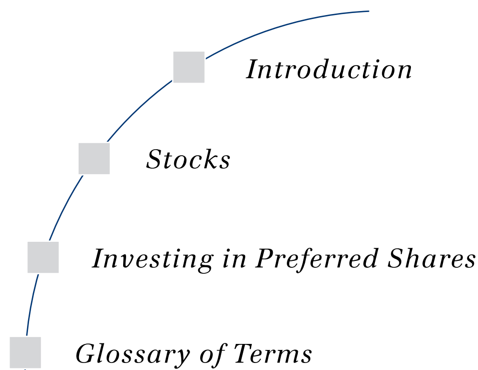
BMO NESBITT BURNS

The Stock Book

BMO Nesbitt Burns®™
Private Client Division

THE STOCK BOOK



Introduction

Stocks

Investing in Preferred Shares

Glossary of Terms

Stocks have been around for centuries. Although the way in which stocks change hands has evolved over the years, their fundamental appeal has remained constant: stocks have consistently demonstrated their superior ability to make money grow.

The unique characteristics of stocks have helped many investors achieve a variety of investment goals: to generate long-term growth, to enhance after-tax investment income, to protect a nest egg against inflation, and to contribute to a comfortable retirement. That is why BMO Nesbitt Burns is pleased to present *The Stock Book*, one of a series of publications designed to introduce investors to financial markets. In the following pages, you will read about how stocks trade, are priced and evaluated, as well as the potential risks and rewards involved in owning stocks.

As one of Canada's largest full-service investment firms, BMO Nesbitt Burns is committed to helping individuals establish long-term investment programs that meet their personal objectives. Your BMO Nesbitt Burns Investment Advisor can help you decide if the inclusion of equities is a prudent investment action. If you have any questions after reading *The Stock Book*, or would like to receive an individual company report from Canada's top-rated research department[1], your BMO Nesbitt Burns Investment Advisor is there to help you.

[1] Brendan Wood International Institutional Equity, Research, Sales and Trading Performance in Canada, 2000 Report

INTRODUCTION

1. What is a stock?

Ownership of a company is divided into equal portions called shares, and collectively, shares of a company are referred to as stock. An investor who buys stock is buying an ownership position in a company. If the company thrives, stockholders will benefit in direct proportion to the number of shares they own – their degree of ownership or equity in the company. If it fails, shareholders may lose part or even all of their investment.

There are two types of stock: common shares and preferred shares. Common shares are the most fundamental form of ownership. Preferred shares are dividend-paying equity instruments. They do not generally offer the same rights, such as voting rights, as common shares but have preference over common shares in the payment of dividends and the liquidation of assets. Preferred shares tend to offer a higher dividend yield than common shares and are usually purchased by investors seeking a steady stream of dividend income, not potential capital appreciation. (For more information on preferred shares, see questions 27 and 28). In this book, the term stock refers to common stock unless otherwise noted.

2. What are my rights as a stockholder?

As a stockholder or shareholder, you are a part-owner of the business, which gives you two rights: to share in the company's profits and to have a voice in management decisions. Common shareholders are entitled to all profits of the company after interest charges, taxes and preferred dividends are paid. Profits can be distributed to shareholders in the form of dividends, but unlike interest on debt, dividends on common shares are not a contractual obligation. Moreover, a company is not obliged to make up for unpaid dividends on common shares. A company's board of directors determines if a dividend will be paid, the amount of the dividend and the payment date.

Your voice in company affairs is heard when you vote at the company's annual general meeting of shareholders and at other special meetings of shareholders. Shareholders usually get one vote for each share owned, although some companies issue different classes of shares with different voting rights. At the annual general meeting, shareholders elect a board of directors who guide and control day-to-day business operations, appoint auditors, and vote on other matters that may require their approval. At the annual general meeting or at special meetings of shareholders, issues such as the sale, merger or liquidation of the business or amendments to the company's charter may be voted on.

3. Do I have to go to shareholders' meetings to cast my vote?

No. Many shareholders, because they lack time or interest, choose not to personally vote their stock. Instead, they may sign and return proxies that are mailed to them by the company. The signed proxy allows someone else to vote on the shareholder's behalf.

