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Investing on common stocks

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ABSTRACT

Stock Exchange is a critical aspect of a financial market. Shares are purchased and sold on stock exchanges. Common stock is security, which represents ownership of an organization. Holders of Common stock choose the Directors and have the right to vote on company policies. Investing stock requires a close review of the financial reports to assess the true valuation of the product. Generally, examining the profit and loss account, balance sheet, and cash flow statement of the company does this. A simpler method to identify out about the performance of the company is to look at its financial ratios, most of which are available in this report. Although speculating is equivalent to gambling, it is not quite the same when speculators seek to make an appropriate decision regarding the future of their companies. These traders are purchasing shares with the expectation that they will only be owned for a limited amount of time before selling. Ratio analysis is important for investment decisions. It not only helps to learn how the business performed. Also, makes it easier for investors to compare the right investing option with firms in the same sector. The philosophy of diversification is one of the main principles of fund management, which basically involves avoiding placing all the eggs in one basket. Investors should never have fewer than 25% or more than 75% of the assets in common stocks. A key part of value investing is making sure the assets have a margin of protection. How large a margin of safety is considered depends on a variety of variables, including market conditions, risk tolerance, and also the company's fundamental prospects. The thinner margin of safety might be accepted in special situations. Decide what you intend to do with your portfolio, and stick to it. Choose an area you're involved in, and discover the news and events that drive it every day. Identify the number of businesses or firms that dominate the market.

Keywords: *Investment, Speculation, Stock Market, Common Stock*

1. COMMON STOCKS

Stocks will now be recognized an essential part of the portfolio of every investor. Different types of stocks are available in the market and common stocks play vital role. It will continue with getting an initial public offering (IPO) for a business to issue stocks. An IPO is a perfect opportunity for an organization to grow, finding extra money. A business will negotiate with an underwriting investment banking firm to initiate the IPO phase, which helps to decide both the form and price of the product. The general public is entitled to buy the new stock on the secondary market once the IPO process is completed.

Stock Exchange is a critical aspect of a financial market. It promotes the trade between financial instrument dealers and targeted buyers. Shares are purchased and sold on stock exchanges. These transactions must conform to government regulations that are intended to protect investors against fraudulent practices. It is a forum where buyers and sellers, come together to exchange financial resources during particular hours of any business day. But only certain businesses listed in a stock exchange are permitted to invest in it.

Common stock is a security, which represents ownership of an organization. Holders of Common stock choose the Directors and have the right to vote on company policies. This type of value shares commonly yields higher return on long run. Also, in case of liquidation, common stock holders have rights to an organization's benefits simply after bondholders, preferred shareholders, and different debtholders are settled completely.

This makes debt and other stocks less risker than common stock. The advantage to common shares is they generally beat the bonds and others over the long term. Most of the organizations issue different kinds of securities. Common stocks represent some degree of ownership in a company which generally comes with voting power, but some does not come with same voting right. (Depending on the company, this can vary.) Investors with common shares are generally not promised a fixed dividend for ever and voting stock grants you the opportunity to vote at shareholder meetings.

Anticipated returns drive stock towards demand. If investors think the earnings of a business will increase, they would bid the price of their stock, particularly if the current price is low relative to the earnings of the firm, as calculated by the P/E Ratio. Expected revenue growth also impacts the price, though earnings are not yet there. This can happen with a new business which has a great deal of potential. Common stocks are proving a more viable and less risky solution to lending. That is because businesses may not have to pay interest to their owners, and they may want to pay a dividend in case of surplus earnings.

Stocks are very liquid; those can sell quickly and easily. Those are flexible, and can even be reallocated into a tax-free retirement account until you start withdrawing the money. Also, in one year a lot of stocks can do much better than other investments.

Common stock is listed in the "Stockholders' equity" section of a company's balance sheet. This is where investors will calculate the total value of their shares, or "net worth," which is equal to the assets of the company minus its liabilities.

The duties of common stock owners are also minimal, as passive holders. They don't need to think about the incidents that exist outside financial intervention. In addition, those securities guarantee a stable financial horizon in the event that a business earns good returns and is increasing gradually. Investors are now not vulnerable to the possibility of losing more capital than they have put in. All of these aims to help investors make the most of common stock growth opportunities without being lost in unwarranted legal liabilities.

