Fundamentals of Money Management

The Stock Market (Cont.)

In the prior article I talked about the Stock Market and their components. We will continue where we left off with a discussion about Stock Market Management and Market Capitalization.

Management Styles

There are two basic styles of stock market managers: Active and Passive.

Active Managers are active players in the stock market. The goal: "Beat" the market by actively seeking securities that will **"add valu**e" to their portfolio through increased dividend yield and price appreciation.

Passive Managers do not attempt to beat the market. They attempt to match the return of a broad market index such as the Dow Jones Industrial Average (DJIA), the S&P 500, and the various Russell 1000, 2000 and 3000 Indices.

Manager Evaluation

All Active and Passive money managers must be evaluated for their performance (they get graded too!). The most common method is to compare their **Rates of Returns (ROR)** to some kind of index. This index is called a **Benchmark**. The DJIA, S&P 500, Russell 3000 are all indices. The manager must beat what is called a **Bogey**. The manager should meet or beat its bogey against its established benchmark by a certain percentage (200 basis points or 2%) above the Index's rate of return. If the manager underperforms their index, their ability to manage your portfolio should be questioned.

Equity (Stock) Management Styles

As there are characteristics associated with stock selection, there are managers who specialize in specific asset management categories. Managers basically fall into the following management styles.

Growth Managers identify companies with above average to high growth prospects. These managers pick stocks with higher **Price to Earnings Ratios** (also known as P\E ratios). They will grow higher in valuations and higher in profitability.

Value Managers identify companies that are undervalued with discounted pricing. These managers pick stocks that have low P\E ratios, low **Price to Book Valuation** and low-sales price ratio, but high dividend yields.

Sector Rotator Managers uses a systematic approach to stock selection by doing what we call a "Top Down Fundamental Analysis" of its economic forecast. They analyze the political climate, interest rates, employment and determine a prognoses for the U.S. economy. They look for industries that will perform well in a particular forecasted economy that will be more profitable than others.

Quantitative Managers, (called quants), use complex mathematical and statistical computer models as a screen for making stock selections.

Technical Managers use graphical analysis in the form of trend and chart lines of stock market price movements. They buy stock based on an up-trend analysis or sell stock based on a down-trend analysis of the market.

Capitalization and Capitalization Managers

What is Capitalization?

Capitalization is defined as the market share price of a company, multiplied by its issues of outstanding shares. Example: AC computers has 900,000,000 outstanding shares issued, and the market price is $540.00 per share. Therefore, their market cap is 900 million shares x $540 dollars per share = $486 billion dollars. Thus, we say their "Market Cap is $485 billion."

Just as we have growth, value and core stocks, companies are categorized into segments.

Large Capitalization (Large Cap) Stocks are companies that have stock valuations of $10 billion or more. The term "Large Cap" is an abbreviation of the term "Large Market Capitalization".

Mid-Capitalization (Mid Cap) Stocks are companies that have valuations between $2 billion and $10 billion. The term "Mid Cap" is an abbreviation of the term "Medium Market Capitalization".

Small Capitalization (Small Cap) Stocks are companies that have valuations between $300 million and $2 billion. The term "Small Cap" is an abbreviation of the term "Small Market Capitalization".

Capitalization Managers

Large Cap Managers invest only in companies that have valuations of $10 billion or more.

Mid-Cap Managers invest only in companies that have valuations between $2 billion and $10 billion.

Small Cap Managers invest only in companies that have valuations between $300 million and $2 billion.

Capitalization changes on a daily basis, but most companies stay in the top of their capital markets.

In our next article we will begin our discussion of the Bond Market.

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