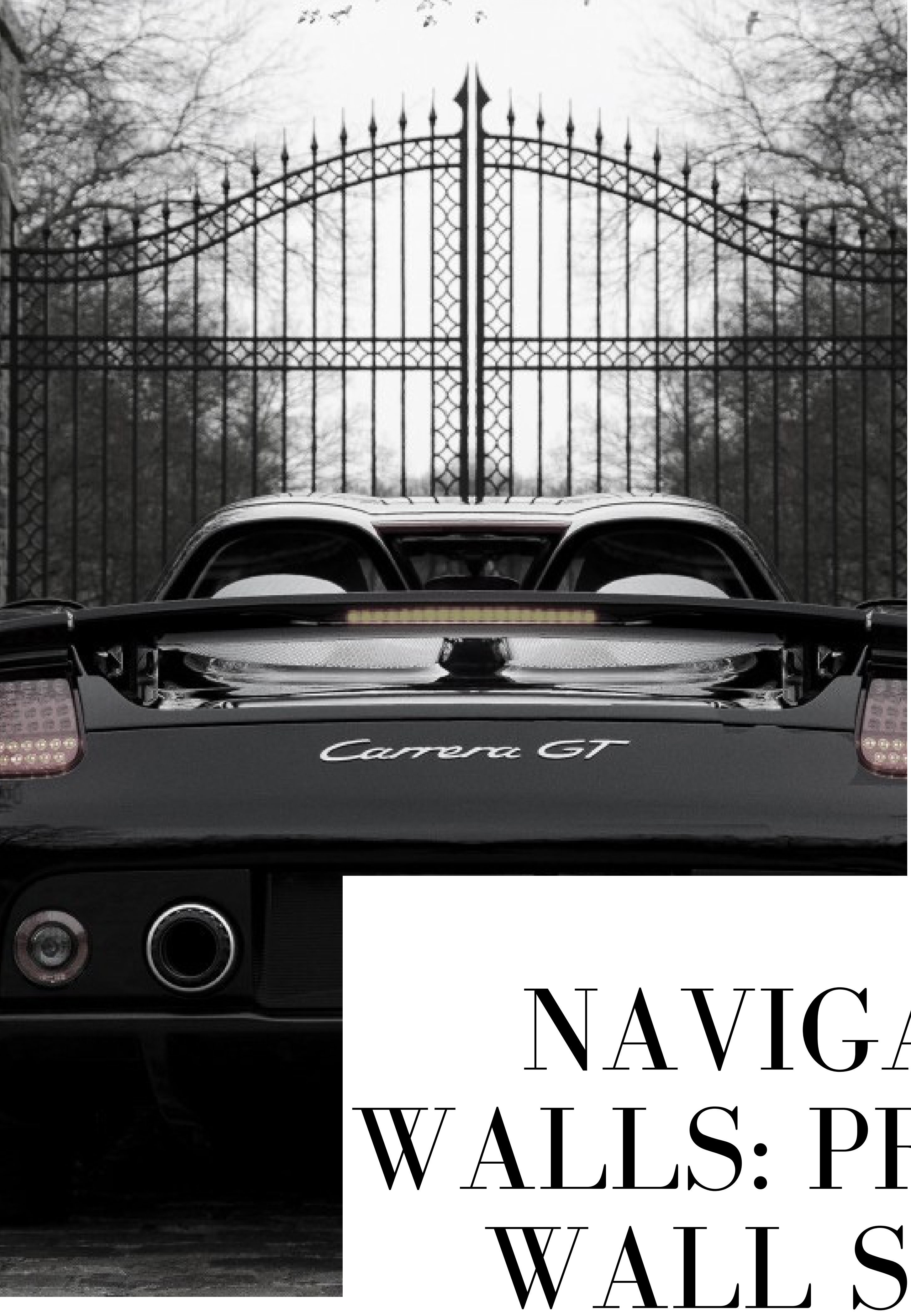

NAVIGATING WALLS: PRISON TO WALL STREET

LEARN STOCK INVESTING AND STORIES OF SURVIVAL

JESSE GREEN III

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Introduction

I want to thank you and congratulate you for choosing to read, *Navigating Walls*.

The purpose of the book is to teach the basic mechanics of investing concepts that are characterized throughout a story of a young man named Jimmy. This book will dive into stock market investing while sharing the story of Jimmy and how he must rebound from “Bear Markets” in his personal life. Throughout this book, you will hear stories of hopelessness and how Jimmy changed his mindset. Would you like to be a part of a company that doesn’t give up when life or circumstances become hard? The most successful people and companies face obstacles but figure out the best way to overcome. Investing is about ownership and believing in the company’s ability to make profits even in hard times.

The stock market is widely accepted as a game wealthy individual’s play. This is halfway true because not only wealthy people, but those with little money can take part in this game. Another perspective to think about is the stock market is not necessarily a game but a wealth building tool. In its simplest form, a stock is just a partial ownership in a corporation. The owners sell a portion of the company to stockholders to gain additional funds to grow the company. The portion of the company that is sold is split into many smaller portions called shares of stock (like a slice of pie). If an investor owns a share of stock, then the investor owns a portion of the company (a slice of the pie).

Sit back, relax, digest and implement the strategies and tips in this book.

Thanks again for purchasing this book I hope you enjoy it!

James (Jimmy): EARLY YEARS

James Freeman (a.k.a. Jim, Jimmy, or Jimbo) was born in Atlanta, GA to Nadine and Gerald Warner. Nadine was the fifth daughter of six total girls born in rural Alabama. She was a college graduate who worked for a large corporation in the human resources department. Nadine was a kind, quiet lady but would not allow anyone to take advantage of her. She grew up in a home full of sisters that showed no mercy to her or younger siblings. They were taught to be tough and have no fear of anything or anyone. Nadine taught young Jimmy how to read, write, and calculate math problems before he started school.

Gerald Warner grew up in Pittsburgh, PA and moved to Atlanta after graduating from high school to follow his cousin who worked in a factory. Gerald saw great benefits of working in a factory for a large corporation because his father and uncles provided a decent life for their families with this line of work. Gerald was able to purchase a home in a nice neighborhood for Jimmy and his younger sister, Ally. The only downside to the factory was the number of hours he spent at the jobsite. During certain times, Gerald would work seventy to eighty hours per week. Even though he did spend a lot of time with the family, Gerald knew his family would be financially secure from his hard work.

At this time, Jimmy was five years old and played little league sports like tee-ball, soccer, and basketball. Jimmy always saw his mother and sister in the crowd cheering him on during games. Jimmy would call his dad at work after each game and tell him all about the highlights.

The next school year, Jimmy started first grade, and he was very excited. The first week of school was so much fun for Jim because he met so many new friends. A young classmate named Nick became Jimbo's (as Nick called Jimmy) best friend. Freeze tag, hide-and-seek, and dodge ball were Nick and Jimbo's favorite games at recess and after school.

One day during after school care, Nick and Jimmy snuck away to go to the convenience store for candy and soda. Both boys ran up the sidewalk into the store before the teacher could see them. While they were in the store, Jimmy and Nick grabbed their favorite candy and two cans of soda. When they went to the counter, Jimmy paid with the $20 bill his mother gave him for allowance, and the cashier gave him the change. There was a man standing outside that saw Jimmy put the change in his pocket. Both boys walked through the door, hearing the bell above clank against the glass, sounding their exit.

Once outside, the man standing a few feet away shouted, “A lil’ man, you got some spare change I can hold?” Jimmy knew that his mom would ask how much money he had left, and if he told her the amount after giving this man anything, there would be more questions to come. If he gave this man any money, his mom would find out about them sneaking off to the store, so Jimmy responded nervously, “Umm, no I only had enough change for my candy.” At this time, Nick grabbed Jimmy’s arm to shove him in the direction of school and safety. The man then shouted in a drunken tone, “You think I’m going to let you lie to my face and leave…Naw, lil homie, it don’t work like that…empty them pockets!” As the man came closer, Nick clinched his can of soda. The man grabbed Jimmy’s shirt and started to dig into his pockets. When the man leaned down a little further, Nick saw his opportunity and with all his force, hit the man in his nose with the bottom of the soda can. Both boys took off running, and the man bent down on his knees still stunned from being hit.

Jimmy and Nick ran straight through the playground into the school doors. By this time, twenty minutes had passed, and the teacher hadn’t noticed they were missing. Even though Nick was not fazed by the situation at the convenience store; Jimmy was shaken by the incident. Jimmy looked at Nick and said, “Thank you so much because I didn’t know what to do…I was so scared!” Nick responded, “That was nothing…people like that are always at my Grandma’s house.” Laughing, Nick continued, “He was just drunk…Did you see how he fell?” Jimmy only slightly grinned because he was still in shock, “Yeah, I guess, and I owe you. From now on, we are going to call each other cousins, like we are really family.”

This incident brought the boys closer together, and they became inseparable. Wherever you saw Jimmy, you saw Nick, and both boys' mothers approved of the close bond. Over the next several years, Jimmy and Nick continued playing sports, making good grades in school and of course, being mischievous.

Jimmy: TEEN YEARS

As the late bell rang in the hallway, Jimmy runs to make it before the teacher closes the door. Jimmy was now a Freshman in high school. His voice had changed, and his mustache was starting to grow. Jimmy was very interested in girls, and everything he did was to gain their attention. Jimmy only wanted to wear expensive clothes and shoes, get weekly haircuts, and have money to spend. Even though Jimmy played sports for fun in elementary and middle school, he played sports for the attention of young women.

Jimmy's obsession with the opposite sex caused him to crave money to impress them. Although Nick liked the young women, he was more interested in making money for what it could provide for him and his mother. Nick's father was put in jail when he was two years old. His father always wanted to make a lot of money but did not fully understand the benefits of gathering funds legally.

Jeremy, Nick's father, was introduced by his older cousin to the fast and seemingly easy money that is made from selling drugs at the age of thirteen. Jeremy jumped into the lifestyle fast by making easy money and spending it just as fast. Jeremy continued this lifestyle for 10 years until he was caught in a drug raid. He was sentenced to twenty years in jail. Nick visited his father in prison once a month, and they had a good relationship despite the prison walls. Nick's father warned him about the fast money lifestyle of selling drugs and warned him to stay away from all aspects of that environment.

Heeding his dad's advice, Nick talked to Jimmy about a way to make quick money with almost no risk. "Jimbo, you ready to get this money?!" Jimmy looked excited and confused as he responded, "I'm always ready to get money…what's the scheme this time?" Nick had a devilish look and laughed slowly, "It's not a scheme…Well not all the way. See we can make money from insurance on credit cards!!!" Jimmy was totally confused now because he barely knew how insurance even worked. Nick continued, "There is a credit card scanner that can get card numbers from several places. Once you have the card number, we can create another card and make purchases. We can also sell the cards too!"

Nick could see Jimmy had some reservations, so he added, "Don't worry my man…The banks and credit card companies always give the people the money back, so no one gets hurt." Jimmy thought about it for a quick second and then responded, "So are you sure no one really loses their money? And what if we get caught…What happens to us?" Nick shook his head in disbelief, "I can't believe you don't trust me at this point after all we've been through. First, we won't get caught because the scanners are easy to setup that no one will ever know, and secondly, the banks and credit card companies have already set this money aside for people like us…so they are basically waiting for us to come and get this money!" Jimmy was a little hesitant about the credit card "Business", but he thought more about it that night. Jimmy began to daydream about all the clothes he could buy, nice cars he could drive, and the girls he could impress with his new-found money. He especially wanted to impress a young lady named Alyssa who wasn't the average teenage girl.

Alyssa was very mature and well liked around school by students and teachers. She was co-captain of the debate team and captain of the soccer team. She was always positive and gave compliments to everyone. Alyssa was two years older than Jimmy and this made her seem even further out of his league. Jimmy figured if he had a nice car, clothes, and could buy Alyssa things then she would find him attractive. So, the next day at school, Jimmy went to Nick and while doing their signature handshake said, "Let's get this money!"

JIMMY: “Business Man”

Jimmy started his business education by learning all the details of the credit card industry, like how and where most people use their credit cards without disregard to small charges. What Jimmy realized was that the small purchases like gas and fast food were the types of transactions that most people didn’t pay much attention to when it came to the amount. He shared this information with Nick, “Look, if we just take small amounts, we can make a lot without ever getting caught. If we run 5,000 cards a day for $0.15, that’s $750 a day! We can keep adding more cards too!” Nick thought about it for a few minutes then responded to Jimmy’s suggestion, “How are we going to get the scanner on fast food machines?” Jimmy already had the solution. While pacing in his room, he explained to Nick, “All our friends at school…Ryan works at McDonalds, Julissa works at Taco Bell, Jeremy works at Burger King, and Darryl works at Subway. We just pay them a little something to put the scanner on the machines.” Nick was confused but then started laughing, “Are you serious? You a church boy! You really think all these people are going to keep quiet if they know how much we are making and not sharing the money? Ain’t no loyalty outside of me and you. That’s how my daddy got locked up… disloyal people.”

Jimmy and Nick kept thinking of a solution without involving a lot of people. Jimmy then came up with a solution, “Why don’t we give then a small portion of the $0.15 and make them partners? We can give them like two cents on each purchase and they can keep an eye on the scanner for us too. Win-Win, right?” Nick looked unsure, “I like the idea, I swear I do, but I don’t trust anybody outside this room bro…We are family and they aren’t. I’ve just seen how this story ends.” Jimmy knew Nick was not completely sold on the idea, so he interjected again, “Let’s just start with gas stations. Then we can go to Ryan because he needs money and probably won’t say anything because he doesn’t want the cash flow to stop.” Jimmy stared at Nick waiting on him to digest his reworked idea. Nick reached his hand out towards Jimmy and did their handshake, “Jimbo, let’s do it. Ryan does need the money, and we can start with him now. We will put the cards on the scanners at the gas stations and explain the process to Ryan at school tomorrow." After that, Nick went home, and Jimmy continued thinking about his new "Business" venture and all the money he was going to be making.

The next day at school, Jimmy asked Ryan if he wanted to make some extra money and explained the plan to Ryan. Just like most of Jimmy's friends, Ryan was all in on the plan to make extra cash. Ryan asked Jimmy, "So what do I need to do because I go to McDonalds for the afternoon shift today. I can put the scanner on in the next few hours!" Jimmy had to slow him down a little and told him he wouldn't be able to start today because the scanners wouldn't be in for a few days. Jimmy told Ryan as soon as the scanners came in, they would meet.

A few days later, fifty scanners were sitting at Jimmy's neighbor's house, the older lady who Jimmy asked to receive the large box. Jimmy and Nick got the box and went to look at their new cash cows. They stood in Jimmy's room and started laughing with excitement…the type of laugh a kid makes when they find out school is closed on a day they had a test they weren't prepared to take. Jimmy decided they should start that afternoon and install at least one scanner to test it out before putting all of them at gas stations. Jimmy knew just the place to install it where no one would expect anything…the same gas station he and Nick bought snacks after sneaking out of after school care.

So, Jimmy nervously drove his mom's car to the pump while Nick rode in the passenger's seat. Nick walked inside to distract the store clerk working as Jimmy quickly put the scanner over the pump's card reader. Jimmy then used his card to get gas and test the pump. Nick came back and jumped in the car, "Did you get it Jimbo?" Jimmy responded in an unsure tone, "Yea, I think so, but we will see." They drove back home to test if the new installed scanner was linked. "Nick! Its linked…my card showed up on the scanner. We can take the $0.15 off now."

After the first scanner was installed, it was a race to get as many scanner's placed at gas stations all over the city. Jimmy met with Ryan, and he installed a scanner on both registers at McDonalds. Within a few weeks, Jimmy and Nick had installed 100 scanners at gas stations and quickly had access to 10,000 credit cards. These credit cards were bringing in over $2000 a day, which was almost three times the money Jimmy and Nick planned on making.

