

1. Explain the relationship between earnings and a stock's market value.

The first way in understanding the relationship between the price of a stock and its earnings is to look at its earnings per share, or EPS. The EPS tells you how much income the company generated for each share of stock. For example -- and let's assume the company pays no dividends -- if a company has \$10,000 in earnings, and 1,000 shares, the EPS would be \$10,000 divided by 1,000, or \$10.

The direct relationship between the price of a stock and its earnings is known as the price per earnings ratio, or P/E. To calculate P/E, simply divide the stock price by the EPS, typically over the most recent four quarters. For example, if the price of a stock is \$50 and the EPS are \$1, the P/E would be \$50.

If a company doesn't produce consistent earnings growth or lower its P/E ratio over time, investors might choose to sell the stock, sending its price lower. Young or growth-oriented companies that have extremely high P/E ratios or lose money might have a high stock price due to projected future growth. But eventually a lack of earnings over a long period of time will drive a stock price down and the company potentially out of business.

One way earnings influence the price of the stock is how well a company performs against expectations. Before most companies report their quarterly financial results, analysts predict the EPS for the quarter based on the company's guidance and other factors. If a company beats the projected earnings, its stock price will usually go up. But if a company fails to reach the projected earnings, its stock price will most likely decline. A company could have a very profitable quarter, but if it makes less than was projected the stock price is likely to fall. Similarly, if a company loses money but the losses are lower than projected the stock price is likely to go up.

2. Which type of stock could help you obtain your investment and financial goals? Justify your choice?

Blue chip as it is strong, stable and mature with a long history of consecutive quarterly dividends which may also be a suitable investment for an investor with an income objective

3. What sources of information would you use to evaluate a stock issue?

1. Financial section of the Newspaper
2. The internet
3. Stock advisory services and corporate news
4. Financial section on the television
5. Financial magazine

4. What is the difference between the primary market and the secondary market?

The difference between the primary capital market and the secondary capital market is that in the primary market, investors buy securities directly from the company issuing them, while in the secondary market, investors trade securities among themselves, and the company with the security being traded does not participate in the transaction.

5. Calculating Total Return. Tammy Jackson purchased 100 shares of All-American Manufacturing Company stock at \$31.50 a share. One year later, she sold the stock for \$38 a share. She paid her broker a \$28 commission when she purchased the stock and a \$42 commission when she sold it. During the 12 months that she owned the stock, she received \$160 in dividends. Calculate Ms. Jackson's total return on this investment.

Cost when purchased			Return when sold		
100 shares @ \$31.5	3150	+	100 shares @ \$38	3800	-
Plus commission	28		Minus commission	42	
Total investment	3178		Total return	3758	
Transaction summary					
Total return	3758	-			
Total investment	3178				
Profit from stock sale	580	+			
Plus dividends	160				
Total return for the transaction	740				

Ms. Jackson's total return on this investment equal to \$740.