

# A Simple Overview of Financial Planning

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**Book One**

**Market Overview**



# Table of Contents

|                                                         |         |
|---------------------------------------------------------|---------|
| Introduction:                                           | Page 3  |
| Chapter 1: Talk in Plain Speech                         | Page 4  |
| Chapter 2: Your Financial Advisor Can't Beat the Market | Page 6  |
| Chapter 3: Conflicts of Interest                        | Page 8  |
| Chapter 4: Means of Deceit                              | Page 10 |
| Chapter 5: High Frequency Trading is a Bad Idea         | Page 14 |
| Chapter 6: Tax Brackets                                 | Page 18 |
| Chapter 7: Definitions                                  | Page 19 |
| Conclusion                                              | Page 40 |

## Introduction

Thank you so much for downloading this e-book. Your day is extremely busy and I appreciate you spending the time to read the book that you have in front of you.

In this book I have listed out various concepts that I think are important to understand for an investor or any customer of a financial advisor. I have tried to explain the concepts in the simplest and clearest ways I can.

Realizing full well that I might not have succeeded in explaining a concept, if anyone ever has any questions please contact me through e-mail ([daniel@danieldollinger.com](mailto:daniel@danieldollinger.com)). You can send me a message through my website ([www.danieldollinger.com](http://www.danieldollinger.com)). My telephone numbers are 503-363-1550 (Salem Office) and 503-570-8727 (Wilsonville Office). You can also contact me through [Facebook](#), [LinkedIn](#), [Twitter](#), [Quora](#), and [Youtube](#).

## Chapter 1: Talk in Plain Speech

Overview: The vast majority of time a financial planning concept can be expressed in simple and understandable language. When an advisor uses confusing terminology, they are probably trying to impress you, trying to intimidate you, and/or they don't know the material that well. Be very wary of people who continually use confusing jargon.

I'll give you two sentences. The first sentence is 'The man walked across the grass. The second sentence is 'The Homo Sapien of 2 distinct allosomes engaged in ambulation by traversing the Poaceae. The two sentences have the exact same meaning. The first sentence is easily understandable. The second sentence is confusing and makes me sound like a pompous jerk. Financial advisors often choose to use the second sentence when they talk about their craft. They often are trying to confuse you as part of a power play. They are trying to convince you that they know best and you shouldn't interfere with their process. My response is that they don't know best. Even if they're sincere in their

desire to help, nobody understands your life better than you do. When you talk with your financial advisor you have all the power. Make sure they know that.

The idea of financial planning is not that complicated. You are considering the things you have (both now and in the future) and what you owe (both now and in the future). Financial planning is simply trying to arrange things so you can pay all your present and future expenses. You do that by increasing the amount of money coming in (investing, getting a higher paying job, etc.) and/or by decreasing your expenses (taking advantage of legal tax breaks, not spending your money on unnecessary trinkets, etc.). If you ever have decided not to buy something because it was too expensive, you engaged in financial planning. If you have ever balanced your household budget, then you engaged in financial planning. Now, financial planners deal with issues a bit more complicated (inheritance, retirement, etc.) but the basic ideas are the same. My point is that you already understand many of the concepts within the financial planning industry. If your advisor cannot

explain something to you so you can understand it; then the problem is with them, not with you.

## **Chapter 2: Your Financial Advisor Can't Beat the Market**

Overview: Your financial advisor cannot beat the market. If they claim they can, then they are lying.

How good are you at predicting the actions of a stranger? Can you guess their ideas about money, the expenses in their life, and the values that drive them? What about a whole crowd of strangers? How about 168 million strangers? I know I can't. There are approximately 168 million people participating in the U.S stock market. Their buying and selling decisions control the price movements up and down of every stock. Those daily, weekly, monthly and sometimes yearly movements are noise. They are in response to people making the decisions in accordance to the events of their own lives. If someone claims they can

predict those movements then they are saying they can predict the actions of everyone in a nation the size of Nigeria. Prices in the stock market are usually roughly correct. They take into account all public information about the company. While due to that noise or hysterias, prices can diverge from what's correct, there is no legal way for anyone to take advantages of those divergences to make money. The only way would be if someone had secret information (that's very illegal).

