Common Terms Used in Securities Trading

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1. WHAT IS THE STOCK EXCHANGE?

The stock exchange provides a market place where shares can be bought andsold.

1.1 What is the Role of the Stock Exchange?

- The stock exchange admits companies for trading at theirsecurities.
- It provides a market for raising capital by companies.
- It provides a market place for shares of listed public companiesto be bought and sold, by bringing companies and investorstogether at one place.
- The exchange's role is to monitor the market to ensure that it isworking efficiently, fairly and transparently.

1.2 Stock Exchanges in Pakistan:

There are three stock exchanges in Pakistan:

i) Karachi Stock Exchange (Guarantee) Ltd.
ii) Lahore Stock Exchange (Guarantee) Ltd.
iii) Islamabad Stock Exchange (Guarantee) Ltd.

Of these, Karachi Stock Exchange is the biggest exchange in thecountry.

1.3 Trading and Settlement:

The stock exchanges have introduced a computerized trading systemto provide a fair, transparent, efficient and cost effective marketmechanism to facilitate the investors.

The trading system comprises of four distinct segments, which are:

i) T+3 Settlement System;
ii) Provisionally Listed Counter;
iii) Spot Transactions; and
iv) Futures Contracts.

1.4 Futures Contract:

A Futures contract involves purchase and sale of a financial ortangible asset at some future date, at a price fixed today.

2. WHAT ARE SHARES?

Each share represents a small stake in the equity of a company. You can buylarge or small lots to match the amount of money you want to invest. Acompany's share price can rise or fall as a result of its own performance ormarket conditions.

Once the shares are brought and transferred in your name your name will be entered in the company's share register, which will entitle you to receive allthe benefits of share ownership including the rights to receive dividends, tovote at the company's general meetings to receive the company's reports.

If you decide to sell your shares you will need to deliver share certificates tothebroker in time for the transaction to be completed.

With the introduction of the Central Depository System (CDS), an investorcan have shares in paper form or can own shares in an electronic book- entryform at the Central Depository Company (CDC).

2.1 Why Do Companies Issue Shares?

Companies issue shares to raise money from investors. This money isused for the development and growth of businesses of companies.

A Company can issue different types of shares such as ordinaryshares, preference shares, shares without voting rights or any othershares as are permissible under the law. These give shareholders astake in the company's equity as well as a share in its profits, in theform of dividends, and a voting right at general meetings ofshareholders.

2.2 Why Do Investors Buy Shares?

Studies have shown that over a twenty-year span, investment in shareshasprovided greater returns than most other forms of savings. Sharescan provide you with a regular stream of income through dividends aswell as the potential for your investments to grow in value. If theprices of shares go up, you can sell them for more than you paid. Thisis called capital gain.

2.3 What are Dividends?

Dividends are returns paid to shareholders out of the profits of thecompany.Returns can be in the form of cash or additional shares ofthe company called bonus shares. Dividends are usually paid once ortwice a year depending upon the company's profit distribution policy.

2.4 What is Capital Growth?

This is one of the ways in which shares differ from deposit accounts.The principal amount of money you put in a bank or any fixed incomesavings scheme always stays the same e.g. if you start withRs.100,000 you will always have Rs.100,000 (other than any interestearned).changes in value according to the performance of thecompany. With good management, the value of your investment inshares of a company can grow over time so that your shares are worthmore than you paid for them. This is capital growth.

2.5 Risks And Rewards:

Buying shares can offer advantages over saving in deposit accounts:your investment may increase in value besides paying you dividends.You share the rewards when the company does well and the price ofthe shares goes up. But if the company performs badly, the share pricemay go down and the value of your investment will be reduced. Otherfactors, such as the performance of the stock market as a whole andthe general economic climate, may also affect the price of your shares.Investment in shares is therefore investment in ‘risk capital’. The Shareholders can be rewarded for taking this risk and the potentialreturn on your money can be higher than that on other investments.You can reduce your risks with careful planning.

3. TIPS FOR INVESTING WISELY

3.1 Know What Investment Products are Available:

The following types of securities are available on thestock market for investment:

- Ordinary shares of listed companies
- Unit trust schemes
- Mutual funds certificates
- Corporate bonds i.e., Term Finance Certificates (TFCs)
- Government securities i.e., Federal InvestmentBonds(FIBs), Pakistan Investment Bond (PIBs) andSpecial US Dollar Bonds.

3.2 Beware of Scams:

Beware of promises of quick profits or sky-high returns. Remember: higherthe gain on investments, higher is the risk involved. This is the fundamentalrisk-reward trade-off.

