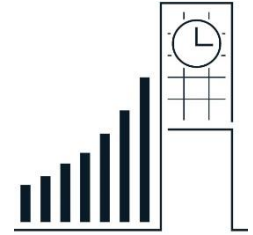


# EQUITY MARKETS OVERVIEW AND INVESTMENT THEORY OVERVIEW

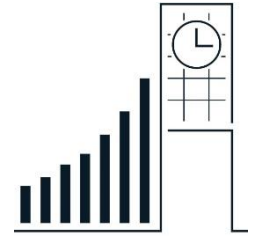
SPRING 2024

# AGENDA



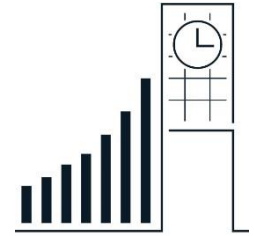
- ▶ What are equities?
- ▶ How to think about equities
- ▶ Equity terms
- ▶ Why would you invest in equities?
- ▶ Investment methodologies
- ▶ “Margin of Safety”
- ▶ Other things to look for

# EQUITIES OVERVIEW

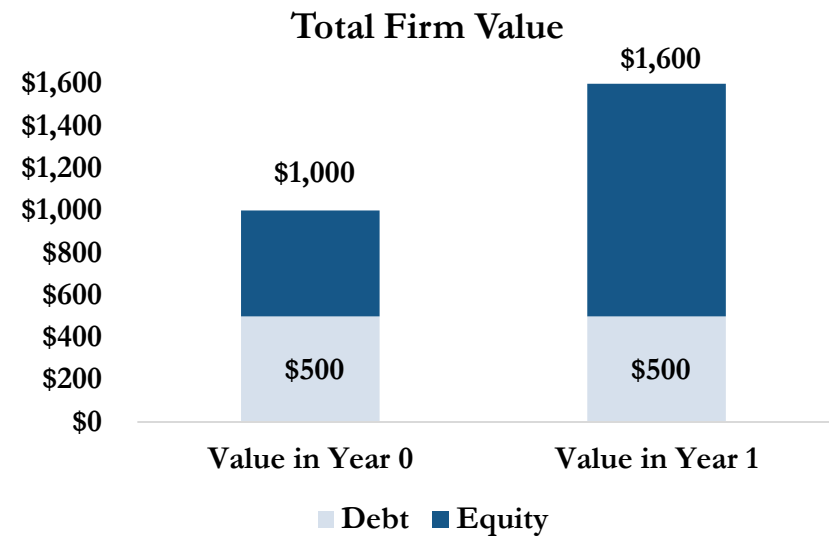


- ▶ When companies need money to expand (build factories, hire workers, etc.) they can sell ownership in the company, also known as “equity”
- ▶ Equity holders have partial ownership in a company, and have the right to the residual earnings of a firm
  - Residual earnings – the profit that is left over after paying interest, taxes, and noncontrolling interests (after cost of capital)
- ▶ The value of a stock is driven by the expected future residual earnings of a company

# HOW TO THINK ABOUT EQUITIES



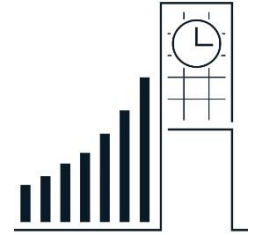
- ▶ The key driver of total value is the future earnings of the firm
- ▶ Equity is left over value after all obligations of the company are fulfilled
  - After debt, noncontrolling interest, other liabilities, etc.
  - Debt and other obligations are typically fixed amounts



- ▶ As a result of positive expectations, the total value of Firm X has grown from \$1,000 to \$1,600

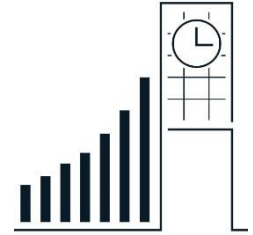
*What is the value of the equity in Firm X for Year 0 and Year 1?*