Hypothetically, even if there was a way to beat the market, the person who has that knowledge would not be a financial advisor. They would borrow all the money they can from banks, credit cards, and other sources. They would invest it all into the stock market and make a fortune. They wouldn't mess with the regulatory and legal minefield that is the financial advising industry. Relative to what this hypothetical super investor can make on their own, the money in financial advising is not good at all. If a person, over the course of a year, turns their 1000 dollar account into a 2000 dollar account, they made 1000 dollars. If a financial advisor, over the course of a year, turns a 1000 dollar account

into a 2000 dollar account, they made roughly 20 dollars all together (1% of assets under management). They made roughly 10 additional dollars due to their efforts. It doesn't make sense financially. So if a financial advisor says they can beat the market, I'm very confident they're lying.

### **Chapter 3: Conflicts of Interest**

Overview: Always be aware of how your adviser makes money. What's in their best interest might not be in your best interest.

Whenever you evaluate a person you need to carefully consider how they make money; how do they succeed? Sometimes how they succeed is not in your best interest. While there are laws in place that are designed to protect the client, there are loopholes that someone can slip through.



In the investment management industry there are 2 basic payment models; with variations and combinations of those models existing. The first model is a commission model. In this model, the investor doesn't directly pay the advisor. The advisor is paid directly by the company that issued the stock or other financial instrument. For example: The advisor convinces the client to invest in the mutual fund or annuity of company A. Company A gives the advisor a commission. The potential conflict of interest is that Company A might not be the best company for the client to be invested in; it might just be the company that is willing to pay the advisor the highest commission.

The second model is a fee-based. In this model the client pays the advisor a previously agreed upon percentage of their assets under management. It is usually 1%. For example: the client has \$100,000 with the advisor. Every year, the client will pay the advisor \$1000. The benefit of this model is that the advisor's success is directly tied to the client's success. If the portfolio goes up in value, the advisor makes more money. If the portfolio goes down in value, the advisor makes less

money. I am a fee-based financial planner. I want my goals to be perfectly in-line with the client's goals.

Ultimately, the choice of payment model is not the most significant factor. Commission-based advisors can be extremely honest. The benefit there is the client doesn't have to pay anything directly to the advisor. Fee-based advisors can be extremely dishonest. A fee-based advisor might still intentionally mislead you to extort money from you. The most significant factor is the honesty of the advisor. Just be aware of what model an advisor is using so you can hold them accountable for their choices.

## **Chapter 4: Means of Deceit**

Overview: There are many ways that a dishonest person might try to trick you. In my experience the most common ways are through complexity, creating urgency, and by manipulating the timeframe.

As I previously mentioned, there is a lot of dishonesty within the financial advising industry. There are laws in place so an advisor can't just lie to you and give you false information. However, they can frame the truth in such a way that it deceives you.

Complexity refers to drowning the conversation or written material in so much jargon that the client's eyes glaze over and their brains turn off. I once encountered an advisor that gave their client a quarterly report that was over 200 pages long. Nobody had the time to read it. Even if someone did read it, it was written so confusingly that it was impossible to understand. In this case, I'm reasonably certain that the advisor was trying to slip things by the client.

In regards to urgency, I'm referring to advisors that pressure you to make a decision quickly. The vast majority of time that urgency is not to your benefit. Via emotional manipulation, advisors are probably trying to prevent you from carefully considering all the facts. I personally hate when salespeople try to give my purchasing decision a sense of urgency.

The vast majority of the time there is no reason for urgency. Financial advising is not an urgent matter. Unless there is a pressing matter such as a family member dying, your business being bought out, etc. (pretty rare circumstances), there is no need to make a financial advising decision within a day, a week, or even a month. Obviously the financial advisor (myself included) would prefer if your decision is made quickly. That way they can plan out their time more accurately, they don't have that doubt of whether or not they got the account, etc. However, it is your money and your life, so however much the financial advisor complains about it, you have all the power.

