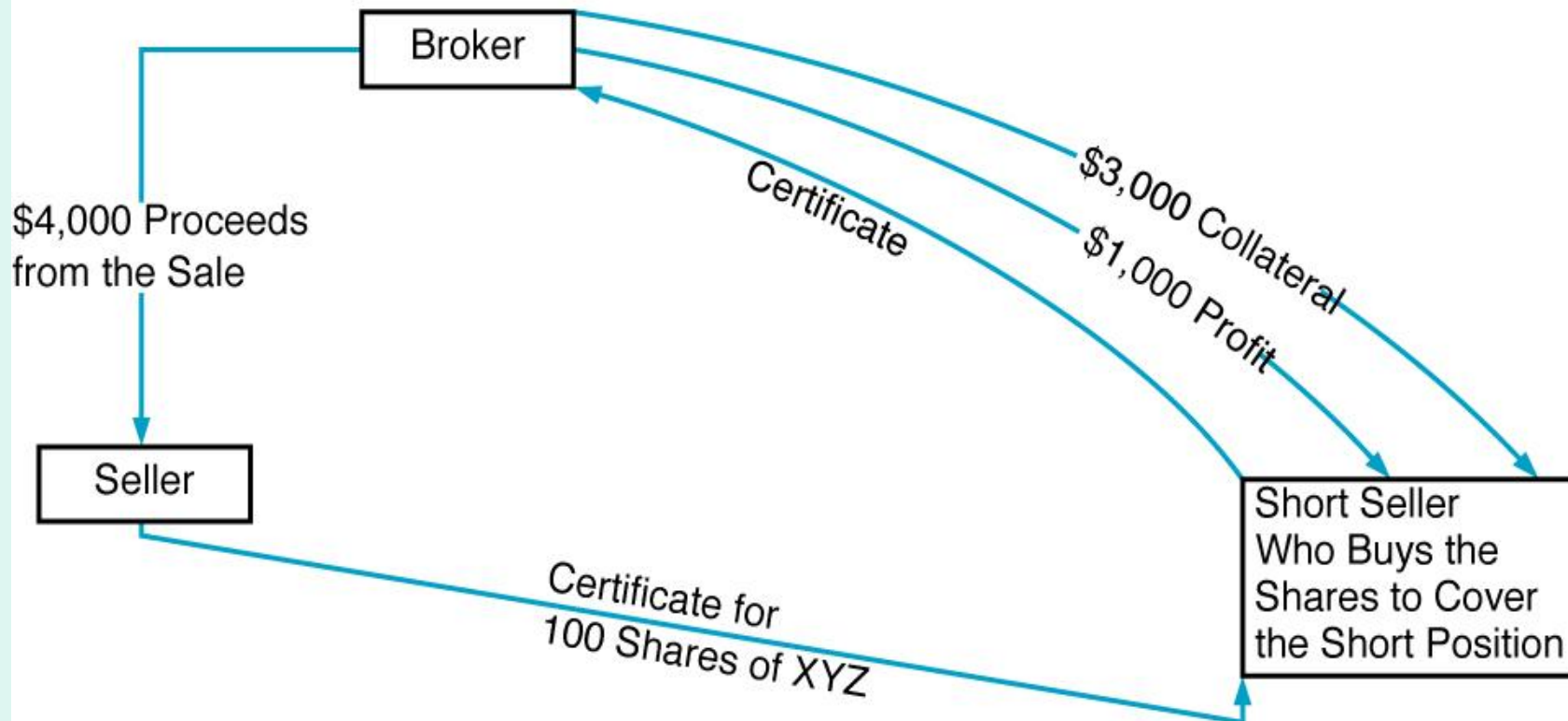
- Premised on prices declining
- Sale of borrowed securities
- Shares must be repurchased and returned to lender

# The Short Sale

- The flow of securities and cash:  
Establishing the position



# The Flow of Securities and Cash: Closing the Position



# Short Interest Ratio

- Shares sold short relative to shares outstanding
- Shares short relative to average daily trading