With the new money, Jim and Nick started buying new, expensive clothes and shoes to wear to school. Everyone started noticing the new outfits the boys were wearing, and it also caught the attention Jimmy's crush, Alyssa. Alyssa pulled Jimmy aside one day during a class break, "Hey Jimmy, when did you start spending so much money on clothes?" Jimmy thought to himself that Alyssa was interested in his new high-end attire and said, "Aww, I've always bought expensive clothes. I just now started wearing them to school though…I can blow money on whatever I want to be honest." Alyssa responded in a condescending tone before walking off, "Oh I see Jimmy…You're big time, aren't you?" Jimmy wasn't too worried about Alyssa because there were so many girls who became interested in Jimmy after they saw the clothes and shoes he was wearing.

Jimmy and Nick continued collecting the money every day for the next two years. They also expanded the amount of gas stations and started paying teenagers that worked at fast food places to setup the scanners. By this time, the two were bringing in $10,000 a day! They both bought expensive cars, Jimmy a Corvette and Nick a Range Rover. They kept the cars at one of Nick's older cousin's house, so their parents wouldn't start questioning where the money came from to purchase the cars. Everything was moving along smooth and they had amassed a small fortune of over four million dollars.

JIMMY: "The Idiot"

At this point in their young lives, Jimmy and Nick were living a dream. They were about to turn 18 years old, in their senior year of high school and making money. They had their entire lives ahead of them, and their futures looked bright. Jimmy was debating on whether to go straight to college or take a year off from school. He could get his own place in the city and throw parties every weekend with the money he was making. Nick, on the other hand, had a different agenda after speaking to his father about their business venture. Nick's father Jeremy warned him about the downside, "Nick, I know the money seems easy right now but trust me, you need to get out while you are still ahead. You can go to college with a pocket full of dough and live your lives. You don't want to end up in here with me, do you?"

After listening to his father, Nick went to Jimmy and told him about what his father mentioned in a low, solemn voice, "Jimbo, I think we need to get out right now. I don't want to end up like my dad. I think we have enough saved up, and we don't want to get greedy." Jimmy looked at Nick and thought about it for a little while before responding to this advice. "Nick, we set everything up to not get caught remember…It's only $0.15 coming off each card and no one notices that amount. You do what you want but I'm not giving up on easy money." Nick knew that Jimmy was right about how making easy money, but he didn't feel good about the scanners anymore and just wanted to get out of the business. Nick told Jimmy, "Bro you know I love you, but I can't do it anymore. You can keep all the future money that's made from the scanners. Just transfer my half of what we already made to me in Bitcoin, that way its not traceable." The two shook hands and Nick went home.

The scanner scheme was no longer a partnership, and Jimmy felt a sudden pressure. He now didn't have anyone to talk about the ideas he had. Jimmy also thought more about what Nick said to him about ending up in jail. Could he really end up in jail?

A few months after later, Jimmy got a call from his friend Darryl, who installed one of the scanners at a fast food restaurant for him. Darryl had been asking a lot of questions lately about how much money Jimmy was making from the scanners. Jimmy always shrugged it off or told him a lot lesser amount. Today, Darryl told Jimmy his uncle, who was from New York, wanted to meet him. Darryl said his uncle was making a lot of money from several different businesses and needed to run some things by him. Jimmy asked what type of things he wanted to discuss, but Darryl wasn't sure. "He wouldn't tell me much, only he heard you were a young entrepreneur and wanted to help you get your business bigger." Jimmy was suspicious about the proposition to meet someone he didn't know about an illegal business. Jimmy learned from Nick not to trust anyone, but he didn't follow his instinct or advice from Nick. Jimmy told Darryl, "If your uncle is talking about money I will meet up with him."

A couple of days later, Jimmy met with Darryl and his Uncle at a Starbucks across the street from one of the gas stations a scanner was placed. After the introductions, Darryl's uncle began to let Jimmy know the purpose of the meeting. "Listen Jimmy, I run a very private but profitable business across New York and New Jersey. I would like to expand to the Atlanta area with your help," Darryl's uncle explained. "The nature of my business involves the credit card scanners but in a larger scale. We bring in a little over one million dollars a day from our operations. The best thing is that we have credit card investigators on our payroll to notify us of anyone calling about missing money." The added security of having someone that works for the credit card investigation team really intrigued Jimmy. He started thinking to himself how much less stress he would have if he knew no one was calling about missing money from their cards.

Jimmy then asked Darryl's uncle, "So what do I need to do to help expand in Atlanta? I, like you, have people who monitor the credit card scanners for phone calls from customers." Darryl's uncle smiled and said, "It's really simple since you have the scanners already setup. I will just need to sync into your system and scan my card on one of the scanners. Then we will monitor all your locations for you. How much do you usually take from each transaction on a card anyway?" Jimmy responded, "Well it depends on the transactions size and type, but the most we get is $0.15." Darryl's uncle looked surprised, “$0.15! Is that all? We can get at least $1.00 on each transaction and split it with you 50/50. That more than triples what you’ve been getting. Fair?” Jimmy was ecstatic, “Yea that’s more than fair! Do you want to scan your card now? The gas station across the street has one of my scanners.”

Darryl’s uncle handed Jimmy his credit card and said, “Why waste time…Sure! Go ahead and scan it while I make a few calls to get everything setup. We can look over your computer system when you get back.” Jimmy shook his head in agreement while grabbing the card and headed out of the door. He pulled up to the gas pump to get gas like he normally did in the past. Jimmy scanned the card, pumped the gas and headed back to the Starbucks.

When Jimmy got back across the street to Starbucks, he motioned for Darryl and his uncle to come outside and get in the car. “Let me show you my system now.” Jimmy opened his computer and showed Darryl and his uncle the transaction he just processed at the gas station. “See! Right there is the transaction. And here are all the other transactions for today. We’ve already made over $7,000, and its only 2 p.m. But I guess that’s chump change for you right!” The three of them laughed and continued looking through the computer. Darryl’s uncle asked if he could sync the transactions to his computer to figure out trends of the market for better protection against being caught. Jimmy agreed and within a few minutes, Darryl’s uncle had all of the transactions on his computer along with the locations of the scanners. Jimmy then asked, “So what do I need to do next and how long will it take for the transactions to go up to $1?” Darryl’s uncle sat for a second and then said, “It usually only takes a couple of days to get everything transferred and tested. We should be up and running by the weekend. I’m headed back in the morning, and I will let you know when everything is secure.” Jimmy shook hands with Darryl and his uncle before they got out of the car.

Jimmy pulled out of the parking lot and went straight to Nick’s house. “Nick!!!! You will never believe how much we can start making and with no risk!! I just met with Darryl’s uncle and his operation is making over one million dollars a day for scanners. The best part is that they have people that work in credit card investigation that track when customers call in about missing money. There is no risk now and more money!!! You got to get back in with me!" Nick sat there and smiled at Jimmy's excitement, but he was not impressed. "That's great Jimbo! I'm really happy for you and hope it really works out for more money and peace of mind. But like I said before, I promised my dad to get out and I have to keep my promise. I've made enough money, and I'm excited to start college! You should see the campus and the college women! I can't wait to start!"

Jimmy cracked a half smile because he was a little disappointed. Darryl's uncle made it very clear that he had to treat the new scanner setup like a full-time job. So, Jimmy shook hands with Nick and said, "I'm really happy for you Nick. We are both getting to do what we want. The crazy thing is you got me into this business. All is good though. I will hit you up tomorrow though bro." Jimmy left Nick's house and while driving he noticed an unmarked police car behind him. He didn't think anything about it until the lights started flashing behind him and sirens began blaring. Jimmy pulled over and noticed three other SUV's that surrounded his car. Jimmy noticed the man in the passenger's seat was none other than Darryl's uncle, special agent Jermaine Dixon. Agent Dixon calmly walked to Jimmy's car door and asked Jimmy to step out of the car. Agent Dixon then proceeded to arrest Jimmy but whispered in his ear, "I'm sorry to do this because you're so young, but the law is the law. You haven't reached 18 yet, so the judge may have sympathy for you. I'm sorry again!"

Agent Dixon was not related to Darryl at all. Darryl was caught by detectives after he tried to install his own scanner at his job. He told the detectives he was only installing it for Jimmy, and there were several installed all over the city. Darryl took the agents to a few of the scanners, but they had to catch Jimmy in the act of either installing the scanners or taking money from a victim's credit card. When Jimmy went to the gas station and showed Darryl's "Uncle" the transactions, it was enough for the agents to arrest him.

The trial came sooner than Jimmy realized. He tried his best to prepare for the worst outcome, but his mind would not allow him to do that. For the previous several months before the trial, he sat in his room and was depressed. He didn't want to talk to anyone at all because of the embarrassment he caused himself and his family. Jimmy's mother, Nadine, tried to comfort her son by making good homecooked meals every day, but there was still the anxiety of Jimmy's upcoming sentencing at the dinner table.

The morning of the trial, Nick came over to go to the trial with the family. They arrived at the courthouse and Jimmy saw not only the agents that arrested him, but also his attorney all standing in the hallway. They all walked into the courtroom and sat down while waiting on the judge to walk into the room. The judge arrived within a few minutes, and Jimmy could barely stand up. He felt lightheaded and had no control of his body as though he was in a dream. The attorneys spoke with the judge, but Jimmy could not focus on anything that was being said. Finally, the judge made his decision, and Jimmy was sentenced to five years in federal prison for his financial crime. The judge told him that he could get time taken off the sentence for good behavior.

Prison would turn out to be a blessing in disguise because the prison Jimmy was going to spend his time was filled with individuals that committed other types of financial crimes. Jimmy could either learn to be a better criminal or change his mind set to legitimate financial businesses.

Jimmy was scared and lonely the first month in prison. He thought about prison fights, killings, and all the of the other things he'd seen in movies about prison. Each night he would lay under the thin sheets with all his clothes on with the pillow over his head because it was cold. All he could think about was Nick living his dream in college while he was stuck between concrete walls without his freedom. He knew he made his own decision, and this was the consequence, but he was not a criminal. To survive the time, he needed to focus on learning a skill. After all, a lot of his friends were enrolled in college.

Jimmy started going to the library to find something that interested him. He read a few books about science and the earth, but these didn't interest him. Each day, Jimmy saw an older gentleman in the library, reading the newspaper and other books. One day Jimmy found a book called *Smart Investing: The Truth about Markets* authored by W.E. Blackburn. He picked up the book and read the back cover. It talked about putting money to work like soldiers that never get tired and getting wealthy even if you were currently broke. This spoke to Jimmy because he knew how good it felt to make money without working; however, this seemed to be 100% legal.

Jimmy started to read the first chapter but was immediately confused by the lingo…bull and bear Market, portfolio, price-to-earnings ratio, and a lot of other terms that were foreign. While he was about to turn the page, a man put his hand on Jimmy's shoulder. He asked, "Can I see what you're reading?" Jimmy handed the man the book, and the man immediately threw the book on the ground. "It's garbage!!!! Don't waste your time!" Jimmy was confused as to why someone would get so upset about a book. Jimmy responded, "Sir, I'm just trying to learn about investing and that is one of the few books in here. Why are you so upset?" The man calmed down and tearfully explained, "I hurt so-so-so many people. I don't want anyone else to hurt from what I say or do. I wrote the book… my name is Winston E. Blackburn. Mr. Blackburn was a 63-year-old former hedge fund manager. Mr. Blackburn was sentenced to fifteen years for financial crimes at his former hedge fund. Mr. Blackburn had served 10 years so far, and the financial lifestyle was far away from his view now.

Jimmy was speechless for a second because he had never met someone that knew about investing or even wrote a book. He was intrigued by Mr. Blackburn. "Mr. Blackburn, it's good to meet you, but I want to learn how to invest. Do you have to hurt people to invest and get rich?" Mr. Blackburn responded, "Not if you do it the right way which is how I started. But greed took over and that's when my mentality changed. Now I'm here instead of relaxing on the beach with my wife and family."

Jimmy thought about what Mr. Blackburn was saying, and it sounded like Nick warning him all over again about not being greedy. "Mr. Blackburn, I was greedy too and that's how I ended up here, but I want to do it different this time. I want to make legal money where no one gets hurt!" Mr. Blackburn immediately responded, "I hear what you're saying, but if I teach you how to invest, you must follow everything I say precisely." Jimmy was excited to read the book and learn directly from Mr. Blackburn, so he said, "Mr. Blackburn, I don't know anything about investing, so I won't have a choice but to do exactly what you say. When can we start?" Mr. Blackburn said they would need to start in a few days, so he could get a teaching schedule together for Jimmy.

That night, Jimmy took the book to his room. He figured if he started reading the book, he could ask Mr. Blackburn questions the next day. With a dim light beside his bed, Jimmy opened the book back up to the beginning.

CHAPTER ONE

Stock and Stock Pricing and the Market: All You Need to Know

Part 1

The first concept we will be discussing is "stock" from a bird's eye view and then we will dive down into "stock pricing." The stock market refers to existing public markets for the purchase and sale of securities (stock). Shares, also called equities, represent a fraction of the ownership in a corporation, and the stock market is a place where investors can buy and sell that ownership. A well-functioning stock market is considered essential for economic development because it gives companies the opportunity to quickly access public capital.

The stock market today has two very important purposes. The first and primary function is to provide capital to companies for use to finance and develop their activities. If a company issues a million shares that initially sell for $ 10, then the company has $ 10 million in capital that it can use to grow its business (minus the fees it pays to a bank). By offering shares instead of borrowing the necessary capital for its expansion, the company avoids getting into debt and paying interest on this debt.

The secondary objective of the stock market is to provide investors, who buy shares, the opportunity to share the profits of listed companies. Investors can benefit from the purchase of shares in two ways. Some shares pay regular dividends (a given amount of money per share that someone has). The other way investors can benefit from the purchase of shares is to sell their shares for profit if the price of the shares increases in relation to their purchase price

After reading about the history of the stock market and how stocks are trading in the markets currently, Jimmy was exhausted. The new manual labor in the kitchen made him exhausted and, by bedtime, he could barely keep his eyes open. Jimmy laid down and immediately fell asleep.

The next morning, Jimmy woke up at 5 o'clock to make it to the kitchen for his job. He was chosen to work in the kitchen for the first portion of his sentence. Jimmy washed dishes and swept and mopped the kitchen floors after breakfast, lunch, and dinner. Additionally, Jimmy would help the kitchen staff with the preparation for all three meals. Jimmy had never done so much manual labor in his life, and he hated it. Everyday his arms and feet would be sore from moving muscles he wasn't used to moving.

During the break between breakfast and lunch, Jimmy went back to the library to find Mr. Blackburn but he didn't see him. Jimmy grabbed The Wall Street Journal newspaper since he saw Mr. Blackburn reading it all the time. There were articles about finance events from around the world. Once he finished reading the articles, Jimmy headed back to the kitchen to help prepare lunch.

It had been a few days since Jimmy had read the book because he was so tired at night. That day he saw Mr. Blackburn, and he told him they would start discussing the book tomorrow during the break. Jimmy knew he needed to finish reading the first chapter, so he could ask Mr. Blackburn questions. So that night Jimmy continued reading Chapter 1.

Part 2

Trading

Trading has had a long history, starting in the 1600's but let's take a good look at how stocks are traded today. There are two ways stocks are traded, called the exchange method and the Over the Counter (OTC) method. Most stocks are traded on stock exchanges such as the New York Stock Exchange (NYSE) or NASDAQ. Stock exchanges essentially allow the market to facilitate the buying and selling of shares to investors. Stock markets are regulated by government agencies, such as the US Securities and Exchange Commission (SEC) who monitor the market to protect investors against financial fraud, and they keep the currency market operating smoothly.

Although the vast majority of shares are traded on the stock market, some shares are traded over the counter (OTC), where buyers and sellers of stocks are generally traded through a broker, or "market maker," who deals specifically with the actions. OTC shares are shares that do not meet the minimum price or other requirements to be listed on the stock exchange.

OTC shares are not subject to the same public disclosure rules as publicly traded shares, making it difficult for investors to obtain reliable information about the companies who issue them.

Over-the-counter equities are generally much weaker traders than exchange-traded equities, which means investors often face significant differences between bid and ask prices for over-the-counter trades. In contrast, publicly traded equities are much more liquid, with relatively low bid-ask spreads.

