

## WHAT ARE STOCKS?

by Judy Loy, ChFC®, RICP® and CEO of Nestlerode & Loy, Inc.

Many people invest in stocks, either individually or through mutual funds but may not realize what they are purchasing. A stock represents an ownership position in a corporation. Typically, investors buy stock of public companies on the open market and the position is fully liquid. It is also possible to own stock in privately held corporations. As an example, my business, Nestlerode & Loy, Inc. is a corporation in which I own the majority of common stock of the company. It is not public and is a privately held corporation. "Stock" is synonymous with the word "equity" and those terms are interchangeable when talking about investments. Stockholders can also be called shareholders.

Stockholders of a corporation are partial owners of a company but don't have the highest claim on the assets; in fact, they are typically last in line. Creditors of a corporation hold higher claim on assets in the event of liquidation. Since shareholders take on greater risk, they also have the chance for highest returns.

There are generally two types of stocks: common and preferred. Preferred stock entitles the stockholder to a fixed dividend and has priority over common in the event of liquidation. Preferred stocks are typically seen as a mix between pure equity and fixed income due to the fixed dividend payment. Common stocks are lowest in priority and geared toward long-term growth.

Within the common stock family, investors break down investing into categories. Stocks can be broken down by the size of their market capitalization: microcap, small, mid- and large cap. Market capitalization is the total dollar market value of a company's outstanding shares and is calculated by multiplying the number of common stock shares trading times the current share price. Because the price of a stock changes, stocks do not remain in any one category and can shift from one size to the next or back. In general, Microcap stocks are those with market capitalization of \$50 million to \$300 million. Companies with a market cap of between \$300 million to \$2 billion are considered small companies or small caps. Mid cap stocks hold values between \$2 billion and \$10 billion. Finally, large cap stocks are those with a market cap over \$10 billion and these are the companies with which we are most familiar. Large cap stocks include Microsoft (MSFT), General Electric (GE) and Apple (AAPL). Small cap stocks tend to be the most aggressive common stock with the most volatility.

Investors also pay attention to valuations in stocks. Growth versus value investing is an age old debate. Value stocks are those that may have fallen out of favor and look to be worth more than their market value. Growth stocks are higher priced and justify that with high earnings growth. The typical way to tell if a stock is value or growth is to look at their price to earnings (P/E) ratio. P/E is a way to value a company by dividing its share price by its per share earnings (P/E stands for Price-Earnings). In simple terms, a company that has a P/E lower than the overall market or lower than other companies in its industry may be seen as a value.

When looking at 401k mutual fund options, you can now more fully understand when a fund is labelled "large cap growth mutual fund". This would mean the fund pools the money of all its investors and puts it into publicly traded common stocks of companies with over \$10 billion in market cap and whose price to earnings is higher than its industry average which is maintained by a higher earnings growth.

I hope this makes some of the arcane terms in investing a little easier to muddle through when reviewing investments.

***Nestlerode & Loy Investment Advisors offer brokerage and investment services to individuals, businesses and non-profits. For a review of your investments and help planning for retirement, please call Judy Loy, ChFC®, RICP® at 814-238-6249 or email [jloy@nestlerode.com](mailto:jloy@nestlerode.com).***