Although common shareholders have the right to earn a return, its frequency is uncertain. For example, a firm might not have enough earnings to offer its shareholders dividends. A company may also decide to reinvest its profits in the venture for expansion purposes.

Investors who plan to invest in common stocks of a corporation should make it a point to carry out a detailed review of common stock using at least ration analysis as mentioned throughout significant ratios.

2. INVESTMENT AND SPECULATION

Investing and speculation will be used in a contrasting way. The Stock exchange consists primarily of speculators and investors. You are aiming to see a profit at the stage where you invested money into a gain. Equally, you expect to get back all the money when you sell the investment. At the moment you 're speculating on the stocks, you 're searching for the expense to drive in your support. But maybe not.

Investing stock requires close review of the financial reports to assess the true valuation of the product. Generally, this is done by examining the profit and loss account, balance sheet and cash flow statement of the company. That can be time-consuming. A simpler method to identify out about the performance of company is to look at its financial ratios, most of which are available in this report. Although this is not a foolproof process, it is a decent way to perform a simple test on the health of a business.

Calculated risk is faced by investors and traders when they aim to benefit from the trades they produce in the markets. Whenever an individual invests money anticipating a return from the project, they invest. The undertaking is basing the decision in this case on a fair conclusion taken after a detailed inquiry into the soundness that the effort has a high chance of success. But what if the same individual invests resources on an organisation which is extremely likely to fail? It may believe in this situation as speculations. The performance or loss is largely contingent on chance, or uncontrollable (external) factors or incidents.

Investors expect to achieve revenue or benefit by taking on an average or below-average sum of risk with a reasonable return on their money. Gain can be in the form of the value-appreciating underlying stock, in dividend income, or in complete return on their expended money. Investing is most generally the long-term process of purchasing and retaining an asset. In order to be listed as a long-term holding the owner must retain the asset for at least a year.

Study and analysis are a crucial aspect of the investment process. It includes analysing the numerous assets, industries and developments or trends emerging on the market. Investors may select their investing strategy or plan their investments using instruments such as ratios analysis.

Speculating is the act of spending capital with a large likelihood of loss in financial endeavours. Speculating searches for abnormally large bet returns that may go one direction or the other. Although speculating is equivalent to gambling, it is not quite the same when speculators seek to make an appropriate decision regarding the future of their companies. These traders are purchasing shares with the expectation that they will only be owned for a limited amount of time before selling. Sometimes, they can shift into and out of a position.

Trading on daily is a kind of betting. Day traders do not actually have any formal qualifications, but are branded as one since they often trade. Generally, they keep their places for one day, shutting until the trading day is finished. Common speculators techniques employ vary from stop-loss orders to pattern trading. A dealer purchase or sell a stock if it hits a certain price. By doing so, the shareholder will mitigate on stock the loss. In the meantime, pattern trading makes use of market patterns to detect openings.

An investment project is one that guarantees principal protection and an appropriate return upon detailed review and speculative operations do not fulfil these criteria. Investing is a way to put aside funds when you're occupied with life and make the investment function for you so that in the future you can enjoy the maximum benefits of your job. Investment is a path to a more successful outcome.

3. SIGNIFICANT RATIOS

Ratio analysis is important for investment decisions. It not only helps to learn how the business performed. Also, makes it easier for investors to compare the right investing option with firms in the same sector. Most of the important ratios are mentioned below.

3.1 Earnings Per Share (EPS)

$$\text{EPS} = \frac{\text{company's profit}}{\text{Outstanding common stock shares}}$$

Company profit can be calculated by net income minus preferred dividend. Outcome of the EPS shows the profitability of the company and it is considered that the higher an organization's EPS, as more profit. To measure the EPS of a business, the balance sheet and financial statement should be used to determine the number of common shares, dividends paid on preferred stock (if any), and net income for the period ended. Using a weighted average number of common shares over the reporting period is more reliable, as over time the number of shares that change.