Stock Pricing

Many investors have wondered how the price of a stock is determined. When a company sells a portion of the company to the public called an Initial Public Offering aka IPO), the price is determined by the investment bank that handles this transaction. After the shares of stock are on the stock market, its simple to determine the price. The simple formula to determine the price of a stock is below:

Market Value (Capitalization) of Company ÷ Shares outstanding= Stock Price

$100M market value÷1M shares= $100 stock price

The price of stock changes when a buyer and seller agree to a different price than the last sell price. When this happens, the new sell price is listed. For instance, the last sell price of a stock was $10.10/share. The buyer puts an order in to buy the stock at $10.20 and the seller agrees to sell the stock at $10.15. The order is executed, and the new list price will post as $10.20.

Sell	*Buy*	*Spread*
$10.15	*$10.20*	*$0.05*

Stock Purchase Spread

The difference in pricing between the sell price and purchase price is called the spread. In stock trading, traders do not correspond with each other to buy and sell shares of stock. Instead, the transaction occurs with a person (machine) that matches a buy and sell order with each other. The person (machine) that matches a buyer and seller is called a broker. The broker receives the money ($10.20) from the buyer, and pays $10.15 to the seller, and the broker makes a $0.05 profit. To figure out what price you can buy or sell stock, you will look at the Bid and Ask of the stock. The "Bid" is the price a trader can sell the stock and the "Ask" is the price a trader can buy the stock.

Sell (Bid)	*Buy (Ask)*	*Spread*
$10.15	*$10.20*	*$0.05*

Jimmy was exhausted and began to fall asleep after reading the section on stock pricing. Jimmy dosed off and fell into a deep sleep. While he was sleeping, he had a dream about a young man around his age that left home to see the world. The young man had a pocket full of money and he figured he would be able to start his new life. The young man caught flight to big city Los Angeles. Once he was there, he met all kinds of people that told him they could make him famous or turn him into a millionaire. One night the young man was told to meet at 8 p.m. for a modelling audition and to bring $500 as a deposit. The directions took him through a back alley and he slowly walked towards a tiny light beside a door etched in a brick building. Suddenly, the young man felt an arm around his neck and then the squeezing pressure that cut off his airflow. As he began falling to the ground, he realized who was choking him…It was himself.

Jimmy woke up sweating from the dream, heart racing and breathing heavily. His mom had always told him dreams have meaning. Since the day he was arrested, Jimmy blamed everyone else but himself. The dream forced him to realize everything that happened to him was because of his actions. He knew that the time had come for him to take responsibility and change his direction in life. Even though he was in prison, he was not dead and there was still hope.

It was currently 2 o'clock in the morning and Jimmy was wide awake. He picked the book back up and began to read again.

IPO

There are several regular participants in stock market trading. The next phase of this chapter is to analyze the stock market players: the investment bank, stockbrokers, and investors.

Investment banks manage the initial public offering (IPO) that occurs when a company decides for the first time to become a publicly traded company offering shares. This is when a company lets the general public buy a portion of the company through shares of stock.

An IPO happens when a company wants to list on the stock exchange hires an investment bank who acts as a "subscriber" of the initial shares offer. The IPO is a long process but there are two important aspects. The investment bank will first calculate the total value of the company and the percentage that the company wants to sell in shares. For example, if the investment bank finds the value of the company to be $100M, the company may only want to issue $40M, or 40%, in shares to the public.

The second aspect of the IPO is pricing of the initial shares that will be sold. Investment banks want to make sure that all shares are sold in the IPO, and pricing is a very important element of accomplishing this goal. Investment banks can setup a contract in two ways to handle an IPO: bought deal and best effort deal. A bought deal is when the investment bank purchases all shares available for sale and then sells those to the public. The investment bank makes money from the spread of how much they paid for the shares and how much they sell them. With bought deal contracts, the investment bank takes all the risk but can also make a substantial profit from the process. In a best effort deal, the investment bank will try to sell all the shares that are available in the issue but by no means is the firm obligated to sell all shares. In a best effort deal, the investment bank charges a flat fee no matter how well or poorly the IPO results. Whether the investment bank negotiates the bought or best effort deal, it is the best interest of the firm to sell as many shares at the highest possible price in the IPO.

Large institutional investors, such as pension funds and mutual fund companies typically acquire the initial shares offered by the company in the IPO

The IPO market is called the primary market or the initial market. Once the shares are issued in the primary market, all transactions with shares are traded in the stock market of the so-called secondary market. The term "secondary market" is a bit misleading because it is the market in which most shares are traded daily.

Primary Market: This is when a corporation first issues a portion of its company for sale to investors in small pieces called shares of stock. These shares of stock have never been traded before. This process is called Initial Public Offering or IPO. IPO's help raise money for the corporation for various reasons. The initial price of each share of stock is set by the corporation and the company assisting with the sale of the shares (Investment Bank/Underwriter).

Secondary Market: This is when investors sell shares of stock they already own to other investors. The price of these shares of stock are governed by supply and demand in the open market. In the secondary market is what most people refer to as the "Stock Market."

Secondary Market (Stock Market)

Securities traders, who may or may not also act as financial advisers, buy and sell shares for their clients, whether institutional investors or individual investors. Today, online brokers such as TD Ameritrade, TastyWorks, Charles Schwab, and many others, give individuals the ability to invest their own money how they want. Once investors are ready to trade their own money, online brokers will assist in setting up an account.

Brokerage houses, mutual fund companies, hedge funds or investment banks employ financial analysts. They are researching publicly traded companies and are trying to predict whether a company's stock is likely to go up or down.

Fund managers or portfolio managers, which include hedge fund managers, mutual fund managers and listed fund managers (ETFs), play an important role in the stock market because they buy and sell large amounts of securities. These large funds can cause significant movement in the stock because of the amount of stock they decide to purchase or sell at one time.

Stock Indexes

The general performance of the stock market is generally followed and is reflected in the performance of several stock indices. Stock indexes are composed of a selection of stocks designed to reflect the movement of all stocks. Among the main stock indices are the Dow Jones Industrial Average (DJIA), the Standard & Poor's 500 Index (S & P 500), the Financial Times-Stock Exchange 100 Index (FTSE 100), the Nikkei Index 225, the Composite Index NASDAQ, and the Hang Seng index.

Stock indexes are a way for investors to keep track of how the stock market and economy are doing. Instead of trying to keep up with every single stock that is traded on the stock market, stock indexes pull out a smaller sample of stocks that represents the overall market.

The DJIA is made up of 30 NYSE stocks of more established companies.

The overall market is usually defined by two market cycles called the "bull" and "bear" markets. The term 'bull market' refers to a stock market in which the prices of shares in general are increasing. This is the type of market in which most investors thrive, since most stock investors are buyers of shares. A bear market occurs when stock prices are generally falling. (More on Bull and Bear Market in Chapter 5)

The Standard and Poor's 500, or S&P 500, is an index made up of 500 NYSE and Nasdaq listed stocks. Many investors believe the S&P 500 gives a more realistic gauge of the market because it takes stocks from more exchanges and from different types of companies (established and growing tech companies).

Analyzing Stocks – Market Cap, EPS, and Financial Ratios

Stock market analysts and investors can observe a variety of factors to indicate whether stocks are likely to rise or fall. Here is a summary of the variables most used for the inventory analysis.

The first factor a lot of investors review is the market capitalization of an action or its market capitalization, is the total value of all outstanding shares. Greater market capitalization generally indicates a more established and financially healthy company.

Stock market regulators require listed companies report regularly on their earnings. Market analysts carefully review these reports, published quarterly and annually, as a good indicator of the quality of a company's business. Among the key factors analyzed in the earnings reports are the earnings per share (EPS) of the company because this reflects the company's earnings divided among all its outstanding shares.

Analysts and investors also frequently review various financial indices to indicate the financial stability, profitability and growth potential of a publicly traded company. These are some of the key financial ratios considered by investors and analysts:

Price / earnings ratio (P / E): Relationship between the price of a company's stock and its EPS. A higher P / E ratio indicates that investors are willing to pay higher share prices for the company's stock because they expect it to grow and its stock price to rise.

Debt / capital ratio: this is a fundamental indicator of the financial stability of a company because it shows the percentage of its activities financed by the debt in relation to capital investors. A lower debt ratio is preferable, indicating primary financing by investors.

Return on equity ratio (ROE): The ROE is considered a good indicator of the growth potential of a company since it indicates the net income in relation to the total of its capital investments.

Profit margin: Investors can consider various profit margin indices, including the operating profit margin and the net profit margin. The advantage of considering the profit margin instead of an absolute number in absolute dollars is it indicates the percentage of profitability of a company. For example, a company can make a profit of $ 2 million, but if this only translates into a 3% profit margin, any significant decrease in its turnover can jeopardize its profitability.

Other commonly used financial ratios include the return on assets (EPS), dividend yield, price / book ratio (P / B), capital ratio and inventory turnover ratio.

The next morning, Jimmy was tired but excited. His mind was racing with the concepts he read about the previous night in the book. He had so many questions for Mr. Blackburn. After breakfast, the prisoners who did not leave for off-site work had a 30-minute break before cleaning the kitchen, bathroom, library, and grounds. Mr. Blackburn told Jimmy to meet him at the library after breakfast.

Jimmy arrived early to the library to meet Mr. Blackburn. When Mr. Blackburn arrived, he was pleasantly surprised that Jimmy beat him there. “I like your punctuality Jimmy. Are you ready to learn the world of investing?” Jimmy smiled and shook his head in agreement. Mr. Blackburn split the concepts of investing into sections just like his book. “Before we get started Jimmy, you said you knew nothing about investing.” Jimmy looked at him with an intrigued look, “Well actually Mr. Blackburn, I read the first chapter. It was a lot of information and confusing. I have a lot of questions for you.”

Mr. Blackburn smiled and shook his head with pride, “Jimmy, I remember when I first learned about investing. I was 15-years-old and working a summer job on a construction site as the sign holder. We were laying a sidewalk in the downtown area where a lot of banks, law firms, and other professionals had offices. When I would get bored, I took a stick and would draw math equations in the wet cement and smooth it back over.” Mr. Blackburn was bent over like he was drawing in the cement to illustrate for Jimmy. “There was a man, Mr. Dukes, that walked by every day and saw me doing the math in the cement. He pulled me aside and told me, ‘You like math?’ I said yes sir. He pointed at his office building and told me to be there the next day at 8 o’clock.

So being young and dumb, I told him I would be there and quit the construction job that afternoon.” Jimmy looked confused, “Why was that dumb? He was giving you an opportunity to start investing right?” Mr. Blackburn grinned as if he had a secret no one else knew and responded, “Well Jimmy, hindsight is 20/20 but what if he just needed me to be there to grab his newspapers and run errands? Or if he wasn't offering me a job at all? I learned over the years to look at all outcomes, in any situation, before making a decision."

Mr. Blackburn was born in Chicago during the 1940's. He was the last of seven children living in the poverty-stricken area of the city. He went to public school through high school. He was the only child in his family to complete high school because all the other children started working at the age of 10 or 11. Mr. Blackburn's older brother went into the army to provide for the family. Older siblings working to provide for the family was a normal situation for this era, but Mr. Blackburn did not take the sacrifice his brother made lightly. He promised his mother and brother, Ivan, he would be rich one day and buy everyone a mansion.

During his younger years, Mr. Blackburn looked up to his older brothers for guidance since their father died from a factory accident. Everyone told Mr. Blackburn that even though his father could barely read, he was a math genius. To connect with his deceased father, he made it his mission to become great at math. Mr. Blackburn always made perfect scores on math tests and quizzes. By the time he was 15 working at the construction site, Mr. Blackburn was doing college level math. This is when Mr. Dukes discovered the young math whiz and took him under his wings.

"The first day with Mr. Dukes was an eye-opening experience," Mr. Blackburn explained to Jimmy. "Mr. Dukes laid down some ground rules as we sat in a diner for breakfast. Mr. Dukes said he would call me Mr. Blackburn because he would respect me just as I would respect him. It was amazing to see a seemingly rich man would have so much respect for a poor kid." Jimmy was sitting at the library table soaking in the story when Mr. Blackburn looked at the clock. "Oh Jimmy! I lost track of time…What questions do you have for me?"

Jimmy first wanted to know how a company would split ownership with the public. Jimmy remembers Nick saying the less people in the business, the less problem you will have. So, to give ownership to the public was a crazy concept to Jimmy and seemed liked problems would be sure to come. Mr. Blackburn explained that the companies only give partial ownership (shares of stock) to the public, and there are also operating agreements in place. Operating agreements layout the exact duties of the company's team, and the public owners generally do not make decisions on the operation of the company. The public ownership gives their money to the company in expectations that the company will invest the money properly.

"I think I understand how this works now. When I had my scanners, I would give a small portion of the money to each of my friends that installed the scanners at the restaurants, but they were only small partners in the business," explained Jimmy. Mr. Blackburn stood up, "Exactly! Think of investors or shareholders as small partners. They give a small amount of money, and they get a small amount of the profits. Your friends didn't control the business just like shareholders don't control the company."

Jimmy took notes on what Mr. Blackburn was telling him. "What is the next concept you need more understanding about Jimmy?" Mr. Blackburn asked. "I was confused on stock pricing…Like the market cap-ittul-zation and shares?" Jimmy responded in an unsure voice. Mr. Blackburn laughed with Jimmy, "Market capitalization or Market cap is just how much a company is worth. There are so many confusing words in this industry that it can take a while to know what they all mean."

Mr. Blackburn compared market cap to Jimmy's scanner business. "Jimmy let's say you and Nick had $50 in the bank from scanner profits and another $50 worth of scanners, real estate, and other assets. This would bring your business to a market cap of $100." Jimmy shook his head in understanding while Mr. Blackburn continued, "Now let's say that you and Nick decide to sell 20% or $20 of the company to the public with 10 shares of stock. Each share would be worth a $2 stock price." Jimmy reiterated what Mr. Blackburn had just explained, "So, you look at the market cap or total value of the company and divide it by the number of shares that are available to get the price per share. How much do Nick and I own in this scenario?" Mr. Blackburn explained, "The two of you will own $80 or 40 shares of stock and you still control the business." Jimmy was going crazy at this point, "We could have had $80 dollars and control of our business!!! Plus, we would have kept the investors $20 which would have given us the full $100 right?" Mr. Blackburn smiled, "You got it Jimmy! We got to get back to work. I know I didn't answer all your questions from the first chapter, but we can finish up tomorrow after breakfast."

Jimmy left the library to head to his dishwashing job in the kitchen. He kept thinking about how he could have started a legitimate business and made a lot more money. Jimmy vowed right then he wanted to start a legitimate business once he was released from prison. When he was done with the kitchen duties, Jimmy went to the computer room to send Nick an email. Jimmy explained how he is learning investment theories from Mr. Blackburn. Jimmy's email stated, "Nick, how's school going? Meeting any college girls? I wish I was there on campus with you, but things are starting to work out here. I met a guy in here that used to be a hedge fund manager, and he is teaching me how to invest. It seems complicated but I'm starting to understand some of the concepts after reading his book. You are probably the smartest person I know, and I think you would really understand investing. It's amazing how much money you can make. Anyway, I have to go my friend. Take care!"

The next morning after breakfast, Jimmy met Mr. Blackburn in the library to continue discussing chapter one. "How did you sleep last night Jimmy?" Mr. Blackburn said in a tired voice. Jimmy responded, "I slept good, but you don't sound great." Mr. Blackburn was bending over in his chair and Jimmy stood over him. "Mr. Blackburn are you sure you're ok? Is your stomach hurting?" Mr. Blackburn shook his head with a distressed look, "Yes I will be fine. It's my ulcer flaring up again. When I get stressed out, it agitates my stomach. I didn't sleep very well last night." Jimmy sat back down and tried to think of a way to help relieve Mr. Blackburn's pain. "Can I get you anything for the pain?" asked Jimmy. "Tea soothes the pain for a little while, but I need medication. I see the nurse in two weeks, and I will see if they can prescribe my medicine. Enough whining though, let's talk investing…what questions do you have for me today?" Mr. Blackburn said sternly.