# TERMINOLOGY



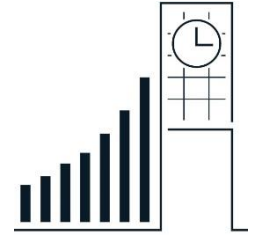
- ▶ Catalyst – an event in the future that has a significant impact on the company
- ▶ Price to earnings ratio =  $\text{Share Price} / \text{Earnings Per Share}$ 
  - Shows you the valuation of a stock (how much you are paying for a dollar of earnings)
- ▶ Market cap – the value of all the company's equity
- ▶ Shorting a stock – borrowing the stock and selling it with the intentions of buying it back in the future (betting that shares will fall in price)

# ABC COMPANY



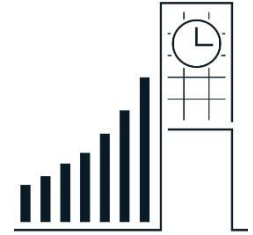
- ▶ Manufactures film for cameras
- ▶ With the proliferation of digital cameras, their business model has been destroyed
- ▶ Should ABC have a high or low valuation?
- ▶ Do they have significant growth opportunities?

# XYZ COMPANY



- ▶ XYZ manufactures electric vehicles
- ▶ With significant growth in the industry, XYZ has seen an increase in competition
- ▶ Should XYZ have a high or low valuation?
- ▶ Do they have significant growth opportunities?

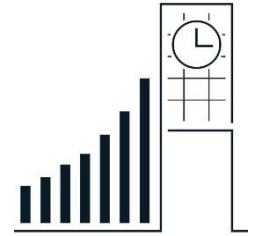
# CHOCOLATE COMPANY



- ▶ Valentine's day is in two months and many people are expecting there to be record sales for chocolates in the U.S.
- ▶ The Chocolate Company is expected to sell \$15mm of chocolate in the week leading up to the holiday
- ▶ If chocolate sales grow 500% and meet the market's expectations, should the stock price increase, decrease, or remain the same?



# WHY INVEST IN EQUITIES?



- ▶ You want to invest in a stock when you believe that the market is not appropriately pricing some piece of information
- ▶ You want to buy a stock when you think the market is not fully appreciating the growth or is too negative on the outlook of a company
- ▶ You want to short a stock when you think the market has fully appreciated the growth or is too positive on the outlook of a company

# INVESTMENT METHODOLOGIES



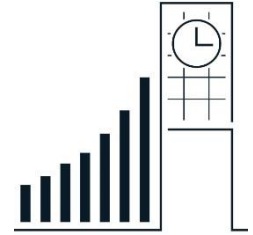
## ▶ Value Investing

- People who look for “cheap stocks” with low valuation multiples and solid fundamentals (industrial companies, healthcare)
- They do comparable companies analyses and run discounted cash flow valuations to determine the “intrinsic value” of a company

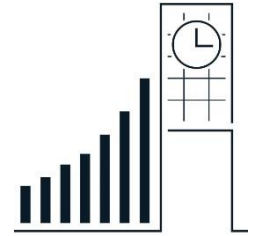
## ▶ Growth Investing

- People who look for stocks with large earnings growth potential that have very high valuation multiples (technology)
- Run discounted cash flow valuations to determine how much growth is priced into the stock

# “MARGIN OF SAFETY”



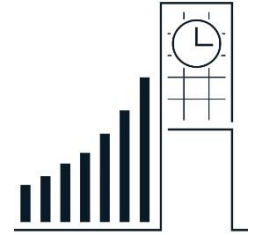
- ▶ When you are looking at an investment you must have some sort of margin of safety built into your valuation
  - Meaning that your valuation models compute the value of the stock to be noticeable higher (long) than the markets current share price
  - Ideally the stock won't move against you significantly because of this buffer or margin of safety built into your models.



# TIPS

- ▶ Generally the stock that performs the best in the competition tells the best story
- ▶ Competitors should be able to articulate what factor or event the market is mispricing
  - This is likely the most important part of the competition
- ▶ The valuation models are still important, but not as important as in the M&A competition

# QUESTIONS?



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