

## CONCEPT: STOCKS, BONDS, AND MUTUAL FUNDS

- **Bonds** are financial securities that promise to repay a fixed amount of principal, generally along with \_\_\_\_\_

- **Coupon Payment** – an interest payment on a bond at the bond's *stated interest rate*
- **Interest** – the cost of borrowing funds, usually stated as a percentage of the amount borrowed
  - > The interest rate that must be paid is aligned with the amount of \_\_\_\_\_ involved in lending
  - > Rating agencies, such as Moody's and S&P, will rate company bonds for credit quality

	Moody's Investors Service	Standard & Poor's (S&P)	Fitch Ratings	Meaning of the Ratings
Investment-grade bonds	Aaa	AAA	AAA	Highest credit quality
	Aa	AA	AA	Very high credit quality
	A	A	A	High credit quality
	Baa	BBB	BBB	Good credit quality
Non-investment-grade bonds	Ba	BB	BB	Speculative
	B	B	B	Highly speculative
	Caa	CCC	CCC	Substantial default risk
	Ca	CC	CC	Very high levels of default risk
	C	C	C	Exceptionally high levels of default risk
	—	D	D	Default

- **Stocks** are financial securities that represent partial \_\_\_\_\_ of a firm
  - Shareholders are entitled to their portion of a corporation's profits
    - > The corporation doesn't pay out all profits, it keeps some as *retained earnings* to fund future projects
    - > **Dividends** – Payments by a corporation to its shareholders
    - > **Capital Gains** – increases in the market value of the stock over the purchase price
  - Stocks do not have a maturity date because a corporation is assumed to continue indefinitely
- **Mutual Funds** – an institution that sells shares to the public, using the money raised to create a portfolio
  - Shareholders purchase shares of the mutual fund, not of the stocks in the portfolio
    - > *Actively-managed mutual funds* have portfolio managers constantly buying and selling stocks
    - > *Passively-managed mutual funds* follow a specific stock index and hold more constant portfolios
  - **Diversification** – reducing risk by replacing a single large risk, with smaller, unrelated risks
    - > "Don't place all your eggs in one basket"