The third way is by manipulating the timeframe. All assets classes (stocks, real estate, bonds, etc.) have good times and bad times. There are times that the price keeps going up and everyone wants them and there are times when the price keeps going down and everyone hates them. Right now (July 2016) we have had a really good quarter. It would be unethical for me to say look how much money I am making for my clients and then use the quarter as example. The reason is that the whole

market went up, so claiming credit for rising portfolio values is intellectually dishonest. Many brokers will manipulate the time frame they present to make themselves look better to clients and potential clients. When the market is hot, they will present a short period of time (to capture only the time when the market was hot). For example: In the last quarter an advisor's portfolio goes up 5% but it is down 1% for the year. They would brag to others "I achieved 5% growth in a quarter, just imagine what I could do over time if you give me your money." They wouldn't mention at all that their account is actually down for the year. When the market is down, they will present a long period (so that they have good periods averaging in). For example: The advisor's portfolio is down for the year 1%. It is however up 5% over the last 3 years. They would brag how they are up for 3 years (a completely arbitrary timeframe) and wouldn't even mention or downplay their decline for the year. Now, I don't personally place any importance on returns over short periods of time but to hide that information is very dishonest.

## **Chapter 5: High Frequency Trading is a Bad Idea**

Overview: High Frequency trading will probably cause you to lose large amounts of your money as various fees will eat away your portfolio.

There are three main ways that I feel high frequency trading is a bad idea. I'm defining high frequency as multiple trades occurring with a day. The ways are brokerage commissions, bid-ask spread, and capital gains taxes.

Brokerage commission is the most public way a brokerage firm makes money. Commissions are what everybody thinks of when the topic of trading costs come up. It is by far not the only cost. When you buy or sell a stock; you are telling the brokerage house to place that order (buy or sell) on the stock market. Whether your broker is Schwab, Ameritrade, Fidelity, etc., the broker doesn't do it for free. They remove a commission from your account. This commission ranges from a couple dollars to hundreds of dollars. I use Schwab (a reasonably low-

commission broker). They charge \$8.95 for a trade. So a round trip (buying and then selling) a stock will cost you \$17.90.

The second way high frequency trading is a bad idea is because of the bid-ask spread. With every trade that you do there is the choice of doing a market order or a limit order. A market order does the trade immediately at the current price. With a limit order you specify the exact price you want to execute the trade at. A limit order takes much longer to execute than a market order for there might not be anybody willing to buy or sell at the price you want. With market orders, you are paying extra for the higher speed of execution. Basically there is a difference with every stock between how much it costs to buy and how much it costs to sell. When you do a market order you pay that spread; when you do a limit order you earn that spread. The spread can be a penny per share for widely traded issues, it can be many dollars per share for thinly traded issues, or it could be anything in-between. It depends on both the particular stock and how popular that stock is. For example: stock A costs \$20.01 to buy, but you can only sell it for \$20.00. So every time

stock A is bought or sold by a market order, the creator of the limit order pockets a penny. A penny may not seem significant but it accumulates very quickly.

Between the two ways that I have mentioned so far, the investor is behind as soon as they start. (Most high frequency trades are done with market orders for the trader requires the higher speed of execution). For example: let's say they buy and sell 1000 shares of stock A and the spread happens to be a penny per share. For 1000 shares, that multiplies to \$10.00. If they do a round trip trade every trading day (there are approximately 250 trading days per year), they paid \$6,975.00 in fees. If they do 2 round trip trades a day, they paid \$13,950 in fees. So when you consider the people who make hundreds of round trip trades a day, you can see how difficult it would be to make any money.

The third way is that short term gains are taxed more heavily than long-term gains (more than one year). Short gains are taxed at ordinary rates.



Long term gains are taxed at preferential rates. The tax rate for long term holdings can be half or less than the short term rates.

For example: the client is single and makes \$35,000 a year from their job. They would be in the 15% federal tax bracket. They make (after paying their fees) \$1000 from the stock market by day trading. They would only get to keep \$850 of their gain. If they had earned that \$1000 by waiting at least a year before selling a stock they would keep all \$1000 of the gain. They would also pay a lot less in fees.

In addition you'll have to pay more for your tax return. Every sale has to be listed separately on the tax return. It is easier now that the brokers will supply downloadable statements, but the statements still have to be reconciled. I once had a return with 3000 trades, it took so much time, I had to surcharge the client an extra fee.

## Chapter 6: Tax Brackets

Overview: People are only taxed at a particular rate on the money that is within that tax bracket.