Jimmy stood up quickly and went to the kitchen. He came back a few minutes later with two cups of hot tea. "Jimmy, you don't need to spend your commissary money on me. I will be fine." Jimmy smiled a devilish grin, "I didn't spend any money. There are tea bags in the kitchen that I used. This is free tea!" and both laughed as Jimmy sat back down.

Jimmy opened his notepad, "So, Mr. Blackburn, I'm having trouble understanding the indexes. I get the general idea of them being a measurement of the stock market, but are the indexes just an average of all the stocks? Who chooses which stocks to be in the index?" Mr. Blackburn was leaning back in the chair at this point, rubbing his stomach and drinking his tea. He put the tea down on the table and began to explain how the indexes are calculated. "Jimmy, let me break down the S&P 500, which is probably the broader index. The S&P 500 index now made up of 500 companies. These companies are broken down into 11 sectors." Jimmy interrupted him, "That is what isn't clear. What is a sector?"

Mr. Blackburn shook his head in understanding, "A sector is an industry. For example, your Nike shoes would be in the shoe or apparel sector. So, the index tries to include all the major sectors in the market. Including all the sectors gives a good gauge of how the stock market is doing. Is that a little clearer?" Jimmy took a deep breath and tried to make sense of this index example, "It's like taking a sample in science class. We used to get dirt samples from all over the school yard in middle school and test it."

Mr. Blackburn said, "Yes! That's what it is, a sample. It's very important that you understand the Dow and S&P 500. I like to look at the S&P 500 because it measures how 500 companies are performing instead of the just 30 companies like the Dow. For instance, let's say that Nike is having a great day on the market, but Reebok and Adidas are down. If we only look at Nike, the assumption is that the market is doing good. If we look at all three stocks, we get a better view that one is up and two are down. Indexes are just samples of the stock market. Just like in science class, you didn't dig up all the dirt in the school yard, but only small amounts from different places. When people say, 'The Market is up today', or 'the market is falling', they are speaking about Indexes being up or down, which represent the overall market."

Jimmy looked at the clock and saw they only had 15 minutes left so Jimmy asked, "Ok the indexes make sense now. What about the primary and secondary markets? Can you explain those to me?" Mr. Blackburn raised his finger like a light bulb had just went off in his head, "Ah, yes Jimmy, primary and secondary markets. Here is a real-life example of primary and secondary markets. Think of a marketplace in the middle of town. In this marketplace, farmers from all the surrounding areas bring fruit (apple, oranges, watermelon), vegetables (potatoes, carrots, greens etc.) to sell to customers. The farmer sets the price for their items. Once the farmers have sold all their products to the customers, they pack up and leave to go home. This is when the secondary market starts. Customers sell the fruit and vegetables to other customers who want to buy for an agreed upon price. The customers buying and selling to each other may buy/sell at a higher or lower price than what the farmer originally sold the goods."

Jimmy still looked confused, "What happened to the farmer after all the goods were sold?" Mr. Blackburn responded, "Great question. The farmer only brought 25% of all the fruits and vegetables he owned to the marketplace. The farmer now has cash to put back into the farm for new equipment, seed, and anything else needed to continue growing crops without selling all their crops. The value of the remaining fruits and vegetables the farmer owns are directly tied to how much they are being sold at the market in town. So, if he originally sold a carrot for $1 but carrots are selling for $1.50 in the marketplace, his carrot inventory has gone up in value because of the secondary market." Jimmy's eyes got big, "I get it now. The secondary market now dictates the value of the stock and not the company or farmer in the story."

A guard walked into the library and shouted that Jimmy and Mr. Blackburn only had five more minutes. Mr. Blackburn waved him off, "Whatever, I can't stand the fact that we are in the library studying books, and these idiots are rushing us. Go ahead though, what else were you confused about from chapter one?" Jimmy thought for a second, "What is a spread…aren't buyers and sellers supposed to agree on the same price?" Mr. Blackburn said, "Technically they agree to buy and sell the stock at a certain price but not the exact same price. Jimmy, it's the exact same way real estate agents make money when they sell a house. Think of a stockbroker in the same manner as a real estate agent/broker. The buyer purchases a house for $100,000, but the seller only receives $95,000 because of the real estate agent/broker fee of $5,000. The difference is called the spread."

Just as Mr. Blackburn was finishing his explanation of a spread, the guard walked in and told them free time was done. Jimmy left the library and headed back to his duties in the kitchen because he had to help prepare for lunch. There was so much racing through his mind: How was the world of investing out there, and he never even knew about it? And to make matters worse, he had money to invest before he was incarcerated. Jimmy knew he had to learn as much as possible about investing. After the day was over, Jimmy headed back to his room for the night and was ready to soak in more information about investing.

CHAPTER TWO

Stock Ratios: P/E, EPS

When you buy a stock, do you use data to make your decision? In this chapter, we will gather some of the most important indicators and explain how to use them to make more informed decisions.

Return on investment (ROI) is simply the money that a company has earned or lost with an investment. If an individual investor invested $1,000 in shares of McDonald's and sold it for $2,000 five years later, the return on investment or ROI was 100%.

The problem with this metric is it's easy to manipulate. Although the calculation is simple, what a company chooses to include in the costs of the investment can change. Did they include all costs in the calculation or selected costs? Before relying on the return on investment, understand how it was calculated.

Earnings Per Share (EPS)

EPS is a measure of the profit of a business. Many measurements and calculations are used in investing. To measure how much a company allocates to each share of common stock, investors use earnings per share. EPS measures a company's profitability.

The basic measurement of Earnings Per Share is as follows:

EPS= Net Income÷ number of common shares outstanding

Here is an example of EPS for Apple in 2019:

Company	*Net Income*	*Shares Outstand*	*EPS*
Apple	*$59.531B*	*$4.72B*	*12.61*

Take the profit, subtract the dividends and divide that number by number of shares outstanding. Although EPS informs the investor of the amount of its earnings per share, it does not provide information on expenses. If a company earns $10 per share but another company earns $12 per share, the profits of the second company are more impressive. If the second company spends more to generate revenue, the second company may not be the better investment. To evaluate the stock, use the EPS together with other measures, such as the return on capital.

Price to Earnings Ratio

The price to earnings ratio (P / E ratio) compares the current price of a company's stock with its earnings per share (EPS). This metric is one of the best ways to measure the value of stocks.

The P/E ratio will change as the stock price changes. As a rule of thumb, the lower the P/E ratio (compared to other companies in the industry) the better. The formula for P/E=Market Value per share (Stock Price)÷Earnings per share (EPS).

Company	*Stock Price*	*EPS*	*P/E*
Apple	*$174.87*	*12.61*	*13.87*

When a stock has a higher P / E ratio than similar companies, investors may see it as overvalued, unless the company has higher growth prospects or something that values a high P / E. Remember that the actual stock price does not provide any indication of value. A higher stock price may be worth less when the P / E is examined.

Return on the Capital

Return on capital/equity (ROE) measures the profitability of a business and reveals the efficiency of a company to generate profits. To calculate the ROE, divide the gain by the amount of capital or the total amount of funds invested in the company. If Company A made a profit of $ 2 million but received $ 1 million in capital, it would be considered more efficient than Company B, which also earned $2 million but had $1.5 million in equity capital. Company A operates more efficiently because it can earn more money with less investment.

The ROE should always be used with other measures to evaluate the health and benefit of a company.

The P/E, EPS, and ROE are the basic measurements that successful investors use to evaluate a company. Digging deeper into the numbers and comparing companies with others in their industry is very important. Look for these metrics in a stock's fundamental analysis section and decide for yourself whether a company is worth your investment.

Jimmy went to bed that night very confused, but he wasn't frustrated because this was the first time he heard of these terms. He went back over the part of the chapter about P/E and EPS to figure out the difference but still wasn't quite clear on the difference. All the lights were off by this time, and Jimmy was tired from the day, so he closed his eyes.

He started thinking about his family, especially his mom and sister. What were their days like without him at home every day? Jimmy knew his mother was heartbroken since he was in prison. She worked so hard to keep him and his sister out of trouble and put them in environments that would help them become successful individuals. The embarrassment and shame that he caused his family made Jimmy feel worthless. He became angry with himself for being greedy and chasing something as silly as money. Tears started to roll down his eyes as the emotions of his situation overwhelmed him. The only thought that eased his mind was he would learn a new skill from someone that made a fortune. With this thought, Jimmy calmed down and finally fell asleep.

Every morning, Jimmy had to wake up at 5 a.m. to help with the kitchen duties. He would drink a cup of cold water to completely wake up and start the day. Grits, biscuits, sausage, and watered-down orange juice was the breakfast served a lot of mornings. Jimmy ate the normal breakfast and headed to the library ready to learn more about the ratio he read about the previous night.

"Good morning Jimmy!" Mr. Blackburn said in an upbeat tone. Jimmy smirked, "Good morning Mr. Blackburn…You seem to be feeling better." Mr. Blackburn held his cup of tea up, "I got some medication late last night. I couldn't bare the pain anymore, and the nurse gave me some pain medicine. Now, I can sip on my tea and concentrate on teaching you my passion…I feel rejuvenated just by talking about it again!" Jimmy smirked again, "That's good and I'm happy to hear your passion is back. I do have a serious question that is not investment related. How do you handle losing your money and being in the dungeon that we are in now? A wave of…of…I guess depression or sadness came over me last night. I thought about my family and the great life I had before."

Mr. Blackburn put down his tea and sat back in the chair while taking a long sigh, “I’m going to be honest with you Jimmy…before I met you in here, I was depressed myself. All I could think about was my family, the lavish vacations, homes, cars, restaurants, and everything else my life entailed before being here. But seeing your passion took me back to the beginning when investing was this big world and I was so excited to learn. You will learn how investing is a lot like life: You will be up, and you will be down. The best thing to do is make sure you pay attention when you are down, so you don’t make the same mistake.” Jimmy shook his head in agreement, “Yeah I know what you’re saying, but it gets really hard to survive mentally when you’re down.” Mr. Blackburn’s eyes got big, “You are absolutely right Jimmy. Keeping your mind positive while you are down is very hard at times but not impossible. Let’s make a promise to each other…We must point out five positive things to each other if either of us is feeling down. Deal?” Jimmy smiled, “I like that idea, and I’m cool with it.”

Mr. Blackburn grabbed the book from Jimmy and casually scrolled through it, “So what chapter did you finish last night?” Jimmy responded, “I got through chapter two about P/E and EPS and all that stuff. It can be confusing and what’s the point of those numbers anyway?” Mr. Blackburn leaned forward and looked at the ceiling while gathering his thoughts, “You are right Jimmy, the numbers seem pointless, but they are very useful, and professional investors start with these numbers when choosing an investment.”

Mr. Blackburn opened the book to chapter two and began to explain, “Jimmy, let me give you a real-life example. If you were thinking about buying a new TV, you would probably compare the features and the price of several TVs. You expect to pay more for more features, right. If a television has fewer features and older technology but costs the same or more than other comparable televisions, this TV may not have a good value. This is how you use P/E ratio as a comparison tool. You compare companies in the same industry by this ratio.”

Jimmy wrote down what Mr. Blackburn just told him. “So, it’s like shopping online and you compare prices to features?” Mr. Blackburn moved his head back and forth as if to signal Jimmy got part of the point. “Yes, Jimmy you are partly right…The only thing is the price of a stock is not an indicator of value compared to other stocks in the same industry. A $50 stock price may be a better value than a $25 stock when you compare the P/E ratio.”

At this point, Jimmy, once again, was confused, and he gave a big sigh, “I thought the point was to buy cheap stocks and sell them at a higher price?” Mr. Blackburn responded, “You do but it depends on the actual stock. So here is another example because I know you like cars and I do too. A normal S-Class Mercedes Benz is a little over $100,000 brand new and a new Nissan Altima is $25,000. What if you went to the dealership and saw a price tag on the Mercedes for $50,000 but $35,000 on the Nissan Altima…Which is a better deal?” Jimmy responded, “The Benz is definitely the better deal!” Mr. Blackburn shook his head in agreement, “Exactly Jimmy…If you were just buying cars with no knowledge, the Nissan Altima would look like a great deal because it’s cheaper. But if you did some homework, the Mercedes is a far better deal because you could turn around and immediately sell it for $100,000 and would probably take a loss on trying to sell the Nissan Altima. A comparable low P/E is usually good when analyzing stocks.” Jimmy wrote this second example down as well. He was starting to understand this complex skill of analyzing the stock ratios.

Their time had come to an end for the day, but Mr. Blackburn reminded Jimmy to continue to focus on the positive in life every day. Jimmy thought about being positive especially when it comes to learning about investing. He walked towards the phone booth and saw that it was empty. He wanted to talk to his family but was reluctant to reach out to them on the phone. Before he went to his job in the kitchen, Jimmy went to use the phone to call his mom.

“Hey, Ma! How you been feeling?” Nadine was on the other end and screamed in the phone, “Jimmy!!! I miss you so much! My son finally called me! Are you alright? Have you gotten the money we put on your books?”

In that moment, a wave of emotions came over Jimmy hearing a familiar voice that was excited to speak with him. Since his incarceration, Jimmy had not spoken to anyone on the phone because he was too embarrassed. With his voice cracking and tears running down his eyes, he tried to respond without his mom hearing the emotion coming through the phone, “Yea…yea ma…I got everything you all sent me. Thank you so much.” At this point, Jimmy could not hold anything back and sobbed on the phone to his mom. “I’m so sorry mom. I…I…just don’t want you to be ashamed of me or disown me.” Nadine responded back to her only son with tears in her eyes, “Jim Jim, you don’t ever have to worry about me disowning half of my heart…Half for you and half for your sister, Ally. I could not live without my heart. I’m not ashamed of you at all. I’m actually proud of you because what you did, even though illegal, shows your potential to do something great.”

Jimmy wiped the tears from his eyes, “I’m so glad you said that because I’ve been thinking about my potential a lot lately.” Jimmy told his mom everything about Mr. Blackburn and how he wrote a book on investing. Jimmy explained to his mom some of the concepts he already learned. Nadine was smiling by this time from Jimmy’s excitement. “Jimmy I’m so happy and proud of you. That sounds so interesting even though I don’t know anything about investing.” The two of them laughed before Nadine continued, “We did get our acceptance letter to visit you yesterday. We were thinking of coming this weekend if that’s ok.” Jimmy laughed a sigh of relief, “Of course! Is dad coming?” Nadine said, “He already said he would take off work whenever we came to visit you. Your dad feels like if he wasn’t working so much maybe he could’ve helped you avoid the place you’re in now.”

Jimmy was silent and could not think of a response to his father taking the responsibility for his incarceration. His mother responded for him, “Don’t feel bad Jimmy. As a parent, we always blame ourselves for anything our children do.” In the middle of Nadine’s sentence, a beep was heard on the phone. Jimmy told his mom, “The beep means we only have 30 more seconds. I will email you all tonight with details of visitation. I love you and tell everybody I live too.” Nadine responded, “I love you too Son. Take care until we get there this weekend.”

Jimmy walked to the kitchen with a smile on his face, and he felt a sense of pride he hadn't felt since he was first arrested. While he was working, he started thinking of all the things he would buy his parents and sister once he was out of prison and investing. He started to think through future scenes of him placing trades on Friday afternoon before heading to the beach for the weekend. Did Mr. Blackburn have a house on the beach from investing profits? What type of lifestyle did Mr. Blackburn really live? And how did he end up in prison? Jimmy knew he wanted to make a living from investing, but he wanted to do everything legally for the rest of his life because freedom became his focus.

That evening, Jimmy continued his journey to learn investing.

CHAPTER THREE

Mutual Fund and Exchange Traded Fund

Many investors hear the concept of diversification but don't know what this entails. Diversification is essentially spreading risk by investing in different types of assets (stocks). If an investor has money in several different stocks, the hope is when one stock is down, several other stocks are increasing in value. The problem with this practice is having enough money to diversify. An investor can diversify with a small amount of money by pooling money together with other investors through a mutual fund.

What is a mutual fund?

Mutual funds are investment strategies that allow you to pool your money with other investors to buy a set of stocks, bonds or other securities, often called a wallet. The price of the mutual fund, also known as the net asset value, is determined by the total value of the securities in the portfolio, divided by the number of outstanding shares of the fund.