4. What are different classes of shares?

A company may have more than one class of common share. Classes are usually designated by letters such as "A" and "B" and have varying terms regarding dividend policy, voting rights, priority of assets in the event of bankruptcy, and authorized number of shares. The different privileges are reflected in the stock price of the different classes of common shares.

5. Do I have greater rights as a shareholder or as a bondholder?

Bondholders have the right to receive interest payments but have no vote in company affairs. Should the company go out of business, bondholders have a higher claim on assets than shareholders and will be paid off before them. In the event of a company's dissolution and the liquidation of assets, the company is legally obliged to pay off its debts – including bank loans and interest owed on bonds and debentures – before owners (shareholders) receive dividends. Shareholders are entitled to whatever is left – which may be nothing. However, owners of common shares have limited liability, which means that no further claims can be made on the shareholders for a company's liabilities beyond their initial investment, even in the event of bankruptcy.

6. Are there other types of stock besides common and preferred shares?

No, but there are other financial instruments whose value is based on stock. Warrants and options are examples of instruments that trade in their own right, but whose value is based on an underlying security such as a stock.

TRADING STOCKS

7. How do I buy stock?

Once a company decides to sell all or part of its ownership to the public, the company will work with an investment firm (an underwriter) such as BMO Nesbitt Burns to bring the new securities to the market, that is, to "go public." This is referred to as an initial public offering (IPO). Several weeks before the IPO, the lead underwriter will publish a prospectus to inform potential investors about a company. This document details the history of the company, its operations, management team, financial position and other details. Securities authorities review the prospectus in order to ensure full disclosure of all material facts.

Once the company receives regulatory approval to sell the shares, the underwriters will purchase the stock from the issuing company, then resell it to investors. The lead investment firm may work with other investment firms (an investment banking syndicate) in order to spread the risk incurred by temporarily owning the entire new issue.

When a company sells shares to the public, it usually also applies for a listing on a stock exchange. A listing makes it easier for investors to buy and sell the company's shares in what is

called the secondary market and provides a daily indication of what investors consider a company to be worth. The secondary market is where investors buy or sell shares that have previously been issued and sold by a company. The company that originally issued the shares receives no funds from trading of its shares in the secondary market.

8. When do I pay for my stock purchase?

On North American stock exchanges, buyers have three days to settle a trade. Sellers have to wait the same three business days to receive payment.

9. Will I receive a stock certificate?

While shareholders may choose to register their share ownership and receive a stock certificate, most keep their stocks in street name (that is, in a negotiable form) and deposit them with an investment firm such as BMO Nesbitt Burns. These shareholders are considered to be beneficial owners. This saves the time of physical delivery, and protects against the costs of securities being lost, stolen or destroyed. Dividends, rights, stock splits, etc., are all automatically credited to their account and they are informed of company reorganization deadlines or other material actions, thereby avoiding costly oversights. They are also offered the security provided by the Canadian Investor Protection Fund (ask your BMO Nesbitt Burns Investment Advisor for the CIPF brochure) and receive regular reporting of the value of securities held in their account.

10. What is the difference between an IPO and other issues of stock?

When a company sells stock from its treasury, it is considered a new issue or primary issue. If it is the first time a company has sold shares to the public, it is considered an initial public offering or IPO. A company whose shares are already publicly traded may wish to raise additional capital in order to expand current operations or other corporate purposes. If it chooses to issue new shares and sell them to the public in order to generate funds, an investment firm such as BMO Nesbitt Burns is usually retained to act as broker, similar to an IPO.

11. What are the benefits of a stock exchange listing to the issuing company?

A stock exchange listing provides increased marketability and ease of financing. A company whose shares are traded on a stock exchange has greater visibility and may also inspire greater confidence among investors due to its obligation to meet regulatory standards. Shares traded on a stock exchange have publicly reported prices which help underwriters and investors value a company and makes it easier to issue new equity and debt instruments.

12. What companies are eligible to list on a stock exchange?

Only companies that meet requirements of a stock exchange will be eligible to list their shares for trading. A stock exchange usually considers a company’s earnings record, working capital, minimum net tangible assets (i.e., the value of property, plant, equipment and inventory, all after debt), the breadth of

ownership of shares, the market value of the shares, and management. A listed company that fails to maintain minimum listing requirements may be delisted.