Something that many people don't understand is that tax rates are not constant for all your taxable income. Every dollar that you earn is not taxed at the same rate. For example: Say the taxpayer is single and they're earning \$100,000 a year. That would put them in 28% federal tax bracket (this is referring to the highest bracket that the taxpayer is qualified for). This person would pay the federal government 10% of the first \$9,275 they earned, 15% of the next \$28,375 they earned, 25% of the next \$53,500 they earned, and 28% of the last \$8,850 they earned. So they pay \$21,036.75 in federal income taxes, for a total federal tax rate of about 21.37%. Depending on the state you live in there might be additional income taxes on the state level.

## Chapter 7: Definitions

### What is a Bond?

People often think a bond is some complicated thing and that misconception is not helped by people who talk about par values and purchasing debt. A bond is simply a loan. When someone purchases a government bond, they are loaning the government money. At some point in the future, the government has to pay you back the principle (the par value) and some interest on top of that. Anyone can issue a bond, which is simply a contract. If you ever borrowed money from a friend and there is some record that you need to pay your friend back, then you issued a bond. That is the primary market.

The secondary market is when people purchase other peoples' loan contracts. Let say Bob lends Frank 100 dollars, and Frank says he will pay Bob 150 dollars in 5 years. That deal is sealed by a contract. Now George offers Bob 105 dollars to buy that contract. So in 5 years Frank will have to pay him 150 dollars. If Bob agrees to the deal that is a

secondary transaction. There are multiple reasons that Bob would agree to the deal. Maybe he needs money right away or he thinks Frank is going to refuse to or be unable to repay the loan.

The risk of default is the main reason why different bond issuers have different interest rates. If you lend money to the government, it is very likely that they are going to pay you back. That likelihood means that the government doesn't need to incentivize you with a higher interest rate when they announce the terms of the loan. On the other hand, let's say we have some guy who launched a company out of his basement. He's an idiot, he's losing money, and you think he'll go out of business in a month. In order for you to be willing to lend money to him, he has to incentivize you with a really high interest rate. An interest rate is simply a way to compensate the lender for taking higher risk.

## **What is a stock?**

Think of a company as an apple. A share of stock is simply taking a bite. A stock is simply a unit of ownership in a company. Let's say you start a company all by yourself. You own 100% of the shares. Next let's say you need money so you split your company into 100 pieces (shares) and sell 25 shares on the stock market. You now own 75% of the company, and people on the stock market owns the other 25%. So you now collect 75 cents on every dollar the company earns and the people in the stock market collect the other 25 cents (via dividends).

Think of a market where the apple is being sold. Buyers and sellers have a different perception of how good the apple tastes. So a lot of haggling occurs. The reason why stock prices fluctuate is that different people have different perceptions of how much your company is worth. For example: Mary might think your company is worth 50 dollars a share, and Tony might think it's worth 100 dollars a share. If the price is currently 75 dollars a share, Tony will buy as many shares as he can

because in the future he thinks he will be able to resell the shares for 100 dollars for a 25 dollars per share profit. All that buying will cause the stock price to move up (the price will continue to move up as long as someone is willing to pay for it). If someone is willing to buy a product from you for 80 dollars, why would you ever sell it to them for 75 dollars? In this example Mary would sell any shares she has and wouldn't buy any more. That selling pressure will drive the price down. If no one wants a product the product gets discounted down to incentivize someone to buy. The battle between the upward and downward forces explains the price fluctuation within the stock market.

## **What is a Mutual Fund?**

A Mutual Fund a legal entity where the manager collects money from other people and invests that money in multiple stocks, bonds, and other securities. Those people, who the manager collected money from, own shares (percent ownership) in the mutual fund. Imagine the mutual fund as a bus. The manager is the driver and the shareholders are the

passengers. The stops of the bus are financial goals. The passengers can choose whatever bus they want to enter, but once they enter they don't have control over where that bus goes. They can only choose when to exit that bus. The main benefit of a mutual fund is diversification. It is basically a fancy version of the expression 'don't put all your eggs in one basket'. So if one of the stocks or bonds in the fund fails, there are other stocks/bonds to make up for it. Think of diversification as a safety net. Imagine you're a restaurant owner. You serve the best steak in the state. Then the farm you get the beef from floods and goes out of business. If your menu only has steak, then you're in trouble. If your menu has multiple types of dishes, you can survive until you find another supplier.

The typical mutual fund has 2 major types of fees that the shareholder has to pay. The first fee is the management fee which is some percentage of the fund's market value. This fee can be very significant and should be carefully considered. If the management fee is 2%, the portfolio has to go up in value 2% in order for you to break even. The second fee is a

commission (or load). A fund can be front-loaded, back-loaded, or no-loaded.