4. IMPORTANT THINGS TO KNOW ABOUT EQUITIES

- If you can afford to take some risk and have the ability toendure the market's ups and downs, equity investments maygrant you good returns.
- Do not invest any money with the stockbroker as a deposit atfixed rate of return. Such a deposit has no legal standing andthe investor is exposed to risk of losing his money.
- You must know the rates of fees and commissionscharged by the broker/stock exchange as these affect yourcosts, and hence your returns.
- The aim of investing in stocks and shares is to buy at lowand sell at high. Knowing when is however, the problem.Many investors attempt to time the market: they try tofigure out when the market is going up and buy before itdoes and then anticipate when it is going to crash and sellbefore that. Usually you try to buy when the upswing hasbegun and sell as the downswing starts. However, suchaccuracy is extremely difficult to achieve.
- The stock market is driven by two emotions: greed andfear. People are caught up in the boom fever and paybeyond the worth of shares this is the greed that drivesbull markets. In bear markets, people get carried awaywith the ruling pessimism and are eager to sell theirinvestments believing in the worst rumors this is the fearthat dominates bear markets.
- Be careful in selecting your broker. Ensure that he/she islicensed by the SEC to trade and the stock broking firmhas a good track record. Give clear instructions to avoidambiguity, check trade confirmations received and keep aproper record of all your transactions. All the registeredbrokers are listed at the web site of SEC**www.secp.gov.pk**

5. HOW TO TRADE?

Your first step is to contact a stockbroker or an investment adviser.

5.1 Introducing Stockbrokers:

Stockbrokers are your link to the stock market. Their job is to help you getthe best price available when you want to buy or sell your shares. Be carefulin selecting your broker.

5.2 The Mechanics of Share Dealing:

There are various ways of investing in the stock market: you can dealdirectly in shares; invest through a unit trust or investment trust or let yourinvestment be handled by an advisor.

5.3 Opening of Account:

Once you have decided the broker with whom you intend to deal, you shouldensure that an account is opened in your name by filling the account openingform. It is imperative that the terms and conditions prescribed in the accountopening form are read very carefully and well understood. It will be in yourinterest if you give clear instructions as to who can operate the account. It ispreferred if the investor gives instructions that business can only betransacted in the account on his instructions.

5.4 Buying/ Selling Directly:

When you have decided to buy/sell shares in a particular company, contactyour stockbroker. You can ask to buy/sell a fixed number of shares or sharesup to a certain value. Get the contract note confirming your orderimmediately and check for the following information.

a) Name and number of securities;
b) Date on which the order is executed;
c) Nature of transaction (spot, ready or forward and also whetherbought or sold);
d) Price at which the transaction is executed; and
e) Commission charged by the broker;

There are two types of orders:

Limit Orders: In a limit order, the client specifies the price at which theorder is to be executed.

Market Order: Also known as at best order, the order is executed at theprevailing market rate.

6. VARIOUS WAYS OF BECOMING A SHAREHOLDER:

Shares of the company are offered at the stock market at the followingstages.

6.1 Initial Public Offering (IPO):

When companies offer shares to the general public for the first time it isknown as a flotation or an Initial Public Offering (IPO). These shares canbe bought directly from the company without paying stockbroker'scommission. You might see an advertisement in a newspaper from acompany issuing shares or your stockbroker might tell you about acompany making an IPO. Simply fill in the share subscription form anddeposit the form along with subscription cheque in a branch of thedesignated bank(s).

6.2 Right Issues:

Right shares are issued when companies need to raise additional capitalto finance their new expansion projects or to meet working capital needs,etc. In case of rights issues, the existing investors have the right tosubscribe to these new shares in proportion to their respectiveshareholdings.

6.3 Trading Market:

The most common way of buying/selling in stock market is throughtrading in the secondary market. Through a stockbroker you can buyshares from existing investors who wish to sell them and vice versa.

7. CDS

Electronic book-entry transfer of securities i.e. CDS has been set up toeliminate physical transfer of securities. This new book-entry system is inline with the international practice and has replaced the manual system ofphysical handling and settlement of shares at stock exchanges. With in theCDS, transfer of shares from one client account to another takes placeelectronically.

The CDS is managed by the Central Depository Company of PakistanLimited, which has been sponsored by the stock exchanges and leading localand financial institutions. Presently, 97 percent of settlements are routedthrough CDS. Investor Account Services have been introduced in order tofacilitate individual investors to maintain their account directly with theCDC. With the implementation of CDS and automated trading system,trading and settlement of securities have become transparent and efficient.

8. WHAT HAPPENS ONCE YOU ARE A SHAREHOLDER

There are several types of shareholders: some are long term investors whosimply tuck away their investments for years while others trade frequentlyand keep a close eye on how their shares are performing. You can checkyour shares' performance in various ways. A daily indicator of share pricemovements is available in many newspapers and also on website of therelevant stock exchange. You may access this information directly orthrough your stock broker/advisor.