13. What are bid and ask prices? What is the bid-ask spread?

In the secondary market, buyers and sellers establish share prices based on their beliefs about the prospects for the company. Prospective buyers bid what they are willing to pay while prospective sellers ask what they are willing to accept. The difference is the bid-ask spread. For large, actively traded stocks, the bid-ask spread is usually very narrow. For example, if a potential buyer offers to pay (bids) $39.50 per share and a potential seller asks for $39.55, the spread is $0.05. The shares will actually trade at either the bid or the ask or somewhere in between.

For smaller, lesser-known shares, the bid-ask spread is often wider. The shares may change hands at the bid price, the ask price, somewhere in between, or not trade at all. A narrow bid-ask spread usually indicates that a stock is liquid, and that investors usually will not have difficulty buying or selling that security. A widening spread indicates increasing degrees of illiquidity; investors should be aware that trading in those stocks may take more patience than with more liquid situations.

14. Where can I find stock quotes?

There is a wealth of information to be gleaned from the business section of major daily newspapers. Most provide information about a stock's trading activity from the previous day including: the highest and lowest price at which it traded; the price of the last trade or closing price and the amount that it differs from the closing price the day before; the number of shares traded, or volume; the highest and lowest price a stock traded at in the past 52 weeks; and its indicated annual dividend, based on the most recent dividend paid. Some newspapers offer more extensive information such as bid and ask prices, the yield that the indicated dividend provides based on the stock's closing price, stock (or ticker) symbol and price-to-earnings ratio (see question 25 for an explanation of the price-to-earnings ratio). Television, radio, and electronic sources also provide quotes with various degrees of detail.

52-week high	Low	Stock	Sym	Div	High	Low	Close	Chg	Vol. (100s)	Yield	P/E ratio
3.17	1.51	Kiwi	KWI		2.97	2.85	2.94	+0.02	92		
46.95	39.55	Pear	PAR	1.80	42.30	41.95	42.30	+0.30	1,120	4.3	13.2
18.20	12.65	Plum	PLM	0.50	17.85	17.20	17.25	-0.50	560	2.9	18.9

BMO Nesbitt Burns Gateway® – a comprehensive online information centre – provides clients with the opportunity to obtain real-time quotes on Canadian and U.S. stocks and options, including price and fundamental data.

15. Are all stocks traded on a stock exchange?

No. Buyers and sellers can trade shares without using the facilities of a stock exchange. Some shares are traded in the over-the-counter (OTC), or unlisted market, which is a communications network linking participating brokerage houses. Stock exchanges, however, provide a transparent, regulated market place to facilitate the trading of large volumes of shares in an orderly fashion.

16. Where do I get more information about a company?

While the completeness of information disclosed by stock exchange listed companies may vary from issuer to issuer, all listed companies are required to prepare an annual report containing a balance sheet, a statement of earnings and a statement of retained earnings (usually combined into one report called the earnings statement), and a statement of changes in financial position. The annual report is prepared after the end of a company's fiscal year. (A fiscal year is a 12-month period, but it does not necessarily begin on January 1 and end on December 31 as a calendar year does.) These financial statements are an integral component of fundamental stock analysis (see Evaluating Stocks, questions 25 and 26).

Another piece of relatively accessible information often included in the annual report is the president's or board of directors' report to shareholders. This report is in the form of a letter and usually highlights the previous year's financial results, new strategic directions, and the outlook for the year ahead. Annual reports may also contain written commentary, charts and tables describing operational results, human resources initiatives, marketing campaigns, and company results by business unit. Where available, annual reports frequently include a 10-year financial statement summary.

Unless shareholders elect not to receive them, annual reports are mailed to all shareholders. In the 12 months between annual reports, interim information is provided by brief, quarterly reports on financial and operational results.

RISK AND RETURN

17. What will the return be on my investment? Will I earn dividends?

Capital Appreciation Potential

The most common reason that investors buy stocks is the anticipation of capital appreciation. As companies earn profits, they are able to reinvest in their businesses and expand operations. This in turn, enhances the prospects for future earnings growth. As one of the two main drivers of stock prices (interest rates being the other), higher expected earnings are positive for stocks, implying that their prices will rise.