In a front-loaded fund, the manager removes part of your invested money before they buy securities. For example: Susan invests 100 dollars into a front-loaded fund. The fund pockets 5 of those dollars, and the remaining 95 dollars is invested into the stock or bond markets. In a back-loaded fund, the manager removes some of the proceeds when you sell your shares. However, the amount they take out decreases the longer you've held the shares. For example: Susan sells within one year of purchase \$100 worth of shares of a back-loaded mutual fund. The fund pockets 5 dollars and you are given 95 dollars. If Susan sells within 3 years of purchase \$100 worth of shares, the fund pockets 2 dollars and you are given 98 dollars. A no-load fund does not charge a load. These funds are often called index funds. A fund is usually only one type of load (front, back, or no).



The shareholder in addition to the management fee and load may be required to pay for additional fees such as transaction costs at the brokerage firm. You need to be careful when you invest in mutual funds due to these fees. For example: You invest 100 dollars into a mutual fund that is front-loaded (at 5%) and there is a management fee (at 2%). The value of the stocks the fund is invested in goes up 6%, but you end up losing money due to all your gains being eaten up by the fees. The loads are primarily used by the mutual fund companies for sales commissions. If your broker or advisor is commission based, watch very carefully for excessive trading. They may purchase new front loaded funds every year in order to increase their commission.

Look at your brokerage statement at your list of holdings. Every holding has a symbol. Mutual funds are four digits. For example, VDIGX is the Vanguard Dividend Growth Fund. You can look it up on Google just by typing in the symbol. Be wary if there is a dash and another letter after the symbol. Those are commission codes. CMUAX-A is the Columbia

Midcap Value Fund and has a front load of 5.75%. -B means a back load (also called a deferred sales charge. Think of an annuity as an example).

I personally never invest my client funds into any mutual fund that has a load. I do not earn commissions of any kind because I feel it is a conflict of interest.

## **What is Fundamental Analysis?**

Fundamental Analysis is a way that people attempt to find how much a company is worth. They then try to buy the stock when the market price is below the actual value of the company. They reason that eventually the market price will rise to meet the actual value of the company.

Conversely they try to sell short the stock when the market price is above the actual value of the company.

There are many fundamental analysis methods but they all involve analyzing the statistics and financial numbers of the company. Data that

could be analyzed are profit, revenue, costs, growth, dividends, etc. For example: Let's say company A stock sell for 50 dollars per share, but company A has earnings of 80 dollars per share. A fundamental analyst would say that stock is undervalued (it should be worth more). They would then buy shares of company A so when the market eventually corrects itself, they stand to make a lot of money.

Some great examples of Fundamental Analysts are Warren Buffett and Benjamin Graham.

## **What is Technical Analysis?**

Technical Analysis is a way that people attempt to find how a market price is going to move. They then try to buy the stock when they think the market price will soon go up or sell short the stock when the stock price will soon go down.

There are many technical analysis methods but they all involve analyzing the past movements and behavior of the market. They generally are not concerned about the company itself. Data that could be analyzed are volume (number of people buying and selling), price movement (did the price move up or down), participant sentiment (number of people that like vs. dislike a stock), etc. For example: Let's say company B stock has been going up in price 10 days in a row. A technical analyst might think it is more likely the stock will go up in price on the 11<sup>th</sup> day.

Some great examples of Technical Analysts are Jesse Livermore and Paul Tudor Jones II.

## **What is the Efficient Market Hypothesis and Random Walk Theory?**

The hypothesis states that all publically available information on a company has already been considered and factored into the stock price.

It is closely related to the random walk theory, which states that all short term price movement is random.

The Efficient Market Hypothesis is contrary to fundamental analysis.

The hypothesis states that are enough rational people out there exploiting inefficiencies that no inefficiency is left for you to exploit.

There is no research left that hasn't already been considered by the millions of people in the stock market. For example: You hear the owner of a company is being honored in a ceremony and you think it will help the company. So you think about buying shares. However, market participants have already acted upon that information so you'll personally get no benefit from that information. Random Walk Theory is contrary to Technical Analysis for the theory states that all the price movements that technical analyst use are meaningless. For example: even if a stock goes up in price 20 days in a row, it has no impact on whether the price goes up or down on the 21<sup>st</sup> day. Instead of picking stocks, followers of modern portfolio theory (efficient market and random walk adherents) manage risk by rebalancing asset classes.