Net Asset Value= Total Value of Securities ÷ Number of Shares

This price fluctuates according to the value of the securities held by the portfolio at the end of each business day. Keep in mind that mutual fund investors are not the actual owners of the securities in which the fund is invested; they only own shares in the fund itself.

In the case of actively managed mutual funds, decisions to buy and sell securities are made by one or more portfolio managers, assisted by teams of researchers. The main objective of a portfolio manager is to look for *investment opportunities to allow the fund to exceed its benchmark, which is generally a widely followed index, such as the Standard & Poor's 500.*

One-way to determine the performance of a fund manager is to review the returns of the fund in relation to this index. Keep in mind that may be tempting to focus on short-term performance when evaluating a fund, but most experts will tell investors it is better to analyze long-term performance, such as yields at three and five years.

For a small average investor, mutual funds can be a smart and profitable investment vehicle. While the individual purchase minimums may vary from one fund to another, they can go up to $ 100; most funds allow you to buy shares with only $2,500. In addition, minimums often increase or decrease if investors buy a fund in a retirement account or use certain intermediation functions, such as automatic investments, to invest regularly over a period of time. Buying shares in a mutual fund is also a simple way to help diversify your investments. This is another way of saying you will not have all your eggs in one basket. For example, most mutual funds have more than 100 values. Creating and managing a portfolio of so many values could be extremely impractical, if not impossible, for someone with only a small amount to invest.

As a mutual fund investor, you benefit from the services of a professional manager who continually reviews the portfolio. Portfolio managers and professional analysts have the experience and technological resources to research companies and analyze market intelligence before making investment decisions. The fund managers identify the securities to buy and sell through the valuation of individual securities, the allocation of sectors and technical analysis. For those who do not have the time or experience to supervise their investments, this can be invaluable.

All mutual funds allow you to buy or sell the shares of your fund once a day at the close of business at the value of the net assets of the fund. You can also automatically reinvest the income from dividends and distributions of capital *gains or make additional investments at any time. For most capital funds, the minimum initial investment required may be considerably less than you would have to invest to create a diversified portfolio of stocks.*

However, an investor may want to buy and sell a "basket of stocks" throughout the day. The best way to do this is by investing in an exchange-traded fund. An exchange-traded fund, or ETF, is a marketable security that tracks a certain index and trades on a major stock exchange. ETFs are available to invest in stocks, commodities, and bonds, and have some of the properties of mutual funds and some properties of common stock.

ETF (Exchange Traded Fund) Similarities with mutual funds

Like a mutual fund, an ETF allows investors to distribute their money without depending too much on an individual stock or bond or without directly owning commodities. For example, an S & P 500 ETF would keep the 500 shares that make up the index in the same proportions. For this reason, ETFs can be very useful for adding diversification and exposure to different asset classes in your portfolio. In fact, many ETFs have mutual matching funds offered by the same companies. Using the S & P 500 example, the Vanguard S & P 500 index fund and the Vanguard S & P 500 ETF are the same product, but in different ways to satisfy the preferences of different investors.

Like a mutual fund, an ETF has an expense ratio, which means a percentage of the fund's assets are used to cover administration and other expenses. ETFs often have lower expense rates than similar mutual funds. The mutual fund Vanguard S & P has a gross expense ratio of 0.16% while its counterpart of ETF charges only 0.05%. However, you will pay standard trading fees when you buy ETF shares which could offset this benefit.

Key differences and benefits of Exchange Traded Funds (ETFs)

Unlike a mutual fund, an ETF is listed on an important exchange, and the price it pays to buy shares is determined as a common stock: its instantaneous market value. Mutual funds calculate their net asset value and the price of their shares once a day while ETF prices change continuously.

As with other common stocks, it is possible to buy an ETF with a margin or sell the shares of a selling ETF. Many ETFs have options available and, like ordinary shares, you will normally pay the standard commission from your distributor when you invest in an ETF (this is not the case with a mutual fund). Recently, some brokerages have started offering a selection of ETFs without commissions, so ask your broker if you are interested.

In addition, many mutual funds have minimum initial investment requirements, while ETFs do not have such rules. The minimum investment you should make in an ETF is simply the cost of an action. Many Vanguard mutual funds have a minimum initial investment of $ 3,000. It is very possible to start investing in a corresponding ETF with less than $ 100, especially if you find one without a commission.

Leveraged ETF

No discussion of ETFs would be complete without mentioning (and warning against) the leveraged and inverse ETFs. As a relatively new idea, some ETFs use leverage and / or derivatives to amplify or reverse the fund's returns. An inverse ETF seeks to produce the opposite return of an index while a leveraged ETF seeks to produce a multiple (X) of the index's daily performance, usually two or three times.

Without going into the underlying mathematics, keep in mind that leveraged ETFs are a bad idea as long-term investments because they tend to fall over the long term, regardless of what the underlying index does. These can be excellent tools for professional traders, but investors should generally leave them alone.

Do you have to choose an ETF or mutual fund? If you prefer easy-to-negotiate investments and not a high minimum initial investment, ETFs may be a good option for you.

One last word of caution: Due to the liquidity of the ETFs, many investors are more tempted to change ETF positions frequently. ETFs that track an index of stocks or bonds are generally designed to be long-term investments, and it is important to treat them in this way.

Jimmy was up at four the next morning and couldn't go back to sleep. Jimmy now had a little under four years left of his sentence, a light sentence for the severity of his crime. Since he was a minor and had no prior arrests, the judge was lenient on him. Jimmy stayed in bed and thought about what he would focus on that morning to stay positive and what he wanted to accomplish over the next four years. He decided to focus on his family coming to visit in a few days. If he could get his family to visit at least once a month, their visit would be his motivation each day. After thinking about his plans, Jimmy got up and headed to the kitchen for work.

"Jimmy! How you feeling?" Jimmy turned around to see Mr. Blackburn sitting at a table in the kitchen drinking a cup of tea. "What are you doing up right now?" Jimmy asked. Mr. Blackburn responded, "Ah, I'm used to waking up early. I usually lay in bed, but my stomach pains were irritating me, so I came to drink some tea. It's fine as long as I have some food on my stomach." Mr. Blackburn sat and read *The Wall Street Journal* while Jimmy helped prepare breakfast in the kitchen. Jimmy watched Mr. Blackburn as he read and wondered what information *The Wall Street Journal* provided. After a while, the other prisoners flooded the cafeteria to eat breakfast. Jimmy caught a seat with Mr. Blackburn. "How's the family Jimmy?" Mr. Blackburn inquired. "You know, they are good. I finally talked to my mom, and she told me that they are visiting this weekend. I'm really excited to see them all!" Mr. Blackburn smiled but didn't say anything. Jimmy wondered to himself did anyone come to visit Mr. Blackburn at all. Both men finished breakfast and headed to the library.

"Jimmy, tell me what you read and what questions do you have?" Mr. Blackburn asked in a somber voice. "Mr. B let's talk about our five positive things we can be thankful for. I'm not going to ask what's bothering you, but I can tell you are dealing with something." Jimmy and Mr. Blackburn were sitting across the table from each other with the investment book between them. Mr. Blackburn murmured, "Ok…I will name two. I'm thankful to be halfway done with my sentence, and I'm thankful to see another year on earth." Jimmy looked surprised and happy, "Happy Birthday MR. B! I had no clue! Forget the book today, we have to celebrate!" Mr. Blackburn laughed, "No, no, no. Maybe another day…I wouldn't want to do anything else on my birthday than to pass this knowledge onto someone that is eager to learn. So, tell me what you read." Jimmy rolled his eyes in a playful way towards Mr. Blackburn, "Alright then Old Man, National treasure, I read about mutual funds." Mr. Blackburn was laughing hard and hitting the table, "Watch out lil' boy before I make your grandma my new chick and make her put you in timeout!" Both Jimmy and Mr. B were laughing so hard they had tears in their eyes. "You are crazy old man!" Jimmy said loudly while still laughing.

After they both stopped laughing, Jimmy asked about mutual funds, "What is a portfolio? You keep mentioning it, and I've heard the name." Mr. Blackburn, still wiping tears from his eyes from laughing responded, "Sorry Jimmy for not explaining that sooner. Think of an investment portfolio as a photo album or photo portfolio. You have several different pictures, and you can choose what to put in the album and take out. Some people have a wedding photo album, a vacation photo album, or just a random group of photos. People put in their photo album what they value the same way investors put things in their investment portfolio. The investment portfolio is just what investments you own."

Jimmy wrote down what Mr. Blackburn just explained. "Mr. Blackburn, I think I understood what a mutual fund is and why you would want to invest in one. It lets you own a lot of stock at once without having to buy all of them directly. What I'm confused about is how can you own all of these stocks without paying full price?" Mr. Blackburn responded immediately, "It's through fractional ownership. The fund has bought the shares of stock in all these companies. Let's say the fund spends $1 million to buy stock in 100 companies and each stock costs a different amount, right. The fund now sells shares of the fund for $10/share and the investors can own a fraction of a share in 100 companies. Does that make sense?"

Jimmy still looked a little confused, “Can you explain fractional ownership in a little more detail Mr. B?” Mr. Blackburn scooted his chair up and grabbed Jimmy’s pen and paper and began writing, “Sure! Let’s say you, as an investor, buy one share of the mutual fund for $10. Now the mutual fund must take $10 and split it by 100 for the 100 stocks it purchased. What is $10 split 100 ways?” Jimmy did quick math in his head, “Ten cents?” Mr. Blackburn nodded his head, “Correct…So they take ten cents and put it in each stock. But let’s say the stock of XYZ is $10 per share. How much can your ten cents buy of the $10 stock?” Jimmy thought about it, “Umm, like 1%?” Mr. Blackburn continued writing, “That’s right Jimmy or one one-hundredth. You would own one one-hundredth of stock XYZ. But if you took your $10 and bought one share of XYZ, you wouldn’t be diversified, and if XYZ went down in value, all your money would be down as well.”

Jimmy nodded his head slowly and made sure he understood the concept, “A mutual fund is just a lot people putting their money together to buy stock?” Mr. Blackburn responded to Jimmy, “Bingo! That’s all it is…A lot of people pooling their money together to buy stock.” It was time to leave the library and go back to their jobs. Jimmy now understood how he could own a small part of a lot of stocks with a mutual fund, and he liked that idea.

The next few days Jimmy and Mr. Blackburn did not meet in the library because Mr. Blackburn had to work an assignment with litter pickup. Jimmy still went to the library and read the first three chapters of the book again to reinforce what Mr. Blackburn explained to him. Jimmy would read a few lines of the book and then start thinking about his family and friends. He thought about the weekend and how he would hug his mom, sister and dad. They had so much to talk about and experiences to share.

Finally, Saturday morning arrived, and Jimmy jumped out of bed at 5 o’clock. He knew the faster he finished his breakfast duties, the sooner he would see his family. Jimmy rushed to finish washing dishes and putting everything away in the kitchen. The prisoners began to come in like any other morning, almost running to grab the best-looking foods.

Jimmy, however, was not eating that morning because he was going to have a special meal with his family. In federal prison, visitors of prisoners can purchase special food items for the prisoner during visitation. Jimmy thought about what type of food he would eat during the visitation, and he decided he wanted fresh fruit salad and vegetables because those are foods his prison didn't normally serve. The clock hit 9, and the guard called names one by one for the prisoners who would go to the visitation hall. Jimmy heard his name called and got in the single file line to be patted down before leaving the cafeteria. Once the pat down was done, Jimmy's heart started pounding harder, and his hands started to shake a little. He could feel the excitement in his body! And then, a few steps forward, he looked through the glass windows into the other room, and there his family was waiting for him. He couldn't contain himself as he hugged his mom, dad, and sister at the same time! "Oh, my goodness, I can't believe you all are here in the flesh! This is the best day of my life!" Jimmy shouted. His mom and sister had tears in their eyes, so Jimmy spoke to his dad, "How are you doing Pops? I'm glad you came to see me…It really means a lot that you wanted to come." His dad just grabbed him again and hugged him without saying a word.

Jimmy and his family sat in the chairs around the visitation room. "Is it hard to sleep here? I would be so scared to close my eyes because somebody might try to kill me," was the first thing Jimmy's sister Ally asked. Jimmy laughed and so did the rest of the family after they saw his reaction to the question. "This isn't that kind of prison. The people here are paper criminals, which is usually financial stuff. It's honestly more like I'm at a camp with bars than a prison," Jimmy told his sister. Jimmy's mom asked, "What has been the hardest thing to adjust to in prison?" Jimmy responded without hesitation, "There are two things I still have to get used to no privacy and no fresh fruits or veggies. I crave fresh food all the time, and there is nowhere to go for privacy. Showering, toilets, and beds are all in open areas. I have to plug my ears to sleep at night." Jimmy's dad asked, "What about abuse? Has anybody tried to abuse you in any way?" Jimmy looked to the ceiling as he thought about the question, "Well, guys are always fighting, and the guards can sometimes be a little rough. No one has personally assaulted me though." As Jimmy was speaking, the small cart came in the visitation room with fresh salads and fruits to buy.

Jimmy bought his food and sat with his family to eat. He told them more about how he was learning about investing in the stock market from Mr. Blackburn. His mother insisted they meet Mr. Blackburn the next visit. "Give me his full name so we can get the approval to visit him as well. We would love to meet someone who is teaching investing to you," Jimmy's mom told him. It was now time for the family to leave, and Jimmy's mom and his sister began to cry. "We just want to take you home with us. We miss you so much Jimbo," Jimmy's sister Ally whispered in his ear as she hugged him. Jimmy's family left the visitation room, and he went back to the courtyard to join the other prisoners for their break after lunch.

Jimmy found Mr. Blackburn and sat down on the bench beside him. "Jimmy!! How was the visit with the fam," Mr. Blackburn asked. Jimmy was smiling, "It was good. They all want to meet you and will do the paperwork to visit you here." Mr. Blackburn looked down at the ground as he was in deep thought. He raised his head and grinned, "I would like to meet them. No one has come to visit me at all, so it will be refreshing to walk in the visitation room with you. That's exciting!" All of a sudden, Jimmy started thinking about stocks and investing, and he explained this to Mr. Blackburn. "You know, seeing my family gives me a new sense of drive and purpose. I can't wait to get out and start really making money for my family. I'm all in now!" Mr. Blackburn patted him on the back, "I'm right there with you my friend. Let's really kick it into high gear on learning the market so when we get out, we can hit the ground running." Jimmy was ready, and he started reading the next chapter of the book that night.

CHAPTER FOUR

The Bull and Bear Market Types

When you talk to someone in a coffee shop, at a ball game, or anywhere about investing, the general sentiment is that investing is synonymous with making money. This is far from the truth because investing has the risk of losing money. The general stock market moves in cycles called Bull and Bear market cycles. Understanding the current market cycle is crucial to investment success.

Bull Market

The market going up aggressively over a specific period defines Bull markets. The Bull market cycle is named after the animal because of how a bull attacks. Bulls use their horns and swing their heads in an upward motion. As the market rises like a bull, there becomes more and more greed in the stock market. You see people thinking, "Oh yeah let's put money into the market because it's going up." Most profits are made during bull markets if the investor bought at lower prices. But when was the price lower to buy the stock? The time to buy the stock is during the market downturn or what is called the Bear market.

Bear Market

The definition of a bear market is exactly the opposite of a bull market. It's a market where quarter after quarter the market is moving down about 20 percent. When stocks signal a bear market, people start to get really scared about putting money into the stock market. If you've ever been in the woods and hear or see a bear, you are afraid.

Interestingly, a bear market is named for the way that this animal attacks its victims. A bear swipes downward during an attack, thus becoming a metaphor for market activity under these conditions. Just like understanding what to do when approached by different types of bears (play dead or make yourself appear large), investors need to understand what to do during Bear markets.

What Causes a Bear Market?