Dividends

As mentioned previously, a board of directors determines the amount (if any) and timing of dividend payments (usually quarterly). Dividends are declared payable in a specified amount as of a certain date of record. Once a dividend has been declared, the shares trade what is called "cum-dividend" or with the dividend. All investors holding the shares as of the record date will receive dividends on the payment date, which is usually about two weeks after the record date. After the record date, the share price usually drops by about the amount of the dividend, and the shares then trade what is called "ex-dividend" or excluding the dividend. The current dividend yield (that is, the annual return provided by the payment of dividends) is calculated as the annual dividend divided by the price of the stock. For instance, assume the stock of a company is trading at $20.00 and pays an annual dividend of $1.16. The current dividend yield would be calculated:

$$\frac{\text{Annual dividend}}{\text{Current stock price}} = \frac{\$\ 1.16}{\$20.00} = 5.8\%$$

Total Returns

When measuring the performance of equities, many investors look at the total return. For example, shares of a company close on April 1, 2000, at $6.00. Over the course of the next year the shares pay a $0.25 dividend. At March 31, 2001, the stock closes at $6.50. The total return for the year ended March 31, 2001, is the sum of the share price increase over the year and the dividend, usually expressed as a percentage of the price at the beginning of the year. Therefore, the total return is:

$$\frac{(\text{Ending price of stock} - \text{beginning price of stock}) + \text{Dividend received}}{\text{Beginning price of stock}}$$

$$= \frac{(\$6.50 - \$6.00) + \$0.25}{\$6.00}$$

$$= 12.5\%$$

18. How do I know if the return on my stock is better or worse than it should be?

While the total return of individual equities does deserve scrutiny, it is the total return of the entire portfolio that is most significant for investors. But how do you know if your investments are performing as well as they should be? Most portfolio managers choose to measure the performance of their investments against an appropriate benchmark. For instance, the manager of a well-diversified Canadian equity portfolio would likely compare his or her performance to that of the TSE 300 index. If the portfolio manager was investing in smaller companies, he or she may decide to choose the BMO Nesbitt Burns Small Cap Index as an appropriate benchmark. If the portfolio consisted of U.S. equities, the S&P 500 might be used.

19. How are my stock investments taxed?

While the tax treatment of equity investments varies from investor to investor according to their personal tax situation, in general, stocks receive welcome tax treatment in taxable portfolios. As compared to the interest income generated by bonds, dividend income is “grossed-up” before taxes are taken off. In fact, because of the preferential treatment of dividend income, it can take as much as $1.37 of pre-tax interest income to equal $1 of pre-tax dividend income on an after-tax basis. Moreover, because common stocks are perpetual investments with no maturity date – unlike the majority of fixed income instruments – it is possible to defer capital gains by holding on to, rather than selling, equity investments. The following table clearly shows the impact of the favourable tax treatment of equities:

AFTER-TAX INCOME

Pre-tax interest income needed to equal $1 of dividend income on an after-tax basis

Based on 2000 top marginal personal tax rates (in dollars)	
British Columbia	1.34
Alberta	1.25
Saskatchewan	1.30
Manitoba	1.26
Ontario	1.30
Quebec	1.32
New Brunswick	1.31
Nova Scotia	1.31
Prince Edward Island	1.31
Newfoundland	1.34
Yukon Territory	1.27
Northwest Territories	1.25

Source: KPMG

20. What are the risks of owning stock?

The risks that face shareholders are both company-specific and particular to the equity markets as a whole. Company-specific risks centre on the failure of a company to perform as expected by the market, and can be caused by earnings shortfalls, management weakness, missed investment opportunities, dividend cuts, bankruptcy, etc. Occasionally, the risks faced by companies are beyond their control, such as poor commodity prices, regulatory change, or the entry of new competition. Any one of these failures to meet expectations by a company would be reflected in its stock price.