Informative articles about many companies are regularly published innewspapers and investment magazines. Your stockbroker may also providevaluable information. Some publish newsletters for their clients, reflectingtheir views on the performance of selected companies. Annual reports ofcompanies also contain useful information. Some companies haveshareholder relations departments, which can help with factual information.

9. INVESTOR PROTECTION:

You should always ensure that the stockbroker you choose is licensed by theSecurities and Exchange Commission of Pakistan (SEC) to trade. Preferstock brokerage firms with good track record. As a shrewd investor, youshould know your rights and responsibilities and should beware of the rulesthat govern your investments as well as the legal recourse available, in casethings go wrong. You can report abuse to the SEC, whose mission is toensure the development of a fair, efficient, and transparent securities andfutures market. Although its main function is regulatory in nature, the SEChas the ultimate responsibility to protect the investor through marketsupervision and ensuring that its laws and regulations are complied with.

Stock exchanges are the frontline regulators; they must play a proactive role.Send all your complaints in writing to the respective stock exchange(s) withfull details, including the complainant's name, address and telephonenumber etc. In case you do not get a response to your complaint, pleasecontact the "Complaint Cell" in the SEC.

10. GLOSSARY OF STOCK MARKET TERMS

Bear – an investor who anticipates a falling market and, therefore, sells the security in the hope of buying it back at a lower price.

Blue Chip – A large well-established company with a history of profitable operation.

Bonds – Fixed-income securities, which entitle the holder to a pre-determined return during their life and repayment of principal at maturity.

Bull – An investor who anticipates a rising market and, therefore, buys the security in the hope of selling it later at a higher price.

Capital Gains Tax – Tax payable on profit arising from appreciation in value of investment, realized at the time of selling or maturity of investment.

Carry-over Trades –Equity repurchase transactions, better known, as “Badla”; these are an established form of transactions used in the stock market for temporary financing of trades by speculators and jobbers.

Dividend – That part of a company’s profits which is distributed among shareholders, usually expressed in rupee per share or percentage to paid up capital.

Earnings per share (EPS) – A profitability indicator calculated by dividing the earnings available to common stockholders during a period by the average number of shares actually outstanding at the end of that period.

Equity – The owners’ interest in a company’s capital, usually referred to by ordinary shares.

Floatation – The occasion when a company’s shares are offered on the stock market for the first time.

Fund managers – A company, which invests and manages investors’ money, with the aim of maximizing capital growth.

Initial Public Offering (IPO) – The offering of equity shares of a company to the general public for the first time.

Insider trading – The purchase or sale of shares by someone who possesses ‘inside’ information on a company’s performance which information has not been made available to the market and which might affect the share price. In Pakistan, such deals are a criminal offence.

Investment companies – A company, which issues shares and uses its capital to buy securities and shares in other companies.

Listed company – A company whose securities are admitted for listing on a stock exchange.

Long position - When an individual purchases securities of a company he is said to have a long position in the company's shares. For example an owner of shares in PTCL is said to be "long PTCL" or "has a long position in PTCL." If you are long, you would like the share price to go up.

Market capitalization – The total value of a company's equity capital at the current market price.

Nominee – A person or company holding securities on behalf of others, but who is not the owner of such securities.

Option – The right (but not the obligation) to buy or sell securities at a fixed price within a specified period.

Ordinary shares – The most common form of shares, which entitle the owners to jointly own the company. Holders may receive dividends depending on profitability of the company and recommendation of directors.

Portfolio – A collection of investments

Price/earnings ratio (P/E ratio) – The P/E ratio is a measure of the level of confidence (rightly or wrongly) investors has in a company. It is calculated by dividing the current share price by the last published earnings per share.

Primary market – Where a company issues new shares, either for the first time, or at the time of issuing additional securities.

Privatization – Conversion of a state-owned company to a public limited company (plc) status.

Private company – A company that is not a public company and which is not allowed to offer its shares to the general public.

Public limited company (plc) – A company whose shares are offered to the general public and traded freely on the open market and whose share capital is not less than a statutory minimum.

Rights Issue – The issue of additional shares to existing shareholders when companies want to raise more capital.

Securities – A broad term for shares, corporate bonds or any other form of paper investment in capital market instruments.

Settlement – Once a deal has been made, the settlement process transfers stock from seller to buyer and arranges the corresponding exchange of money between buyer and seller.

Short Selling- The act of borrowing stock to sell with the expectation of price reduction with the intention of buying it back at a cheaper price.

Stockbroker – A member of the stock exchange who deals in shares for clients and advises on investment decisions.

Stock Market – The market place where shares of publicly listed companies are bought and sold.

Unit trust – An open-ended mutual fund that invests funds in securities and issues units for sale to the public. It can repurchase these units at any time.

Yield – The aggregate return earned on an investment taking into account the dividend/interest income and its present capital value.

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