Generally speaking, a bear market is one that is showing signs of a decline. Share prices are dropping to the point where seasoned investors believe that this trend will continue, at least for the foreseeable future. Most experts agree that a bear market is one in which securities prices have fallen 20%, if not more, from recent highs, spawning widespread pessimism from investors. How long bear markets will last varies wildly depending on the specific situation. Some can last for just several weeks while some bear markets can last years. A cyclical bear market can even last several years depending on the contributing factors.

Bear Market History

There have been eight true bear markets since 1926. Their lengths varied wildly, with one lasting just six months and another nearly three years. The worst of them saw an 83% drop in the S&P 500, while the other end of the spectrum represented a 21.8% drop. One of the most famous examples of a bear market was the 1987 market crash, which saw a 29.6% drop that lasted roughly three months.

Bull vs Bear Markets

It's important to remember that a bull market is characterized by a general sense of optimism and growth, which tends to catalyze greed. A bear market is associated with a general sense of decline, which tends to instill fear in the hearts of stockholders.

The stock market has always been a leading indicator for the overall economy. There are four phases of an economic cycle: expansion (increase), peak, contraction (decline), and trough. Economic expansion is measured by an increase in gross domestic product (GDP) jobs, availability of credit, and other key indicators. The stock market has historically risen several months before an economic expansion. Stock market highs usually coincide with unemployment lows, which indicates a thriving economy. These are times of a bull market, and general optimism can be felt on Wall street.

Bear markets are leading indicators of economic contraction. Stocks see a general decline months before an economic contraction, which is a decline in real personal income, industrial production, and retail sales. Eventually during an economic contraction, companies begin to lay off their workforce, which increases the unemployment rate. This increases the general sentiment of a failing economy, and the stock market continues to decline.

The government plays a key role in economic cycles and in the stock market. The main tool the government uses to manipulate the stock market and economy is through interest rates. The government raises and lowers interest rates to either help the economy expand or to slow down expansion when it is growing at an unsustainable pace.

Should You Buy in a Bear Market?

The first rule of investing is to capitalize on fear and greed, and smart investors like to buy when there's fear. In other words, when the market is going down, a smart investor is a buyer. When the market is going up, they are generally selling. When most people feel scared or nervous in a bear market, investors should be looking to buy $10-dollar bills for $5 bucks. This scenario is like going to the Dollar store and finding luxury items that are normally much more expensive. But what happens if the stock continues to go down in value? If the stock continues to fall, you purchase more in increments. When the stock goes up again, this is the time to collect those profits.

Buying stock during market decline seems like an easy concept to implement, but it is not. Market timing is very hard to do even when all signs and indicators point to a certain narrative, the market can be irrational. The concept of buying companies and not just stocks is very important in these situations because if a company is healthy, the stock price will eventually reflect that health.

The next morning, Jimmy woke up and went to check his email before heading to the kitchen. He had an email from Nick, "King Jimbo! I've been taking this stock class at school, and we've learned about Bull and Bear markets. I see what you're saying about this stuff being interesting, and we definitely should have started investing when we had the chance. My teacher told us about how much money was lost during 2008 and that was a great time to buy stocks and real estate, but everyone was selling their stock then. I guess people really don't know when to buy or sell. How is everything on your side? I get some time off soon, and I'm going to come visit you. Your mom texted me last night and said they saw you this weekend, and you were looking good and seemed to be doing well. Keep your head up bro and I'm putting more money on your books this week. Stay up Jimbo."

Jimmy was happy to hear from Nick and how he was learning about investing at school. He knew they had started a business together before, and they could do it again with investing. The thought of Mr. Blackburn, Nick, and himself starting an investment company together intrigued Jimmy. What if they could do it and make billions? With Mr. Blackburn's years of knowledge, along with Jimmy and Nick's social media and business savvy, they could make a fortune.

After breakfast that morning, Jimmy went to meet Mr. Blackburn at the library. "How did you sleep Mr. B and how's your stomach feeling," Jimmy asked Mr. Blackburn. "I slept pretty good last night, and my stomach has been fine with the medication. Hopefully this ulcer is healing. How was your evening? Did you get some reading done?" Mr. Blackburn responded. "I slept pretty good last night after reading about Bull and Bear markets. I got an email from my friend Nick, and he is learning about the same thing in his investment class at school," Jimmy told Mr. Blackburn as he leaned back in his chair. "After I read Nick's email, I started thinking about how he and I are learning about investing at the same time. We did pretty good in our other business together as well. I think partnerships like that and the bond you and I are forming was meant to be," Jimmy stated in a more serious tone than usual.

Mr. Blackburn raised his right eyebrow, with a curious look on his face, “What are you trying to say Jimmy?” Jimmy sat for a second before responding, “I think the three of us should start an investment firm together. Nick is great at understanding when to take risks and when to pull back, just like a good investor. You have so much knowledge of investing that it couldn’t fail.” Mr. Blackburn shook his head left to right and looked down at the ground, “Jimmy, I’ve told you before, I am done with that life. The only reason I chose to help you is because you were eager to learn, and no money is being transferred, only knowledge. If you and Nick want to open a firm, then go for it. But I am not going to have any part of that world ever again. It has caused so much hurt and pain in my life!” Jimmy looked disappointed, but he understood how Mr. Blackburn felt. He was ashamed of his previous life as well.

Jimmy switched subjects back to investing, “So Mr. B, like I said before, I read about Bull and Bear markets last night. I understand what they are, but I don’t understand why investors don’t know that a bull market will return and just buy stocks during bear markets. It seems easy to me.” Mr. Blackburn looked puzzled, “What do you mean investors should just buy during bear markets? Are you suggesting that investors know the future?” Jimmy laughed embarrassingly, “Not know the future, but just understand that the market will go up again and just buy when the market is down.”

Mr. Blackburn responded, “Jimmy, you told me a little about how much money you were making with your scanners. Why did you not get out when your friend did? You had to know that at some point it would end.” Jimmy sat in his seat, and it started to click for him, “Honestly, I thought the money would never stop. I thought I would never get caught, and the good life would continue. I guess I should have gotten out during my bull market, right?” Mr. Blackburn shrugged his shoulders, “That’s human nature Jimmy. When things are good, we feel it will last forever and when things are bad, it’s hard to see things ever getting better. Life has ups and downs, Jimmy, just like the stock market. The market never continues to go up or down forever and with that in mind you must decide at what point you want to buy and sell.”

Jimmy wrote down what Mr. Blackburn was saying on the notepad. “The majority of people sell when the market is falling, so they won’t continue to lose money and will buy if the market is moving up, so they can make as much money as possible. The bad part about this style is that a lot of investors sell at the bottom and buy at the top.” Jimmy looked confused, “But how do you know when the bottom or top is taking place?” Mr. Blackburn shook his finger to signal Jimmy figured out a complicated math problem, “Jimmy, that is the trillion-dollar question. Nobody knows when the top or bottom is happening; there are only probabilities and speculations from analysts. One thing I always did was to continue buying companies that have stood the test of time which meant that they have survived recessions, market lows, and even depressions. Those companies know how to endure during the worst of times.” Jimmy wrote this information on his notepad, so he could go over it with Nick.

By this time, the break was over, and Jimmy had ten minutes before he needed to be in the kitchen. He decided to write an email to Nick. “Nick! I’m great my man, honestly! I was depressed for a little while, but I was finally able to focus on some of the positive things in my life, which changed my perspective. I’m glad you are enrolled in the stock class at school and learning some of the things Mr. Blackburn is teaching me. I told him the three of us should start an investment company when we get out, but he was not on board at all. I will have to continue to work on that. He did tell me that no investor knows when the market is at the top or bottom, and people sell when its time to buy and buy when it’s time to sell. Tell me more about the college life. Anything happening with the college women or parties? Anyway, I got to go, but we will talk soon and please let me know when you plan to visit. Also, try to get approved to see Mr. Blackburn as well because I want you to meet him. Take care my man.”

Jimmy left the computer room and headed to the kitchen. He was thinking about what it would be like for him and Nick to be running an investment company together. Giving back to the community, providing jobs to people that would probably work in the investment world. Just then, Jimmy dropped the pan in the dish water. That’s it, Jimmy thought to himself. If he could show Mr. Blackburn how they would employ people that didn't have a chance and give back to the community, maybe Mr.B would be on board with starting an investment fund again.

That night, Jimmy went back to the computer room, and he had received an email from Nick. "It's crazy here my man. I'm glad you are in good spirits because I've wanted to tell you about so much. There are so many beautiful, and intelligent women here. The parties aren't much different than high school parties except there are no curfews, and the women are older. I don't go to too many parties at all though. I try to stay out of trouble. I did meet a girl named Megan, who is an economics and finance double major. She understands investing because she grew up around it. We talk a lot about the concepts and how-to time market moves. She talks a about making money when the market is going down or in a bear market, I think this is called short selling. I'm going to figure out how to do that soon though. I will be there in another week, and I will make sure Mr. Blackburn is on the list to visit. Take care Jimbo!"

Jimmy went back to his room and opened his book to the chapter called short selling. Jimmy wanted to know more about how to make money when the market was moving down.

CHAPTER FIVE

Short Selling Stock

Short Selling

Short selling is a great tool to use when the investor believes the company is overvalued and will go lower in price. Investors can still make a profit even in bear markets, from short sales. Short selling is the practice of an investor taking shares in loans, from a brokerage firm. The investor then sells the shares that were borrowed in the secondary market and receives the money from this sale of shares. If the price of the stock falls as desired by the investor, the investor can obtain a profit by buying enough shares to return to the broker the amount of shares he has borrowed at a lower total price than the one he received for the sale of actions.

For example, if an investor believes that Apple Stock is likely to fall from its current price of $20 per share, he may deposit what is known as a margin deposit to apply for a loan and borrow 100 shares of the broker's stock. Then, he sells these shares at the current price of $ 20 each, which gives him $ 2,000. If the stock falls to $ 10 per share, the investor can buy 100 shares to return to his broker for only $1,000, which leaves him with a profit of $ 1,000.

Shorting stocks or short selling involves timing and more risk than simply buying a stock. The reason for the unlimited risk is because the price of the stock the investor shorts can theoretically go up infinitely. Unlike buying stock, where you can only lose what you invest, shorting stock can cause the investors to owe the brokerage money. Many investors go into deep debt from shorting stock losses.

Short Squeeze

As an investor, you must look at every possible scenario when analyzing stock. Before shorting a stock and risking more capital than you have, look at the potential loss through the short interest ratio.

Short interest is a simple ratio to calculate how many investors are shorting the stock. To calculate short interest, take the number of shares that are short against the average daily volume of shares traded.

Short Interest Ratio= <u>*Short Interest*</u>

Avg. Daily Vol.

$$\text{Short Interest Ratio} = \frac{\text{Short Interest}}{\text{Average Daily Trading Volume}}$$

Both numbers can be found on most finance website (i.e. Yahoo Finance). Let's look at Apple Inc. (AAPL) stock to calculate the short interest ratio (figures are daily amounts).

Share Statistics

Avg Vol (3 month) [3]	30.29M
Avg Vol (10 day) [3]	30.23M
Shares Outstanding [5]	4.6B
Float	4.35B
% Held by Insiders [1]	0.07%
% Held by Institutions [1]	60.95%
Shares Short (May 15, 2019) [4]	49.55M
Short Ratio (May 15, 2019) [4]	1.62

(Yahoo Finance)

Short Interest Ratio= 49.55M/30.29M

Short Interest Ratio=1.63 (Approx.)

What the short interest ratio means is that it will take 1.63 trading days, or a day and half, to cover all the short shares outstanding. This can be a great thing if the stock begins to move up in value because investors that have short stock do not want to lose too much money if the stock moves higher. What do the short stock investors do? They begin to buy the stock to stop their losses which causes the stock to move even higher. This concept is called a short squeeze. In a *short squeeze, short sellers cause the stock to move higher relatively quickly, which causes more short sellers to stop losses, which causes the stock to move higher over and over and over again.*

Let's look at ABC stock to see how this concept works. ABC stock has just reported great news which causes the stock to move higher from $20 to $30 on Tuesday. ABC stock has a short ratio of 4.5 (4 ½ days to cover all short positions). On Wednesday, short sellers try to stop their losses and buy the stock, flooding the market with demand for the stock. Just like in any business dealing, when demand for a product is high, the price generally rises. Because demand is high for ABC, the stock rises again on Wednesday from $30 to $35 and again on Thursday from $35 to $38. By Friday, the short ratio was down to 1.5, and demand was not as high as previous days.

At first glance, you might think that short selling stock would be as common as owning a stock. However, relatively few investors use the short sale strategy. One of the reasons is the general behavior of the market. Most investors own shares, funds and other investments that they want to increase in value. Over time, the stock market has generally increased, despite temporary declines. For long-term investors, holding shares was a much better bet than selling the entire stock market.

Sometimes, however, you will find an investment that you think will fall in the short term. In these cases, short selling can be the easiest way to take advantage of the misfortunes experienced by a company. While short sales are more complicated than simply buying stocks, they can save you money when others see their investment portfolio reduced.

The short selling stock risk

Short selling can be profitable when you make the right decision, but it carries greater risks than those incurred by common equity investors. When you buy a stock, you lose as much as you pay for it. If the stock reaches zero, you will suffer a total loss, but you will never lose more than that. On the other hand, if the stock goes up significantly, there is no limit to the benefits you can take advantage of.

With a short sale, however, this dynamic is reversed. Your potential benefit is limited, but there is no theoretical limit to the losses you may incur. For example, suppose you sell 100 shares short at a price of $ 10 per share. Your income from the sale will be $ 1,000 (100 shares x $10=$1,000). If the stock reaches zero, you will keep all the $ 1,000 originally collected. However, if the stock rises to $100 per share, you will have to spend $ 10,000 (100 shares x $100=$10,000) to buy back the 100 shares. This will give you a net loss of $ 9,000, nine times the initial profits of the short sale.

However, even if short sales are risky, it can be a useful way to take calculated positions against a company. Managing your risks is important, but when used sparingly, short sales can diversify your investment exposure and give you the opportunity to generate better returns than those with only equity and other investments.

In addition, a broker may force the investor to cover the cost at any time. This means the investor will have to buy the shares at the current price to return them to the broker. If it turns out that the stock price is higher that day than the day the broker loaned it, the investor will pay nothing. The broker will usually only ask the investor to cover the position in the open market if other investors want to sell the same stock short at a higher price. If this happens, the investor will realize a loss on the stock. Short sales can temporarily raise the price of the shares to low-value shares. If everyone thinks that the stock price is falling and that there is a race against the sale of short-term stocks, insufficient coverage can increase the price of the shares.

Let's analyze the benefits of the short sale.

Like derivatives (stock options, futures, forwards, etc.), short sales potentially allow an investor to generate high returns without having to spend a lot of money in advance. The only investment outlay are the fees with the broker. If the investor is right and the price of the stock sinks, everything is completely a gain minus the broker fees. Second, short selling is one of the few ways to make money in a bear market. Bear markets are synonymous with losses, but with short selling, the investor can make money.

Now that we have analyzed the benefits of short sales, let's look at the disadvantages before moving on to the next chapter. Short sales only return money if the stock price drops. If the investor makes a mistake, and the price goes up, there will be losses. The real risk is that your loss is potentially unlimited. If the price increases, you must buy it at this price to return the stock to your agent. There is no limit to your loss. Short sales have even worse consequences for the stock market and, therefore, for the economy. It can take a normal stock market and break it. If many investors or hedge fund managers decide to sell the shares of a company in short, they can literally force the company to go bankrupt. Many experts say that short sales contributed to the demise of Bear Stearns in the spring of 2008 and to Fannie Mae and Freddie Mac later that summer. When the short sellers attacked Lehman Brothers in the fall, it was enough to cause panic. Short selling will always be a great tool for the short-term market moves, but not a long-term investment strategy.

Jimmy was abruptly woken up by blaring sirens! His heart was racing because he didn't know what was happening. Through the loud speakers you could hear one of the guards saying in a matter-of-fact tone, "Everyone to the yard immediately!" Jimmy put on his pants, shirt, and shoes and headed to the main yard. It was 2 a.m. and everyone was still half asleep. Once everyone had arrived and lined up, guards walked to each prisoner and firmly did a search on their body. Then from the bullhorn the main guard announced, "We are doing a search of every room in this prison. If you have any contraband in your room and would like to confess, we will go easy on you. But, if we find it on our own, the punishment will be severely worse. Your choice!" Jimmy looked around at everyone and tried to find Mr. B in the dimly lit yard but couldn't see him.