21. How can I lessen this risk?

As an investor, you can limit the impact of company-specific risks on your portfolio through diversification. By adding a sufficient number of equities to a portfolio, it is possible to reduce the risk associated with individual companies. In other words, the volatility of a portfolio's performance is reduced when the portfolio comprises several stocks. In Canada, it takes 30 stocks (when selected at random) to reduce the average variance of returns to a level comparable to the overall market, but good planning can bring portfolio risk down to market level with fewer securities.

22. Is that the only risk to owning stock – that the company performs poorly?

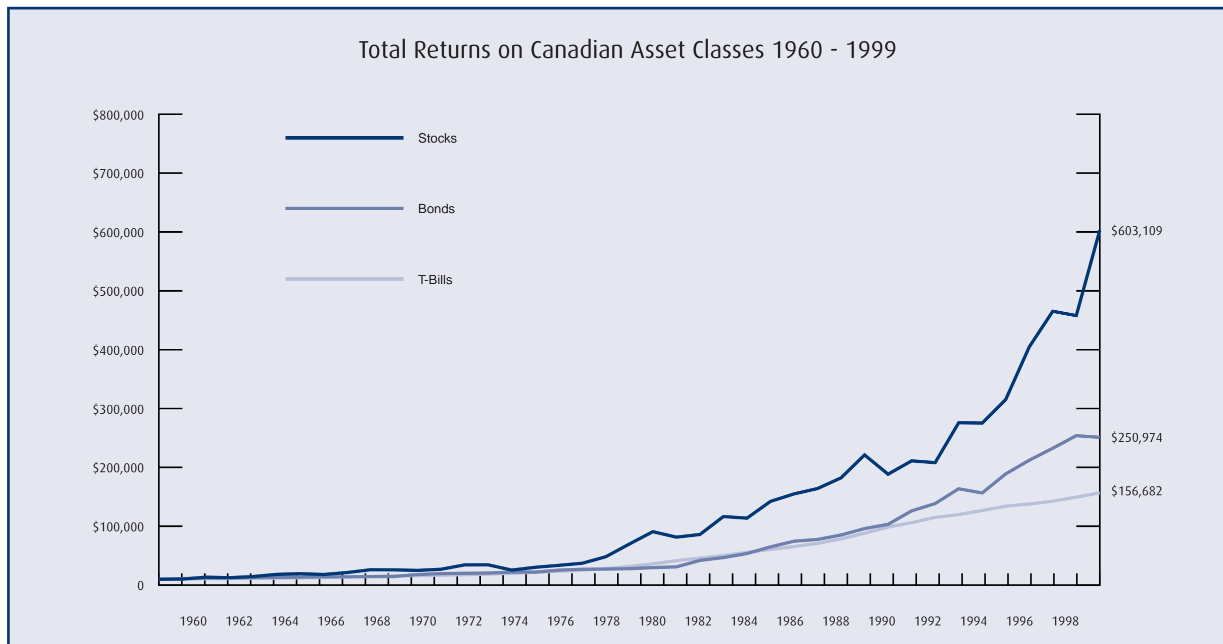
No. The other risk facing equity investors is market, or systemic, risk. Even when individual companies and their management teams perform well, rising interest rates, inflation and general market corrections (for whatever reason) will hinder the performance of all companies' shares to varying degrees. Investors should also consider their portfolio's asset mix – the proportion of stocks, bonds and cash – as a way of reducing risk.

23. Is it less risky to buy only bonds – or just put my money in GICs – rather than buy stocks?

To get a clearer perspective on the true nature of equities (and how their inclusion can affect the performance of your portfolio), it is necessary to look at how they act over long periods of time – both in terms of risk and return. For instance, the figure on the next page shows the total returns for Canadian stocks (as represented by the TSE 300), bonds (as represented by Scotia Capital Universe Bond Index) and three-month treasury bills. This chart tells an important investment story: since 1960 to the end of 1999, stocks have provided the best returns.

Moreover, as discussed in question 19, equities enjoy certain favourable tax treatments when compared to bonds and treasury bills. Indeed, studies have shown that only equities – and neither bonds nor T-bills – preserve their purchasing power after both taxes and inflation.

