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1) Why do corporations issue stock? Why do investors buy that stock? (10 points)

Answer

One of Corporation goal is try to make the highest profit. By corporation issue stock, the corporation will turn from private to public because the corporation now allow outsider to get involved in the business as one who raise money to be capital for further investment or any purpose of use and give them right as a member of the owner of the corporation. Stocks consist in to two form of market. First one is Primary market, the market for new issued stock. Any corporation which offering the stock for the first time will sell stock in this market and be called IPO (Initial Public Offering). Second one is secondary market. In this market, investors freely trade stock sell stock that they own and buy stock that they want by matching the offered price and buying price. The reason of issuing stock are several, mainly for sake of corporation and ongoing growth. For example, to use for develop new products, to buy more advance equipment to pay for building and inventories, to hire more employees and to decrease debt.

On the other hand, Investors buy that stock for many reasons. But the main concept here is to gain opportunity of return from investment.

To gain difference from selling price and buying cost, trader in secondary market buy that stock for expected value of that stock to be increase and sell it in the future.

Dividend is other reason for buying the stock, each corporation will have different dividend pay policy. Investor will buy stock accordingly to their preference.

One of strategy to reduce the risk is diversify, as reduce the risk of one company with other company. For example company A selling sun glasses and company B selling umbrella. If investor already has stock in company A. Investor, one of strategy, will buy stock of company B in order to diversify risk of whether condition and seasonal(rainy and sunny).

The other possible reason is managing power, Investor buying stock to have influencing power to the corporation. One who have higher amount of stock have, for example, more votes, can influence the corporation decision on making policy and direction of growth.

2) How do interest rates in the economy affect the price of a corporate bond? (10 points)

Answer

To see relationship, first we have to know that bondholders will receives the interest as state on the bond for the rest of bond life (for simplicity; coupon bond). But, for the market interest rate, the rate will change due to the economy change.

Second, if investor have 10 percent coupon bond.

When market interest rate increase, the market interest rate is at 11 percent. As the market interest rate increase, investor will demand that new bonds will pay at 11 percent. Meanwhile, compare to the existing bond which pay only 10 percent less than the market rate, There will be lower in demand for existing bond. Thus, bondholder will face <u>reduce</u> in capital gain of the bond they hold. Therefore value and price of that bond decrease. Note that, this happens when only bondholder sell bond before the maturity because the capital gain calculate from buying price and selling price.

When market interest rate decrease, the market interest rate is 9 percent. As the market interest rate decrease, investor will demand that new bond will pay at 9 percent. Meanwhile, compare to the existing bond which pay higher at 10 percent. There will be higher demand for existing bond. Thus bondholder will face <u>increase</u> in capital gain. Therefore value and price of that bond increase. Again, Note that, this happens when only bondholder sell bond before the maturity because the capital gain calculate from buying price and selling price.

In conclusion, when interest rate increase, the price of bond decrease. When interest rate decrease, the price of the bond increase. Applying to the practice, investor should buy bond when interest rate is dropping and sell bond before the interest rate increases.

3) How important is the investment objective as stated in the fund's prospectus? (Extra Credit 5 points)

Answer

The mutual fund prospectus is the document for the investor who interest in that mutual fund. It contains information that need to know and understand before investor making decision to invest.

Example of contain information are as follows.

1. Investment Objective
2. Investment Strategy
3. Investment Risks
4. Historical Performance
5. Fees & Expenses

Investment objective will reflect the types of stock and bond invest to achieve those objectives. So, those investors who look for stable return should not invest in fund that has objective of high return because, with objective of high return, fund manage can invest more in higher risk. The example of types of investment objectives are long term capital growth, stable income and high total return.

In summary, investor must understand the objective and find appropriate fund that match with their objective which can be several reasons such as, generate an additional income, increase saving, protect saving from inflation and reduce tax liability. In order to, invest their fund with the right and proper of mutual fund for their own benefit.