Some great examples of modern portfolio theorists are Eugene Fama and Burton Malkiel.

## **What is Risk?**

Risk is the possibility that at a particular moment in time, you won't have enough money to pay for whatever you need to pay for.

The market fluctuates up and down like a roller coaster. The magnitude of the fluctuation is called risk. Most of these movements mean nothing. They are statistical noise. Think of a drunk standing at a light pole and staggering about. This graphic example is the random walk theory. Short term movements are noise.

Now step back a bit and look at the movements over a month. The little gyrations are gone. There is still a lot of random jerking about, however. A bad or good return for a month, does not mean much but means more

than it does for a day. A year means more than a month. Ten years means more than a year and so on.

In general, the more risk (the more fluctuations) you endure, the higher the long term return of your portfolio will be. However, in the short term that portfolio might be down. It could be in continuous freefall for 2 years or more. The portfolio will probably go up in value over the long term (20 years) but that doesn't help you in the short term. If you need that money to pay for something now then you're in trouble. My 92 year old mother takes very little risk in the stock market because she doesn't have the time to wait out a market collapse. If her portfolio drops 50% in a market meltdown, she doesn't have 20 years for the portfolio to make up for that lost ground and to surge higher. She needs that money now. Risk depends on your point in life. For example, somebody who is still working can recover from an investment disaster better than a retired person. They have more years in front of them. Risk also depends on emotional tolerance. I know young people who emotionally can't handle any risk and old people who want maximum risk.

There are two basic kinds of risk. Individual stock risk are the weird good or bad things that happen to one company. A new product, a lawsuit, the Tesla autopilot malfunctioning, a cure for cancer from a drug company, etc. are examples. They cannot be profitably predicted. Remember all information is known and already reflected in the stock price. Market risk is the whole market going up and down. A mutual fund holds many stocks. Therefore, the individual stock risk is blended out. The weird good and the weird bad cancel. That's a good thing. Even if a company is making a lot of money and is growing well, there is always the chance that a freak storm is going to destroy the factory and drive the company to bankruptcy. There is no way of predicting that; there is no reason to take that risk. Mutual funds do not cancel market risk. I use an allocation towards short term bonds together with rebalancing to reduce market risk.



## **What is Rebalancing?**

Rebalancing is simply buying and selling things in a portfolio so a particular asset class is a previously agreed upon percentage of the portfolio. For example: A client (with a \$100,000 portfolio) told their advisor they want their portfolio to be 50% cash and 50% stocks. So their portfolio is \$50,000 of cash and \$50,000 in stocks. The value of the stocks rises so the portfolio is now 40% cash and 60% stocks. So their portfolio is \$50,000 of cash and \$75,000 in stocks. The advisor would sell \$12,500 of stock to bring the portfolio back to a 50:50 split. The portfolio would therefore be \$62,500 in cash and \$62,500 in stocks. There are many different types of asset classes. Some examples are real estate, precious metals, artwork, bonds, etc.

## **What is a Commodity?**

A commodity as it is defined in the financial markets is a physical good that is considered the same as all other goods of that same commodity classification. For example: cattle is a commodity. One cow is

considered the same as any other cow. If you buy a cow, you just bought a commodity. Other examples of commodities would be oil, coffee beans, gold, etc.

## **What is a Derivative?**

A derivative is any contract that concerns the buying and selling of securities or commodities at a future date. For example: you're a restaurant owner and you meet a great apple supplier. You currently have plenty of apples but you know you will need them in the future. So you agree to buy 1000 apples from the supplier in one month at a particular price. This is an example of a type of derivative called a futures contract. The buyer and the seller have an obligation to satisfy that deal in a month; no matter what the market price is at that time. The other main type of derivative is called an option. Unlike a futures contract, an option doesn't have to be satisfied. The holder of the option has the choice or the *option* to cancel. For example: the restaurant owner tells the apple supplier they will pay the supplier 1 dollar per apple in a

month. If the supplier agrees, then even if the market price rises to 100 dollars per apple, the restaurant owner can still buy apples at 1 dollar a piece. If the market price drops to 20 cents apiece, the restaurant owner can cancel the contract and buy it at the lower market price. The reason the supplier is willing to offer that option is that the restaurant owner pays the supplier a premium as a way to compensate the supplier for the market price risk. So the restaurant owner might buy the option contract from the supplier for 50 dollars.