Of course, this outperformance comes with more potential risk: the volatility of returns is generally higher for stocks than for bonds, which are both riskier than treasury bills. One can observe the increased volatility by comparing the smoothness of the lines in the figure on the next page. The smoother the line, the less volatile the returns. However, in the long run, the risk in buying just bonds or only GICs is that you sacrifice the inflation protection provided by equities.[2]



[2] If you would like a more in-depth examination of the risk and return characteristics of Canadian asset classes over long periods of time, please ask your BMO Nesbitt Burns Investment Advisor for a publication called *Stocks, Bonds or Cash? Choosing the Correct Asset Mix*.

24. How can I take advantage of the opportunities offered by stocks and not exceed my tolerance for risk?

The key to successful investing does not lie in trying to time the short-term direction of the stock market (an extremely difficult proposition). It is being able to strike a balance between the risk and return of different types of investment instruments that you are comfortable with and that allows you to meet your financial goals.

Each asset class – stocks, bonds and cash – has its own characteristics that can influence how your portfolio manages the trade-off between risk and return. In a diversified portfolio, the key to this trade-off is an asset mix that is appropriate given your investment goals. A long-term investment strategy will allow you to manage the risk and reward trade-off intelligently.

EVALUATING STOCKS

25. How do I select a specific stock to purchase?

There are two types of analysis used by professional research analysts: fundamental and technical. It is a fundamental stock analyst's responsibility to be an expert in his or her given field and to be able to identify stocks with the best potential returns in the covered sector of the stock market. To accomplish this, an analyst uses a number of qualitative and quantitative tools in order to develop an investment recommendation. An analyst will be familiar with an industry and the specific company through trade journals, the financial press, company press releases, annual reports and other public documents. The analyst will also interview key managers such as the CEO and CFO, visit the company's operations and speak with its competitors, suppliers and clients.

FINANCIAL DATA (SAMPLE)					
	Price of Stock	Indicated Dividend	Stock Market Cap'z'n	Forecast Earnings 2000	2001
Warshaw Inc.	$23.00	$1.30	$650 M	$2.80	$3.20
Brothers Inc.	$23.00	$0.15	$113 M	$1.04	$1.35

Using financial statements, and the information gleaned from interviews and site visits, the analyst will develop operational and financial models or "what if" scenarios. These models allow a comparison of the company to others in the same sector and rank the relative attractiveness of the company within its sector.

26. How does fundamental analysis differ from technical analysis?

Technical analysis is the study of stock price and trading volume charts. A technical analyst does not even have to know what a company does to develop an investment opinion. A technical analyst believes that analysing charts of various aspects of a stock's trading history provide enough information to indicate future performance.

PREFERRED SHARES

27. What are preferred shares? How do they differ from common shares?

The most striking difference between preferred and common shares is that the dividends of preferred shares are usually fixed, and are higher yielding than common stock dividends. Preferred shares are issued with a par value, and their dividends are stated as a percentage of this par value. After they are issued, preferred shares trade on major stock exchanges like the Toronto Stock Exchange just as common shares do.

Preferred shares have "preference" over common shares in two ways. First of all, the holders of preferred shares are entitled to dividends before any dividends can be paid out to common shareholders. The second way in which preferred shareholders have preference is with respect to the assets of the company. In the event of the dissolution (bankruptcy) of a firm, preferred shareholders rank before the common shareholders (but after all other creditors) in the distribution of the company's assets.

The market price of high quality preferred shares primarily reacts to interest rate movements (like bonds) and to the financial stability of the issuer, whereas the price of common shares reacts to the company's reported and prospective earnings, and general market news. For this reason, preferred share prices are usually less volatile than the price of common shares from the same company.

Preferreds also tend to offer higher dividend yields than common shares. Investors usually purchase preferred shares for the expected steady stream of high dividends, and not for potential capital appreciation.

28. What are some of the different features of preferred shares?

Investors interested in preferreds can choose from a wide variety of securities with many different features.

Cumulative

If a company fails to declare a dividend on its preferred shares, no dividend will be paid to the common shareholders. All accumulated preferred dividends, from past and present years, must be paid in full before any dividends

are paid out to the common shareholders. Most preferred shares in Canada have a cumulative feature. Preferred shares without this feature are called "non-cumulative."

