

Investment Environment and Financial Instruments

Real Assets vs Financial Assets

- Real Assets
  - Assets used to produce goods and services
  - Mostly tangible in nature
  - Buildings, Plants, Machineries
- Financial Assets
  - Claims to income
  - Derived from real assets
  - Mostly intangible
  - Stocks, Bonds

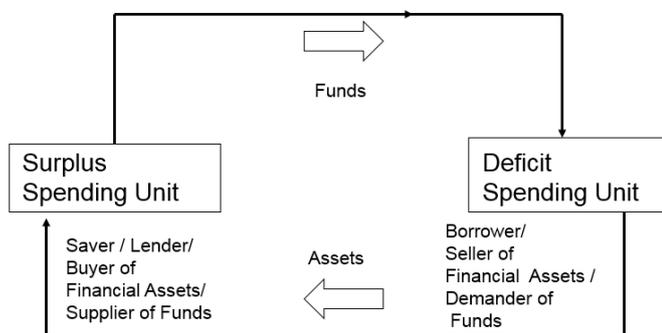
Financial Assets

- Consumption Timing
  - Postponement of consumption
  - Time value of money
- Risk Allocation
  - Repackaging of business risk
- Separation of Ownership & Management
  - Facilitates diversification, liquidity and professional business management

Clients of Financial System

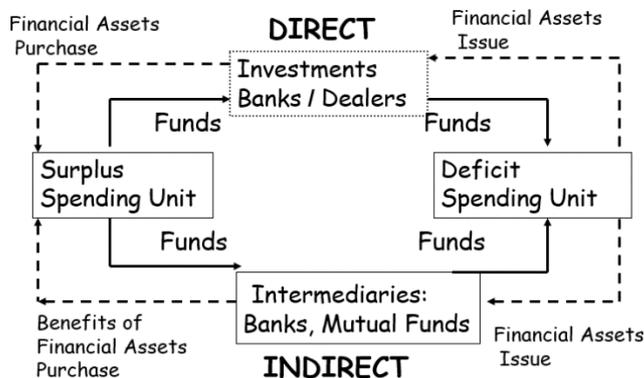
- Household Sector
- Business Sector
- Government Sector
  - Surplus Spending Unit
    - Income > consumption + investment on real assets
  - Deficit Spending Unit
    - Income < consumption + investment on real assets

Flow of Funds



Financial Assets = Financial Claims

Direct VS Intermediated Investing



## Financial Institutions

- Financial Intermediaries ( Banks, Investment Companies, Credit Unions)
  - Channelize surplus funds of household sector to business sector
  - Enjoy economies of scale & specialization
  - Minimise Search and Negotiation cost
  - Improve liquidity of Investments
  - Diversify risk
  - Earns spread, charges service fees etc.
- Investment Banks
  - Help businesses to raise capital by selling financial securities to the public
  - Manage public issues of Stocks and Bonds
  - Cost effective service
  - Certification
  - Charges service fees

## Financial Instruments

- Money Market
  - Short term, highly liquid debt market
  - Primarily for Government & Business Sector
- Bond Market
  - Longer term debt market
- Equity / Stock Market
  - Market for business ownership shares
- Derivative Market
  - Futures, options and other derivatives

## Money Market Instruments

- Treasury Note
  - Short term Government borrowing
  - Discounted security
- Certificate of Deposit
  - Time deposit with bank
  - May not be withdrawn on demand
  - Denomination \$50,000 to \$100,000
- Commercial Paper
  - Sort term unsecured debt issued by big companies
- Bank Accepted Bills
  - Bills of exchange endorsed (accepted) by banks
  - Allows customers to use banks credit rating
  - Banks charge fees
  - Discounted security with active secondary market
- Repos (Reverse Repos)
  - Usually overnight borrowing using government security as collateral

## Bond Market Securities

- Treasury Bond
  - Longer term Government Debt
- Semi Government Bond
  - Bonds issued with implicit or explicit guarantee of the Commonwealth Government e.g. bonds issued by state governments
- Corporate Bonds
  - Long term borrowing by non-government entities

## Stock Market Securities

- Ordinary Shares
  - Represents ownership shares in a corporation
  - Voting rights
  - Residual Claim
  - Limited Liability
- Preference Shares
  - Features of both equity & debt
  - Fixed dividend but not certain
  - Riskier than debt

## Derivatives

- Securities that derive their value from underlying assets (Stock, Bond, Commodities...)
- Primarily used for hedging & speculation
- Over The Counter – Forwards, Swaps
- Exchange Traded – Futures & Options