## **What is Shorting?**

The usual ways of thinking about stocks or commodities is that you buy them at a given price and then you later sell it. Shorting reverses that process. When you short something you borrow the stock or commodity from your broker (at a given interest rate), you then sell it. Later you buy the stock or commodity on the open market and give it to your broker. For example: The investor borrows 100 shares of stock A from their broker and they agree to pay the broker 1 dollar per day in interest. They

sell the borrowed shares for 1 dollar each on the open market. 30 days later the price of the stock is 50 cents per share. The investor buys the shares on the open market for 50 cents per shares and gives them to their broker. They made 50 dollars on the transaction (100 - 50). After you subtract the interest (30 dollars) the investor is left with 20 dollars of profit.

Shorting is incredibly risky as your potential loss is infinite. If the stock price had risen to 1000 dollars per share, you still would be required to buy the stock on the open market. When you're required to buy back the shares (whether you want to or not) depends on your account margin. It is simply the ratio between the value of the shorted stock and the value of your account. If that ratio gets too high the broker will demand the shares back.

## **What is a Stock Index?**

A stock index is a large basket of stocks. A single number has been obtained by manipulating the prices of the individual stocks within that basket (usually a weighted average). For example: The S&P 500 is a stock index. It is composed of 500 large companies. Its price is a weighted average of the component prices. The Dow Jones Industrial Average (the Dow in common usage on every TV set and newspaper in the country) is an index made of 30 large companies.

## **What is a Financial Statement?**

A financial statement is a report that presents the financial facts about a company. There are 3 main types. Those types are a balance sheet, an income statement, and a statement of cash flows. You can also prepare financial statements about a person.

A balance sheet reports the financial situation of a company at a particular moment of time. As of this date what does the company own

and what do they owe. For example: Company A has \$500,000 in cash and \$100,000 in equipment. They have \$600,000 in assets. The company owes \$400,000 to the bank (they took out a loan). That \$400,000 loan is a liability. The difference between assets and liabilities is equity, which in this case is \$200,000 ( $600,000 - 400,000$ ). Equity is essentially what a company owns that is not owed to somebody else.

An income statement reports for a time period (a year, a quarter, etc.) how much money is coming in and how much money is going out. For example: company A sold \$600,000 worth of widgets to their customers. That is their revenue. They spent \$400,000 on salaries, equipment, marketing, etc. The company has income of \$100,000.

A statement of cash flows reports for a time period (a year, a month, etc.) the amount of cash that comes in and goes out of a company. For example: company A brought in \$500,000 of cash and spent \$400,000 of cash. The statement also tracks the sources of the cash inflow and what the cash is being spent on.

The difference between cash inflow and revenue is that revenue include accounts receivable, which is when a product has been sold but the seller has not yet received cash for it. Cash inflow only accounts for cash received. The difference between cash outflow and expenses is that expenses include accounts payable, which is when a product has been bought but the buyer hasn't yet paid any cash for it. Cash outflow only accounts for cash paid.

## **What is Market Capitalization?**

Market capitalization of a stock is the price per share multiplied by the total number of shares that are out there in the market. There are 4 main classifications of market capitalizations.

Microcap: \$0.00 to \$300 million

Small Cap: \$300 million to \$2 billion

Mid Cap: \$2 billion to \$10 billion

Large Cap: \$10 billion and up

## **Conclusion**

Thanks again for downloading this e-book. If you have any questions please contact me. My contact information is reprinted below.

## **How to Contact Me**

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Salem Oregon Fax Number: (503) 363-7462

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E-mail: [daniel@danieldollinger.com](mailto:daniel@danieldollinger.com)

## **Address for Salem Oregon Office**

187 High Street S.E. Salem, Oregon 97301

## **Address for Wilsonville Oregon Office: (By appointment only)**

28652 SW Costa Cir E. Wilsonville, OR 97070

## **Hours of Operation**

Saturday and Sunday: Closed

Monday - Friday: 8:30 am – 5:30 pm

If the times above do not work for you, please contact me and we can work out an alternative time to meet. Meetings can be either in-person or done remotely.