Convertible

Some preferred shares are convertible into the common stock of the underlying company. The convertibility option is available to the preferred investor at a fixed ratio within specified time limits. Convertible preferreds provide investors a higher yield and a more secure position than common shareholders, yet still allow investors the opportunity to benefit from potential price appreciation of the common stock (though by a lesser degree). After the time limit has expired, convertible preferreds revert to a normal "straight" preferred status.

Floating Rate

Instead of paying a fixed rate of dividend from year to year, some companies pay dividends that respond to changing levels of interest rates. Often the dividend is pegged to the prime lending rate. Some companies put lower and upper limits on the size of the dividend to protect shareholders and themselves from volatile swings in interest rates.

Retractable

Holders of retractable preferred shares have the right to tender the securities back to the issuing company at a fixed price at one or more future dates. The shares are usually retractable at their par value plus any accrued dividends. Retractable preferreds will provide capital appreciation when the stock is purchased below par, and then tendered back to the company at its par value.

Redeemable (or Callable)

A redemption or call feature means the issuing company has the right to call back the shares at a specified price after a specified date. Callable preferred shares are often redeemed at par value plus accrued dividends. All Canadian preferred shares have this call feature. For this reason, it is very important for potential investors to be aware of a preferred share's yield to call, as well as the current yield and/or the yield to retraction.

For more information on preferred shares, please ask your BMO Nesbitt Burns Investment Advisor for our publication called *The Unique Features of Preferred Shares.*

Visit on the World Wide Web at www.bmonesbittburns.com.

GLOSSARY

Annual report – These are the formal and audited financial statements and report on operations sent to shareholders after the end of a company's fiscal year.

Arbitrage – The attempt to make a trading profit from inefficiencies in financial markets. For example, an arbitrageur may simultaneously buy a stock on the New York Stock Exchange and sell the same stock on the Toronto Stock Exchange if there is a favourable price difference.

Arrears – Preferred share dividends that have not been paid as indicated are said to be "in arrears."

Asset mix – The blend of stocks, bonds and cash within a portfolio.

Authorized shares – The number of shares that a company is legally allowed to sell. The number of shares outstanding in the secondary market may be only a fraction of the total number of authorized shares.

Averages or Indices – Statistical measurements of securities prices that are used to gauge where "the market" is, or as performance benchmarks.

Balance sheet – Financial statement that outlines the company's assets, liabilities, and the amount of wealth attributable to shareholders, i.e., shareholders' equity.

Bear market – A market in which security prices are declining. An investor who is bearish expects the overall market or an individual security to go down.

Beneficial owner – When no certificate is issued for an investment and the security is held at a brokerage firm, the security is said to be held in street name. The beneficial owner is the true owner of the security.

Blue chip – This term describes large capitalization stocks with well-known, successful track records and usually a history of continuous dividend payments.

Board lot – The number of stocks in the normal trading block as determined by a stock exchange. For stocks over $1, a board lot is usually 100 shares.

Book value – The equity attributable to shareholders. On a per share basis, it is calculated: (Shareholders' equity/ number of shares outstanding). Value investors like to look for stocks trading at or below their book value.

Bull market – The opposite of a bear market, that is, a market in which prices are rising.

Call option – A derivative instrument that gives the holder the option, but not the obligation, to buy a certain stock from the seller of the call option at a predetermined price (the strike price) on a specified day (the exercise date), regardless of the market price of the stock. If you choose to buy the stock, you exercise your option; if you don't, the option expires worthless.

Cash flow per share – An accounting measure that includes net income plus any non-cash charges, such as depreciation, amortization, deferred income taxes, etc. Fundamental analysts frequently use cash flow per share to measure a company's financial health and its ability to pay dividends and to expand operations.

Derivatives – Any financial instrument whose price is determined by the price of something else. Examples of derivatives include: call options, put options, warrants and futures. Like any financial tool, derivatives can either be used in a prudent, or in an aggressive fashion.

Diversification – Blending together securities with different risk and return characteristics in order to reduce the overall volatility of a portfolio.