## Stock Market Index

- Market Benchmark
- Index Construction
  - Price weighted vs. Market value weighted
- All Ordinaries, S&P/ASX 300, S&P/ASX 200...
- Dow Jones industrial Average (USA)
- Nikkei (Japan)
- FTSE (UK)

## Issues and Trends

### Classical Issues

- Corporate Governance – Agency Problem
  - How can shareholders prevent managers wasting their money on unproductive projects?
    - Agency Cost
    - CEO compensation
    - Board Structure

### Classical Issues

- Market Efficiency
- How fast market prices reflect new information?
  - Weak form efficiency
  - Semi strong form efficiency
  - Strong form efficiency

## Summary

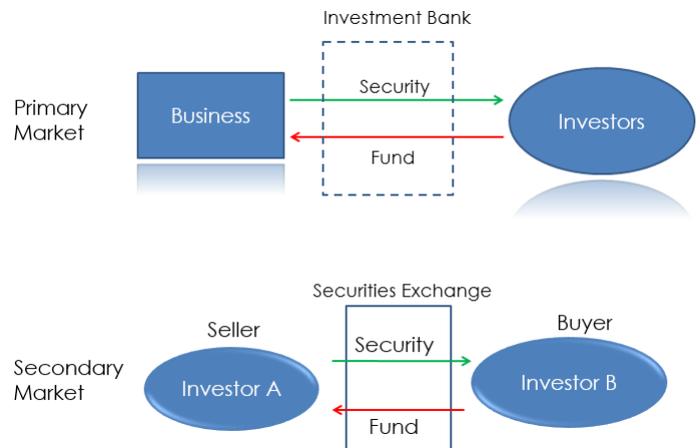
- Financial assets & their characteristics
- Clients of the financial system
- Financial institutions & their role
- Financial instruments
  - Short & long term
  - Debt, Equity & Derivatives
- Issues & trends of investment environment

## Security Trading and Funds Management

### Securities Market

#### Primary Market: Equity

- Primary Market
  - Initial Public Offerings
  - Seasoned New Issues
- Types of Primary Market
  - Public Offering
  - Private Placement

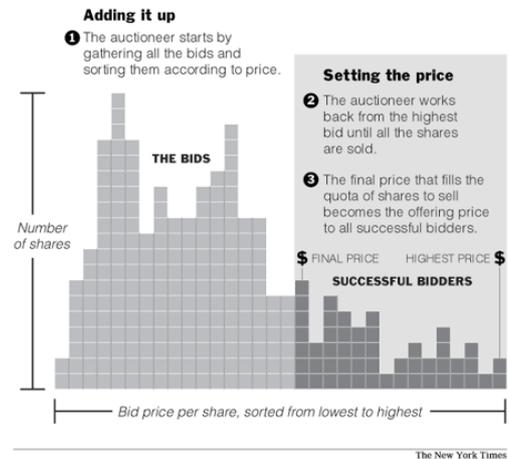


#### Initial Public Offerings

- Initially going to the market to raise funds for a project
- Book building vs Fixed Price
- Dutch Auction –
  - WR Hambrecht : *OpenIPO*
- Costs of an IPO
  - Expenses
  - Under pricing

#### A Dutch Auction Primer

Google is planning to use a Dutch auction to set the price of the shares in its initial public offering. Here is how the auction process will find the highest price at which all shares can be sold.



#### Investment Banks

- Facilitator of external financing
- Process of issuing securities:
  - Deal Origination
    - Analyzing and advising function
  - Deal Execution
    - making market aware, compliance with legal documents

#### Underwriting

- Underwritten vs. Best Efforts
  - Underwritten: firm commitment on proceeds to the issuing firm
  - Best Efforts: no firm commitment
  - Underwriting syndicate
  - Tombstone advertisement

Issue Size

Total No of shares on Offer

Issue Price

Investment Bankers

Underwriters

This is a prospectus for AT&T Wireless Group Tracking Stock, dated April 26, 2006. Key information includes:
 

- Issue Size:** \$10,620,000,000
- Total No of shares on Offer:** 360,000,000 Shares
- Issue Price:** Price \$29.50 Per Share
- Investment Bankers:** Goldman, Sachs & Co., Merrill Lynch & Co., Salomon Smith Barney
- Underwriters:** A list of various financial institutions including Citigroup, J.P. Morgan Chase & Co., and others.