After what seemed like an eternity, the search was over, and everyone went back to their rooms. Jimmy was wide awake because of the commotion and knew he wouldn't get much rest, so he just laid in bed until it was 5 a.m. Still tired from the little sleep he'd gotten, Jimmy got out of bed and headed to the kitchen. He finished his normal kitchen duties and headed out to breakfast where he usually ate with Mr. Blackburn. But today, Mr. Blackburn and several other people weren't at breakfast. Jimmy thought to himself, where was everybody…Did they find contraband in their rooms?

As breakfast time ended, Jimmy was becoming more concerned about Mr. Blackburn. He went to the library to wait on Mr. B, but no one walked in other than the usual guard. After a few minutes, Jimmy went to the guard and asked, "Do you know where Mr. Blackburn is right now? I didn't see him at breakfast at all." The guard tried to think, "I don't know exactly where he is but if you haven't seen him after the search last night, he's probably in a holding cell with the others, waiting to see the warden for contraband." Jimmy told him about their meetings each morning and the guard told Jimmy, "I know exactly who you and Mr. Blackburn are and I like both of you. I can make a call to see where he is located."

After calling around, the guard told Jimmy that Mr. Blackburn had been rushed to the hospital last night. Jimmy began to panic, “Do you know where they took him and what was wrong with him?” The guard shook his head and said, “No I don't really know where they took him or what was wrong. I know they usually take prisoners to Memorial Hospital.” Jimmy began to really worry at this point because he knew Mr. Blackburn had several health issues including his stomach ulcer. Jimmy sat in the library for a few minutes to gather his thoughts and figure out what he needed to do. He left the library and went to the phone station to call the hospital but unfortunately, they could not give information about inmates. It was now time for Jimmy's lunch kitchen duty, so he went to the kitchen.

During the same week, Nick was learning about shorting stocks in class. Nick's professor explained to the students how short sales work with stocks. Nick was still confused about how this strategy works. So, he stood up and asked the teacher when the best time would be to short a stock and also how do you do it. The teacher responded, “I can tell you how to do it, but there is never a good time to short a stock.” Nick then asked, “But if an investor can make money when the market is falling isn't that a good thing? I'm sure there are people making money when the market is going down right?

Nick's professor looked at him then around at the rest of the class and said, “There are people who make money when the market goes down, but they are professionals. The way that shorting a stock works is that you are essentially borrowing something that you don't own. General rule of thumb is to buy low and sell High. With short selling, you are doing the same thing but in opposite order. You are selling high, and hopefully you can buy it back low. Another difference is that you don't own the stock, and so you are waiting for it to come down in price. But what if it never comes down? What if you sold the stock for $100, and it shoots up to $300? Now you owe the broker an additional $200 that you may not have.”

Nick sat there in his seat and took notes on what the professor was saying. Nick raised his hand again, “So, if you short sale, you may owe more than you originally invested?” The professor responded, “Yes you can own a lot more than you originally invested.” Nick look confused, “But what about making profits in the short term from short selling? You can always sell, or I should say buy, the stock back if you start losing more than you want right?” The professor took a deep breath, “Yes, but you don’t know when to buy it back. Class, a rule of thumb, stay away from shorting stocks.” Time had ended for class, but Nick knew there was a way to profit from stocks falling in price. He would have to ask Mr. Blackburn and get his thoughts on short selling stocks when he met him.

That evening, after dinner, Jimmy was still trying to find out how Mr. Blackburn was feeling and if he would be ok. He was in the T.V. room relaxing when Mr. Blackburn walked in with band aids on his arms. “Mr. B! Man, I’ve been looking everywhere for you. What happened?”, Jimmy asked as he jumped up to great Mr. Blackburn. Mr. Blackburn took a seat beside Jimmy, “Last night, I started throwing up severely. I went to the nurse, and she advised that I be taken to the hospital. When I got to the hospital, they ran normal tests and that saw the ulcer was enlarged. I got stronger medicine and now everything should be fine. You thought I got caught up in the raid last night, didn’t you?” Jimmy laughed, “I swear I was thinking to myself, Is Mr. B moving “white” on the low and they caught him. His old tail needs to sit down somewhere and trade these stocks!” Mr. B and Jimmy both laughed and grabbed their stomachs. “Naw Jimmy, I wouldn’t be that stupid. Only legal investing for me. Have you read some more,” Mr. Blackburn asked Jimmy. Jimmy shook his head up and down, “Yes sir I did. I have some questions about short selling, but we can talk about that tomorrow. You just need to rest tonight.” Jimmy and Mr. Blackburn both left the t.v. room and went to bed.

The next day after breakfast, Jimmy and Mr. Blackburn met in the library. “I’m glad you’re feeling better Mr. B and nothing too major was wrong,” Jimmy told Mr. Blackburn. “Yea I was blessed, and I feel a lot better with the new medicine. So, what questions do you have for me about short selling stocks,” Mr. Blackburn asked Jimmy. “Well, Nick and I both have a few questions. Nick sent me an email and said his professor told the class to not short stocks because it’s only for professionals and you will usually lose money. Is that true?" Mr. Blackburn sat up in his chair with an irritated look on his face, "You know Jimmy, he's halfway right because shorting stocks can be risky. But I've made a lot of money from shorting stocks because I did it for short time periods. It's not a strategy where you will short something for several months or years but just enough time to catch the small dips in the stock market."

Jimmy began to understand how the method of shorting stocks is supposed to be used. "So Mr. B, when is the best time to short a stock?". Mr. Blackburn responded, "It's not really a specific time but there is one thing to look for when shorting; make sure the stock has moved up in price recently because most investors want to buy low. If most investors want to buy low and sell high then if the price is high, what will most investors do? Sell! And that can cause a drop in price in the short term and allows you to profit from a short sell." After this explanation, Jimmy knew everyone could make money from short selling stocks, and Nick's professor wasn't completely accurate.

Later that evening, Jimmy emailed Nick and explained what Mr. Blackburn taught him about short selling. He told Nick that his professor may have never traded stocks short and may not understand how it really works, but they could discuss it more when he visited. Jimmy felt good about making money in any type of market since learning about shorting stocks. After the long emotional night before, Jimmy was exhausted. He went to his room and fell asleep without reading any more of the book.

The next morning, before heading to his kitchen duties, Jimmy checked his email and saw one from Nick. "Jimbo, thanks for letting me know what Mr. Blackburn told you about shorting stocks. I thought there was a way to make money from shorting stock without being a professional. I want to learn more about that and how to make consistent money in the market. I will be there in two days and can't wait to see you and Mr. Blackburn. We can talk about everything…Take care Jimbo." Jimmy was excited to see another familiar face visit because it made him feel more connected to the outside world. It was Friday morning and Nick was coming to visit on Sunday. Jimmy knew he, Mr. Blackburn, and Nick would talk about stocks the majority of the time, but he also wanted to hear more about college life. Throughout the day, Jimmy started writing down questions to ask Nick because he didn't want to forget anything. By the end of the day, Jimmy had a page full of questions for Nick.

Jimmy laid down that evening full of excitement. He knew he wouldn't be able to sleep, so he opened the book up to the next chapter.

CHAPTER SIX

DIVIDENDS

A dividend is the distribution of the reward, a portion of the profits of the corporation are paid to a class of its shareholders. In simpler terms, dividends are a portion of the company's profits that are given to shareholders. For example, ABC company decides to pay a 5% dividend on each share of stock. The shares are trading for $100 per share, so the company will pay a dividend of $5 for every share the investor owns. If an investor owns 1,000 shares, the investor will earn $5,000 in dividends.

Dividends are decided and administered by the company's board of directors but must be approved by the shareholders through their voting rights. Dividends can be issued in cash, shares or other property, although cash dividends are the most common. In addition to corporations, several mutual funds and exchange-traded funds (ETFs) also pay dividends.

A dividend is a symbolic reward paid to shareholders for their investment in the capital of a company. It usually comes from the net benefits of the company. If most of the profits are retained within the company as retained earnings, which represents the money that will be used for the current and future business activities of the company, the rest can be allocated to the shareholders in the form of a dividend. However, companies can sometimes pay dividends even if they do not realize the desired benefits. They can do this to maintain their record of regular dividend payments. Corporations want to maintain the record of regular dividends because they want to be viewed as a stable company for all investors.

The board of directors may choose to issue dividends in different periods and with different distribution rates. Dividends can be paid with a defined frequency, for example, monthly, quarterly or annually. For example, Walmart Inc. (WMT) and Unilever PLC ADR (UL) make regular quarterly dividend payments. In addition, companies can also issue non-recurring special dividends, either individually or in addition to the expected dividend. With strong commercial performance and a better financial outlook, Microsoft Corp. (MSFT) declared a special dividend of $ 3.00 per share in 2004, which was significantly higher than the usual quarterly dividends ranging between 8 and 16 cents per share.

Large, well-established companies with more predictable benefits are often the best dividend payers. These companies tend to pay regular dividends when they seek to maximize the wealth of their shareholders outside of normal growth. Companies in the following industrial sectors regularly register dividend payments: commodities, oil and gas, banking and finance, medical care and pharmaceutical products and public services. Structured companies such as Master Partnerships (MLP) and Real Estate Investment Trusts (REIT) are also the largest Dividers that pay dividends because their designation requires specific distributions for shareholders. The funds can also issue regular dividends according to their investment objectives.

It is highly likely that new companies and other high-growth companies, such as those in the technology or biotechnology sectors, do not offer regular dividends. Since these companies may be in the early stages of development and may incur high costs (as well as losses) from research and development, business expansion and operational activities, they may not be able to have sufficient funds to issue dividends. Even middle-market or for-profit companies that make a profit avoid paying dividends if they aim for above-average growth and expansion and may wish to reinvest these profits in their businesses instead of paying dividends.

There is another way that companies can reward their shareholders other than cash. A dividend in shares is a dividend payment made in the form of additional shares instead of a cash payment. Companies may decide to distribute this type of dividend to registered shareholders if their available cash is insufficient. These distributions are generally recognized in the form of fractional payments per existing share, for example, if a company paid a dividend in shares of 0.05 shares for each share held by existing shareholders.

Also known as a "dividend in shares," a dividend in shares is a distribution of shares to existing shareholders instead of a cash dividend. This type of dividend occurs when a company wants to reward its investors but does not have the capital to distribute or wants to maintain its existing cash for other investments. Dividends in shares also have a tax benefit in the sense that they are taxed only when the shares are sold by an investor. This makes them advantageous for shareholders who do not need immediate capital.

The board of directors of a public company, for example, can approve a dividend in shares of 5%, giving existing investors an additional share of the company's shares for every twenty shares they already own. However, this means that the set of available shares increases by 5%, which dilutes the value of existing shares. Therefore, in this example, although an investor who owns 100 shares of a corporation may receive 5 additional shares, the total market value of those shares remains the same. In this way, a dividend in shares is very similar to a division of shares.

When issuing a dividend in shares, the total value of the shares remains the same from the point of view of the investor and the company. However, all stock dividends require a journal entry on behalf of the company that issues the dividend. This entry transfers the value of the shares issued from the deferral account to the paid capital account. The amount transferred between the two accounts varies depending on whether the dividend is a dividend in shares or shares.

A dividend in shares is considered small if the shares issued represent less than 25% of the total value of the outstanding shares before the dividend. A small entry is made in the stock dividend journal that transfers the market value of the shares issued from the retained earnings to the paid capital. Dividends in large shares occur when the new shares issued represent more than 25% of the value of the total number of shares outstanding before the dividend. An associated journal entry is made to transfer the nominal value of the shares issued from the retained earnings to the paid-in capital.

Once Jimmy finished reading the chapter on dividends, he was tired, and his mind was spinning from the information. Free money! Do dividends really mean free money? Surely that's not what it really means, Jimmy thought to himself. He would have to ask Mr. B in the morning.

The next day after breakfast, Jimmy met Mr. Blackburn in the library. Mr. Blackburn sat down. After casually looking through some of the books in the library, Mr. Blackburn asked, "You excited about tomorrow Jimmy?" Jimmy responded, "I am excited, but are you excited? Nick is excited to meet you. We see you as an oracle or a titan!" Mr. Blackburn politely laughed, "Thank you both for the confidence in me, but I'm neither of those anymore. I do want to change my legacy though, and I want to talk to you about the investment firm."

Jimmy sat straight up and with an excited expression, "Yeah! What are you thinking about the investment firm and what legacy?" Mr. Blackburn asked Jimmy, "How do you feel about truly helping people…More of a social conscious firm?" Jimmy looked confused, "So we would be like the Salvation Army? How would we make money?" Mr. Blackburn shook his head in disagreement, "No Jimmy, not like the salvation army. The world is changing and companies that focus on a greater purpose will outlast those that are simply about profits. I've done enough chasing profits in my lifetime, and I want to help people now. We are put on this earth to fulfill a purpose, and I think we can fulfill this purpose."

Jimmy was completely confused at this point and questioned Mr. Blackburn, "I'm confused. How do we fulfill a purpose? I want to invest and make money to help my family, just like you wanted to help your family." Mr. Blackburn sat and looked at the ceiling to try to figure out a way to explain the concept to Jimmy. Mr. Blackburn responded, "Jimmy, I'm not saying you won't make a lot of money, but you will feel a lot better if you focus on making the world a better place. You've had money before, but did this make you fulfilled? See once you buy the big house, cars, and nice clothes, what keeps you going?" Jimmy shook his head in agreement, "But how do we have a greater purpose with investing?" Mr. Blackburn shrugged his shoulders, "That is what we need to figure out between the three of us. What can we do to have a positive impact on society? Maybe its teaching younger children about finances and how to invest or maybe we hire ex-convicts in the firm as traders. There are so many ways to have a positive impact, and if I'm going to be a part of the investment firm, that's how it will be done." Jimmy grinned and quietly said, "So you're saying you will do it old man?" Both men laughed, and Mr. Blackburn said, "Yea I will do it skinny jeans!" Jimmy shook Mr. Blackburn's hand and gave him a hug before saying, "I know it's hard to go back into the investment world, but I think we can make a difference like you said. I can't wait to tell Nick about the plan."

Mr. Blackburn asked Jimmy, "Did you read any last night?" Jimmy nodded his head in agreement, "I did, and it was the section about dividends. I've heard a lot about dividends before, so it was good to read about the meaning. But instead of us talking about it now, lets wait until tomorrow, so you can explain it to me and Nick." Mr. Blackburn agreed with this plan. Jimmy and Mr. Blackburn sat and talked more about their future investment firm more before it was time to leave the library.

That night, Jimmy was barely able to sleep. He couldn't wait to see his best friend Nick. After breakfast, Jimmy met Mr. Blackburn in the visiting room and they both waited for Nick. Mr. Blackburn was nervously rubbing his hands, "I don't know why I'm so nervous. I wasn't this nervous when negotiating large merger deals."

Jimmy put his hand on Mr. Blackburn's shoulder, "Mr. B, there's no need to be nervous. We look up to you, so you can't do wrong in our eyes." Just then, Nick walked in the room with the other visitors. Jimmy shouted, "Nick!" The two of them hugged each other tightly for several moments. After hugging, they shook hands and embraced once more. The love between the two friends had not faded at all. "You getting big Nick! You in the gym?" Jimmy asked Nick. Nick laughed in a humble manner, "Man, I'm trying to stay in shape. I see you getting that jailhouse workout. You got jailhouse tats too, don't you boy!" The three men laughed so hard tears were rolling down their eyes. Finally, Jimmy introduced Nick to Mr. Blackburn. "So, you are the Oracle! It's so good to finally meet you Mr. Blackburn. I did a lot of research on you and your firm. I feel like I learn more from you than my professors in school," Nick told Mr. Blackburn. Mr. Blackburn shook Nick's hand, "I'm not an oracle or anyone special. I can only teach you how not to do things, and I'm excited to help you both, anyway I can."