Dividend reinvestment programmes (DRIPS) – Some companies offer investors the opportunity to reinvest funds they would have received as cash dividends into common stock. The amount of the cash dividends that would have been received, divided by the price of the shares on a certain date, will be the number of shares credited to a DRIP account. Due to mathematical leftovers, shares are usually accumulated in fractional amounts.

Earnings per share – What falls to the bottom line after a company has met its obligations, divided by the number of shares outstanding. Earnings per share (EPS) is the key forecast made by fundamental analysts in their attempts to rank the relative performance prospects of stocks.

Equity – The balance sheet value attributable to common shareholders. Equity is also another name for the asset class of stocks.

Fiscal year – Companies can choose any day of the year on which to end their business year. The twelve months used by the company in the presentation of their annual report is known as its fiscal year.

Income statement – Also known as the Profit & Loss Statement. The earnings statement shows the amount of revenues taken in, and the expenses incurred to generate those revenues.

Large cap – A stock with a large stock market capitalization (typically greater than $1 billion). All blue chip stocks are large cap, but not all large cap stocks are blue chip.

Liquidity – The ease with which a share can be traded on a stock exchange.

Odd lot – A trade of a number of shares less than a board lot (see Board Lot, above).

Penny stock – A low priced, speculative security.

Poison pill – A provision to protect against a hostile take-over. Usually, a poison pill is triggered if a single shareholder accumulates more than a certain percentage (e.g. 10 per cent) of shares outstanding. In that event, all other current shareholders would have the option to buy treasury shares at a fire sale price. This would effectively dilute the ownership of the intended acquirer, make additional share purchases prohibitively expensive, and hopefully dissuade them from further hostile action.

Preferred shares – High yielding equity instruments that attract some investors due to their hybrid stock/bond nature. Preferreds tend to offer higher dividend yields than common shares and are usually purchased by investors seeking a steady stream of high dividends, as opposed to capital appreciation.

Proxy – A form that, when signed, gives authority for someone else (usually a member of the company's board of directors) to vote a shareholder's stock in his or her absence.

Put option – The opposite of a call option, a put option holder has the right to sell a certain stock to the put option seller at a predetermined price on a specified day, regardless of the current price of the stock.

Rally – A slang term for when the market rises. A rally can be limited to a day, or can extend over a period of weeks. A bull market will experience many rallies.

Share buy-backs – Occasionally, companies will announce that they have initiated a share buy-back of their own stock. This means that they will go out into the secondary market – just as regular investors do – and begin to buy their own stock, and retire it as treasury stock.

Short sale – The opposite of being long. A short position involves selling a security not already owned, with the hope of being able to purchase it back at a later time at a lower price. A short seller borrows the stock to be sold from his or her broker, sells it, and pays interest on the borrowed stock. A tactic for aggressive investors only.

Small cap – A stock with a small stock market capitalization.

Stock splits – A split increases the number of shares while decreasing the stock price in the same proportion. For instance, say you own 100 shares of Megatron Software Inc. The stock has had a wildly successful year and has increased in price from $22 to $75. Many Canadian companies believe that their stock becomes less attractive as the price becomes higher. If Megatron believed this, they could have a three for one stock split. This would mean that instead of holding 100 shares at $75, post-split you would hold 300 shares at $25. There is no real change in total value to the shareholder; rather, each share represents a different proportion of ownership.

Stock market capitalization – The total market value of the common stock of a company. It is calculated by multiplying the price of stock by the number of shares outstanding. Companies are often arbitrarily categorized by their capitalization as large, mid-size or small. In Canada, a company with a market capitalization of $1 billion or more is generally considered a large capitalization stock.

Treasury stock – Authorized shares that are not outstanding. Shares are sold from a company's treasury in the primary offering.

Warrant – A derivative instrument that gives the holder the option, but not the obligation, to buy a certain stock from the company at a predetermined price (the strike price) on a specified day (the exercise date), regardless of the market price of the stock. If you choose to buy the stock, you exercise your warrant; if you don't, the warrant expires worthless. Warrants differ from call options in that if you exercise a warrant, you end up buying new stock from the company itself; with a call option, you buy stock from another investor. While aggressive investors may buy warrants in the secondary market, frequently warrants are attached as a "sweetener" to other new issues, such as debentures.

BMO NESBITT BURNS — A PROFILE

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