# Short Interest Ratio

- Indication of future demand

or

- Measure of expected future price change

# Foreign Securities

- Foreign stocks traded in American markets
- American Depository Receipts (ADRs)
  - expressed in dollars and not the local currency
  - registered with the SEC

# Regulation: The Federal Securities Laws

- The federal security acts
  - Securities Act of 1933
  - Securities Exchange Act (1934)
  - Public Holding Company Act of 1940
  - Investment Advisors Act
  - Sarbanes - Oxley

# The Securities and Exchange Commission (SEC)

- Full disclosure of information
- Registration of securities
- Enforcement of the federal securities laws
- Suspension of trading

# Full Disclosure Documents

- 10-Q report
- 10-K report
- 13-Q report
- EDGAR

# Sarbanes-Oxley Act of 2002

- Creation of the public accounting oversight board
- Requires independence of auditors

# Sarbanes-Oxley Act of 2002

- Certification of corporate financial statements by CEOs and CFOs
- Criminal penalties

# Sarbanes-Oxley Act of 2002

- Firewalls between investment banking operations and financial analysts' recommendations

# The Securities Investor Protection Corporation

- Insures accounts against failure by brokerage firms
- Similar to FDIC

# The Sale of New Securities: The Private Placement

- Direct sale of securities
- Eliminates selling costs
- Features can be tailor-made for both parties

# The Sale of New Securities to the General Public

- Initial public offerings (IPOs)
- The role of investment bankers

# The Sale of New Securities to the General Public

- The mechanics of underwriting
  - the originating house or managing underwriter
  - the guaranteed sale - firm commitment
  - underwriter bears the risk
  - the syndicate

# The Sale of New Securities to the General Public

- The mechanics of security underwriting:
  - underwriting discount
  - prospectus
- Best effort agreements:
  - issuing firm bears the risk.

# Pricing an IPO

- Underpricing leads to windfall gains to initial buyers.
- Overpricing inflicts losses on initial buyers and the investment bankers.
- Tendency to underprice to assure a successful sale

# The Price Volatility of IPOs

- Prices can rise dramatically.
- Many firms eventually fail.
- Few investors get to participate in IPOs.

# Regulation of Initial Public Offerings

- Registration of new securities
- The prospectus
- Securities and Exchange Commission (SEC)
- The shelf-registration
- The lock-up

# Prospectus of an Issue of Common Stock of Yahoo! Inc.



All of the shares of Common Stock offered hereby are being offered by Yahoo! Inc. Prior to this offering, there has been no public market for the Common Stock of the Company. For factors considered in determining the initial public offering price, see "Underwriting".

In connection with this offering, the Underwriters have reserved approximately 200,000 shares of Common Stock for sale at the initial public offering price to persons associated with the Company.

**See "Risk Factors" commencing on page 6 for certain considerations relevant to an investment in the Common Stock.**

The Common Stock has been approved for quotation on the Nasdaq National Market under the symbol "YHOO".

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

Price of the stock to the public and total proceeds

Per Share .....	Initial Public Offering Price \$13.00	Underwriting Discount(1) \$0.91	Proceeds to Company(2) \$12.09
Total(3) .....	\$33,800,000	\$2,366,000	\$31,434,000

Underwriting discount

Proceeds to the company

(1) The Company has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933. See "Underwriting".

(2) Before deducting estimated offering expenses of \$700,000 payable by the Company.

(3) The Company has granted the Underwriters an option for 30 days to purchase up to an additional 390,000 shares at the initial public offering price per share, less the underwriting discount, solely to cover over-allotments. If such option is exercised in full, the total initial public offering price, underwriting discount and proceeds to the Company will be \$35,870,000, \$2,720,900 and \$36,149,100, respectively. See "Underwriting".

The overallotment

The shares offered hereby are offered severally by the Underwriters, as specified herein, subject to receipt and acceptance by them and subject to their right to reject any order in whole or in part. It is expected that certificates for the shares will be ready for delivery in New York, New York, on or about April 17, 1996, against payment therefor in immediately available funds.

Lead underwriters

**Goldman, Sachs & Co.**

**Donaldson, Lufkin & Jenrette**  
Securities Corporation

**Montgomery Securities**