The three men sat around a table towards the corner of the room to eat their fruit and salads they purchased from the food kiosk. "Let's get to it Mr. Blackburn. Teach me how to make ten million within the next week," Nick asked Mr. Blackburn. Mr. Blackburn finished chewing the food in his mouth and then responded to Nick, "That's easy. You will need three things: a gun, a mask, and a getaway driver. Then you walk into a bank and take the cash. Simple!"

Nick and Jimmy both laughed, and Jimmy told Nick, "I told you he was cool. I love this man!" Mr. Blackburn interrupted the two lifelong friends, "Ask me about anything you want. I know you both have some questions about dividends. What are your questions about those?" Nick responded, "I read about it in my textbook, and I did some research on dividends. Dividends are a consistent stream of income for the most part, right?" Mr. Blackburn nodded his head and responded to Nick, "Yes, it is a consistent stream of income. I would say you can depend on dividend payments about 98%-99% of the time. Companies want to pay their dividend, so they can be viewed as stable in the eyes of investors. Large investment funds and pension funds must invest in what are seen as stable investments: bonds, T-bills, and dividend paying stocks or funds. Corporations don't want to lose investments of billions of dollars, so they make sure to pay the consistent dividend."

Nick knew that business is all about perception, and dividends were perceived as a characteristic of a financially secure company. Nick told Mr. Blackburn, "My professor told us that dividends are the way to get rich. He said it's like getting free money every quarter. But it seems like you would have to invest a lot of money to make the dividends worth anything. Did you invest in dividend companies?" Jimmy interrupted before Mr. Blackburn could respond, "Yes. I was thinking dividends seem like free money, but the example in the book showed an investment for one hundred thousand would give you five thousand if it was a five percent dividend. That doesn't seem like that much to me." Mr. Blackburn nodded his head in agreement with both Jimmy and Nick before responding, "Both of you are partially correct. Dividends and dividend stocks can be used for capital preservation, which is a strategy used by investors whose main objective is to not lose money. They don't necessarily care about growing the money." Jimmy looked confused, "What investor wants to lose money though and what is capital preservation?"

Mr. Blackburn continued with his explanation, "That's where Nick's professor is wrong. Dividends won't necessarily make you rich because the rates aren't much. Most investors have accumulated a lot of wealth are more interested in saving money. For instance, let's say you have five hundred million right. Would you rather make twenty-five million each year with very little risk of losing it or fifty million with a lot of risk?" Jimmy looked at Nick and they both said they would rather make twenty-five million with a little risk. Mr. Blackburn nodded his head in agreement, "Exactly! If you have five hundred million, you probably care more about not losing money than making more money. I've always liked dividends because it is a reliable source of income from a well-established company. The stock won't move up or down too much, but you will get a constant stream of income. This is best for investors that aren't looking for their money to grow by a large percentage fast."

Mr. Blackburn tells them more about how to invest in dividend stocks. Mr. Blackburn said, "You have to buy dividend stocks like you buy any other stock. You must buy when the stock goes down in price, so that you make money when the price goes back up. The dividend is just a bonus when you don't have a lot of money."

Jimmy and Nick were starting to understand why investors would choose dividend stocks. Jimmy asked Mr. Blackburn, "What did you do with your dividends when you received them?" Mr. Blackburn responded, "I always reinvested it in the company that paid it, which bought more shares. It's a way to grow the money over time. Dividends are supposed to be a portion of the company's profits. Just like you and Nick had your business and took profits, this is essentially what a dividend payment is for investors."

Nick wanted to know more about Mr. Blackburn's investment company and more trading stories, so he asked Mr. Blackburn, "How much money have you made in one day from trading?" Mr. Blackburn laughed, "Well I will tell you a couple of stories. The first time I ever made a descent amount was when I first started full time at the Investment firm. Firms don't start new traders out with a lot of money, so I had two-hundred and fifty thousand in the account. I started the morning with one trade that made five thousand, and then another one that made seven thousand and several other ones. By the end of the day, I made one-hundred and eighty thousand dollars profit. That is still my best trading day in terms of feeling proud. It changed everything for me because people started to notice me at the firm. But the largest dividend payment I ever received was five million dollars from Verizon Wireless." Nick and Jimmy were going crazy at the amount of the dividend payment. Nick told Mr. Blackburn, "So if you have enough money, you can just collect dividend payments and live from that money?" Mr. Blackburn nodded his head in agreement, "Yes you can. When you have enough money, dividends are great."

Jimmy, Nick and Mr. Blackburn talked more about stocks for the rest of the visit. Mr. Blackburn told the two young men about the time he bought a Ferrari and a beach house with a dividend check. "One day, my partner at the firm made a bet on the 2004 NBA championship between the Detroit Pistons and the Los Angeles Lakers. The Lakers were the favorites to win by anyone that watched basketball because they had a stacked team. So, the bet was half that quarter's dividend payment from Verizon Wireless, which was $2.5 million. I chose Detroit to win, and my partner chose the Lakers. The Detroit Pistons won the championship and I got the $2.5 Million. I went to the Ferrari dealership and grabbed a Navy-blue convertible Ferrari with cream leather. My wife wanted a house on Hilton Head Island, so I bought a house there as well. This is how great dividends can be when you already have money to invest." Jimmy and Nick were both smiling in amazement. Jimmy told Nick and Mr. Blackburn, "If we had put the money we made in a stock like this, we could have lived from the dividend payments and never worked again. That's crazy! Five Million would give us two hundred and fifty thousand a year. Just crazy!!"

Jimmy and Nick talked more about college life. Nick explained to Jimmy and Mr. Blackburn how it's encouraged to ask questions and challenge professors to explain theories more in depth. Nick spoke about college classrooms, "Everyone is an adult and has their own thoughts, so when the professor says something, students will challenge it. When my professor talks about short selling being bad and only for professionals or how you can get rich from dividends, I always challenge it because he was never a professional trader. Learning from you, Mr. B, helps me learn how real traders think." Mr. Blackburn told Nick and Jimmy, "College and traditional education, especially with investing, is just a foundation to learn the theory. Like riding a bike, you learn from doing it. You can read a book about riding a bike and balancing on two wheels, but you can only get the true feeling of it when you ride. Same with investing."

By this time, the visitation time came to an end. Mr. Blackburn and Jimmy stood up to tell Nick goodbye. Mr. Blackburn told Nick, "You can send emails to me as well with questions you have from your classes. Jimmy and I talk about investing every day. Take care of yourself young man and stay focused." Jimmy shook Nick's hand and hugged him, "Take care Nick. Thank you for everything my man. Money on the books, checking on me, driving to visit and holding me down. It means so much!" Nick walked out after hugging Jimmy and Mr. Blackburn.

When Nick got back in class the next day, he wanted to know more about investing. The next chapter they covered in his class was over retirement and tax deferred accounts. The professor, understanding his students would be interested to hear about retirement, went about teaching this subject a different way. The professor started by saying, "Today we are going to learn about the Uncle Sam. Uncle Sam is the family member that shows up to the family picnic with a 2-liter soda but will eat several plates and takes a to-go plate for later. This is the family member that always takes more than they give." The class laughed at the professor's description of the U.S. government being characterized as "Uncle Sam." The professor continued to describe Uncle Sam, “You see, it is written in the family will by your granddad, that everyone in the family must share a part of their money with Uncle Sam. So, your parents, other aunts and uncles, and siblings must all give Uncle Sam money. And what does Uncle Sam do with this money…Whatever he wants!” There was dead silence in the class, and Nick was listening harder than anyone. The professor looked at his classroom and paced the front of the room while continuing his description, “Uncle Sam buys some stuff for the family during holidays, but not everyone agrees with what he buys. How does the family get away from not giving Uncle Sam so much money?” The students looked at each other, and they started to get a little upset that a will would be written in this way.

One student spoke up, “How does Uncle Sam know how much everybody makes though? They can lie about how much they make right?”. The professor shook his head in agreement, “Uncle Sam has access to everybody’s bank account, and he knows how much they make. They can’t lie about it. Any other suggestions?” The class looked around at each other, but no one raised their hand. The professor continued, “Uncle Sam is the US government. The government takes a part of your money in the form of taxes. You work but the government takes a portion of the paycheck. However, there are a few ways you can invest without paying taxes right away. Tax deferred accounts are great for avoiding taxes until you decide to pay them.” There was a young woman that shouted, “Freedom!” The class burst into laughter and clapped at the young woman’s comment. The Professor told them, “Let’s talk about retirement accounts: 401K’s and 403B’s. I know this sound crazy, but they are just tax codes to identify the type of account. The most talked about is the 401K because that’s what most employers provide. These are simply a savings account that can reduce your taxable income.” Nick raised his hand and asked, “I know this is a stupid question, but what is taxable income and how does the 401K reduce it?” The professor nodded his head to signal Nick was not asking a stupid question, “No Nick, that’s not a stupid question. There are a lot of people who don’t understand this stuff. Taxable income is just your salary or paycheck. The entire thing can be taxed or in other words, taxable. When you take a portion of that income and put it into a 401k, the income goes down; therefore, it is not taxed. Here’s an example. You make fifty thousand dollars a year, but you put five thousand into a 401k. You now only pay taxes on forty-five thousand instead of fifty thousand. That is reducing taxable income." Nick nodded his head to show he understood the professor.

Once class let out, Nick sent Jimmy an email about what he learned in class. Nick told him about taxable income and retirement accounts. Nick also said he wanted to know what Mr. Blackburn thought about retirement accounts and taxes. This was all new information, and both Nick and Jimmy needed understanding from Mr. Blackburn.

After the day was over, Jimmy went to check his email and read what Nick sent him. He'd heard about 401k's but didn't know what they were or how they worked. Jimmy was excited to learn about them since everyone talked about it. He wanted to join in these conversations and have knowledge about the subject. Jimmy wrote Nick back and told him he would read about it and ask Mr. Blackburn. That evening Jimmy started the chapter about retirement accounts.

CHAPTER SEVEN

Retirement Account

IRA

An individual retirement account (IRA) is a tax-efficient investment tool that people use to allocate funds for retirement savings. There are several types of IRA starting in 2019: Classic IRA, Roth IRA, SIMPLE IRA and IRA SEP. Sometimes called individual retirement agreements, IRA investments can include a range of financial products, including stocks, bonds, ETFs and mutual funds. A self-directed IRA is a type of traditional or Roth IRA that allows investors to make all investment decisions on their behalf. Self -directed IRA's provide access to a wider range of investments, such as real estate, private placements and foreclosures.

Taxpayers establish traditional IRA and Roth IRA accounts while small business owners and self-employed workers establish SEP and SIMPLE IRA accounts. An IRA must be established with an institution that has received approval from the IRS to provide these accounts. Options include banks, brokerage firms, credit unions with federal insurance and savings and credit associations. Generally, individuals open IRA accounts with brokerage firms.

In most cases, contributions to traditional IRAs are tax deductible. For example, if someone pays $ 6,000 in their IRA, they can claim that amount as a deduction on their tax return, and the Internal Revenue Service (IRS) will not charge taxes on this income. However, when this person withdraws money from their account during retirement, these withdrawals are taxed at their regular income tax rate. As of 2019, annual individual contributions to traditional IRAs cannot exceed USD 6,000 in most cases. If you are 50 years of age or older, you can contribute up to $ 7,000 a year using the updated contributions.

There are different types of pension plans, but in this book, I only deal with the largest savings plan, 401 (k) and 403 (b). A 401 (k) is a retirement plan sponsored by the employer. It allows workers to save money and invest a portion of their salary before taxes. Taxes are not paid until the money has been withdrawn from the account.

The 401 (k), named for the part of the tax code that governs them, was introduced in the 1980s as a complement to pensions. Most employers offered pension funds. The pension funds were administered by the employer, and the employee received a stable income during retirement. (If you have a job in government or have a strong union, you may still be eligible for a pension). But as the cost of administering the pension increased, employers began replacing them with 401 (k).

With a 401 (k), you control how your money is invested. Most plans offer a range of mutual funds consisting of stocks, bonds and money market investments. The most popular option is usually funds with an objective date, a combination of stocks and bonds that become progressively more conservative as you retire.

A 403 (b) plan is a pension plan for certain employees of public schools, tax-exempt organizations, and certain ministers. These plans can invest in annuities or mutual funds. A 403 (b) plan is also another name for an annuity plan with fiscal protection, and the characteristics of a 403 (b) plan are comparable to those of a 401 (k) plan.

Whether your job provides a 401k or a 403b, it's important to evaluate the available investments and understand the expenses and the administrative costs of the plan. From an informed position, you can best decide where and how to invest your money. Keep in mind that when an employer match is available, contributing to an expensive plan may still be a smart move.

After reading the chapter over retirement accounts, Jimmy fell asleep. The next day, Jimmy met with Mr. Blackburn in the library after breakfast. Mr. Blackburn walked in with a smile on his face, “How are you feeling Jimmy?” Jimmy responded, “I’m excited because I’m starting to understand more about investing. I read about retirement accounts in the book last night, and Nick learned about it in class. We had a few questions about it.” Mr. Blackburn nodded his head and signaled Jimmy to continue.

Jimmy continued, “Are retirement accounts really a way to hide money from taxes? If so, I want to put all my money in a retirement account, so I won’t have to pay taxes.” Mr. Blackburn laughed at Jimmy’s comment because he was so naïve, “Well there is only a certain amount you can put into a retirement account. But let me explain how retirement accounts work. When it’s raining outside, people use an umbrella. Retirement accounts are used as an umbrella against taxes. Taxes eat into your profits, so it is always good to evaluate how taxes will affect your returns. The longer you can invest your money without paying taxes, the more you will make with compounding the returns.”

As Jimmy was writing down the umbrella analogy Mr. Blackburn was explaining, a guard walked into the library. The guard handed Mr. Blackburn a letter, and Mr. Blackburn ripped it open. As he read through it, tears started to stream down his face. Mr. Blackburn’s friend, who was an attorney, was working tirelessly to help release his convicted friend. The letter stated that Mr. Blackburn would be released from prison within a month and would be on house arrest for 18 months.

Jimmy sat in his chair waiting for Mr. Blackburn to gain his composure and explain what was in the letter. As Mr. Blackburn wiped his eyes, he explained what the letter said, “It says I have less than a month in here. I am so excited to be back home, but I will miss our time a lot. I will begin setting up the investment firm when I get home. We will continue studying the markets together along with Nick, so that when you get out, we can start investing."

Jimmy was excited for Mr. Blackburn because he had been in prison much longer. All the time he sat in his cell with no hope was coming to an end. But selfishly, Jimmy thought about being there by himself with no close friends. He would have to study more about investing even more now. Jimmy looked at Mr. Blackburn and smiled, "I'm happy for you my friend. I need you to call and write me as much as you can. Also, could you send me more books on investing?" Mr. Blackburn nodded his head in agreement, "Of course I will send you books on investing, and we will talk everyday like we have been. The next thing you will learn about are stock options. That's how we can make more money. But first we will need to figure out a way to make money to put into the fund. No one will give convicted felons money to invest, so we will need other ways to make money."

The next month flew by for both men as they planned how to make money once Mr. Blackburn was released. Jimmy thought of ideas such as selling different products like clothes and other items. Mr. Blackburn was thinking of selling investment courses and books to raise money for the investment firm. One day Mr. Blackburn told Jimmy an idea, "Jimmy, if we setup an investment firm that is specifically geared to helping ex-convicts, I believe people will be more willing to help us. I would like to offer investment jobs to ex-cons and pay for them to get the proper licensing to start their own business. For instance, a guy who wants to be an electrician, we can pay for him to go to school and get his license. That way he will be able to provide for his family." Jimmy loved this idea and was ready to get started.

The day finally came for Mr. Blackburn to be released. He gave Jimmy all his food and anything of value. Mr. Blackburn made sure Jimmy knew he would be in touch on a regular basis, and they would continue talking about investing and the investment firm. Jimmy told Mr. Blackburn, "Don't be nervous about going back into the investment world. You have a different mindset and reason for investing now. You have done great things in your life and it's time to continue." After they hugged, Mr. Blackburn walked out of the door.