3.2 Price to Earnings Ratio (PE Ratio)

$$\text{PE RATIO} = \frac{\text{market value per share}}{\text{earnings per share}}$$

The P/E ratio is one of the most generally utilized stock analysis utilized by investors for deciding stock valuation. Also, it is demonstrating whether an organization's stock cost is overvalued or undervalued. Generally, PE Ratio demonstrates the rupee amount an investor can think to put resources in to an organization in order to get one dollar of that organization's income. That's why the P / E is often referred to as the price multiple, as it indicates how much buyers are able to spend per rupee earnings. When a stock is currently trading at a 20x P/E ratio, the meaning of that is a buyer is able to pay Rs.20 for Rs.1 of the actual earnings. A high P/E could imply that a stock's cost is high comparative with earning and perhaps overvalued. On the other hand, a low P/E may show that the current stock cost is low comparative with earning.

3.3 Book Value Per Share (BVPS)

$$\text{BVPS} = \frac{\text{common equity}}{\text{Number of shares outstanding}}$$

BVPS book value is the equity amount allocated to common shareholders, measured by the number of shares issued. This number reflects the overall amount of equity in a company, which calculates a firm's asset value on a per-share basis. If a stock is undervalued, the book value per equity would be greater in comparison to the actual market stock price. The calculation is used mostly by stock holders to calculate the market price of an entity. When the company's BVPS grows, the stock should be considered as more profitable, and the stock price should grow.

3.4 Dividend History and Dividend Yield

$$\text{Dividend Yield} = \frac{\text{dividend per share}}{\text{price per share}}$$

The dividend yield, calculated as a percentage, is a financial ratio (dividend / price) that indicates how much a business pays out in dividends each year relative to its stock price. It is necessary for investors to note that higher dividend yields do not necessarily mean enticing investing opportunities, since a stock's dividend yield may be raised as a consequence of a dropping stock price. The dividend yield will be estimated from the financial statements of the previous full year. In the first three months since the organization published the annual report, that is acceptable; but, the longer it has been after the annual report, the less important data becomes for investors. Alternatively, investors are even able to incorporate the last four quarters of dividends, taking the trailing 12month income results. Using a trailing dividend number is appropriate because whether the dividend has just been lowered or increased it will render the yield too big or too low.

Since dividends are distributed on a quarterly basis, several investors can take the last quarterly dividend, subtract that by four, and use the result as the annual dividend for measuring yield. This strategy would represent the recent policy adjustments, but not all businesses would be charging just a quarterly dividend. Some companies pay a small quarterly dividend with a large annual dividend.

If the estimation of the dividend is carried out during the broad dividend payout it would give an excessive value. Lastly, certain businesses offer a payout more often than annually. A monthly dividend may result in too small an estimate of dividend yields
An investor will look at the past of dividend distributions before determining whether to measure the dividend yield and determine which approach would produce the most reliable performance.

3.5 Debt/Equity Ratio

$$\text{D/E ratio} = \frac{\text{total liabilities}}{\text{Total shareholder equity}}$$

The debt to - equity (D/E) ratio is determined by dividing the total liabilities of a corporation by its equity to the owner. Such figures are available on the financial statements of a firm's balance sheet.

The debt-to - equity ratio (D / E) measures the overall liability of a company with the equity of its lender and can be used to determine how much credit a firm is using.

Higher debt ratios continue to suggest to shareholders a company or stock with a greater risk. The D / E ratio, though, is difficult to compare across business sectors, where optimal debt sums differ. Creditors will often adjust the D / E ratio and concentrate on long-term debt mainly because the probability of long-term debt varies from that of short-term debt and payables.

3.6 Return on Equity (ROE)

$$\text{ROE} = \frac{\text{net income}}{\text{average shareholder equity}}$$

ROE is the percentage term of the net profit of a corporation, as it is paid to owners as an interest. This calculation provides an alternative calculation of the competitiveness of the company to creditors and analysts, which measures the productivity with which a corporation earns income, using the funds spent by shareholders. Average equity of the shareholders is determined by adding equity at the start of the year. The start and end of the period may match with the time the net income is received during.

In general, a higher ROE ratio means the business is more effectively leveraging capital from its creditors to improve business efficiency and enable it to develop and expand and produce growing revenues.

4. PORTFOLIO POLICY

A portfolio is a set of similar financial investments, such as stocks, bonds, securities, real estate, cash and cash equivalent. You can prefer to own and maintain your portfolio yourself, or you can allow your portfolio to be handled by a money manager, financial planner or other finance professional. The philosophy of diversification is one of the main principles of fund management, which basically involves avoiding placing all the eggs in one basket. Diversification aims to minimize the danger by allocating expenditure between separate financial products, sectors and other categories. Investor should never have fewer than 25% or more than 75% of the assets in common stocks.

There are many forms to diversify. It is up to you if you plan to do so. Your potential ambitions, your risk profile and your attitude are all considerations in determining how your portfolio should be designed. You can think of a portfolio of investments as a pie divided into pieces of differing wedge-shaped sizes, each piece representing a different asset class and/or investment category. Investors aim to build a well-diversified portfolio in order to obtain a risk-return portfolio allocation ideal for their degree of risk exposure.

Although stocks, shares, and cash are commonly seen as the main building blocks of a portfolio, you might be able to expand a portfolio of several different asset forms including real estate, gold stocks, artwork, and other accepted ways. Investors should think about how long they have to invest while constructing a portfolio, equivalent to risk management.

The market prevails that if we take a low risk our return will be significantly smaller and we will get a better return with a higher danger. But in truth it's not really valid. When we attain a bargain circumstance with the proper safety margin than we have a greater chance of having a better return with the reduced or managed risk.

5. SAFETY MARGIN

$$\text{Safety Margin} = 1 - \frac{\text{Current Price}}{\text{Fair Value}}$$

A key part of value investing is making sure the assets have a margin of protection. Margin of safety is an accounting theory in which an individual only buys shares when their stock price is considerably below their intrinsic value. In other terms, if a security's stock price is slightly below the intrinsic value calculation the gap is the protection margin. Since investors may establish a safety margin according to their own risk expectations, purchasing shares while the gap is present helps to create an investment with limited downside risk. To purchase at an undervalued price, you will need to realize first what the fair price is. You can use P/E ratio as fair value. How large a margin of safety is considered depends on a variety of variables, including market conditions, risk tolerance and also the company's fundamental prospects. Thinner margin of safety might be accepted on special situations.

Investors use both qualitative and quantitative criteria to assess the inherent value of a company, including firm management, governance, market efficiency, assets and profits. Then the stock price is used as the point of reference for measuring the safety margin. But it does not guarantee a good investment, primarily because it is extremely difficult to evaluate the "real" worth, or intrinsic value, of a business. Investors and researchers may have some way of measuring market value, although these are less reliable and precise. Furthermore, forecasting a company's profits or sales is extremely challenging.

By comparison, if a stock were priced well above its fair value, then the margin of protection for that form of investment will be Zero, making the shares potentially riskier. Every investor should understand that the idea of margin of safety which is a key to selecting healthy common stocks. Losing any capital is an inherent aspect of saving and you can't do much to avoid it. Still, to be a good investor, you have to take responsibility for ensuring you never lose any or any of your assets. The most profitable moment to become a stockholder is when the price is dropping. Value investors invest in declining markets with a margin of safety, which protects them from significant losses.

5. STOCK SELECTION

Finally, you wanted to start investing. The first step towards choosing investments is to decide your portfolio 's purpose. Everyone's investment aim is to make money; however, investors can concentrate on producing a revenue supplement during retirement, retaining their income, or capital appreciation. A fund can be diversified through various industries. Stock picking is the purchase of equities depending on a series of factors, aiming to produce a favourable profit. It is really challenging to evaluate large quantities of knowledge in today's world environment and arrive at an investment judgment. Decide what you intend to do with your portfolio, and stick to it. Choose an area you 're involved in, and discover the news and events that drive it every day. Identify the number of businesses or firms that dominate the market.

It is important to stay up with news and views from the sector. Reading financial news and keeping up with business articles by writers whose opinions you 're involved in is a passive type of study. A blog post or news story may form the base of an investment thesis. Rules for the common stock picking for the investor's portfolio are stated and it is accepted to use the rules.

- Need adequate but not require unnecessary diversification.
- Chosen organizations should be big, prestigious, and financially stable.
- Organisation should have a long record of consistent dividend payment.
- Stock price should not be more than 15 times average earnings of the past three years.

Let's use a big successful global organization as an indication of investment. This firm will offer a regular dividend that rises yearly, an (Investopedia, n.d.)d it can be at low risk for profit. An investor can prefer to invest in this business over the long term to return their capital satisfactorily while taking on relatively low risk. In addition, the investor can add few related companies to the portfolio from various industries to diversify and further minimize their risk.

6. REFERENCES

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