

Break Down Your Money

**HOW TO GET BEYOND THE NOISE
TO PROFIT IN THE MARKETS**

Tracy Byrnes



WILEY

John Wiley & Sons, Inc.

Break Down Your Money

Break Down Your Money

**HOW TO GET BEYOND THE NOISE
TO PROFIT IN THE MARKETS**

Tracy Byrnes



WILEY

John Wiley & Sons, Inc.

Copyright © 2008 by Tracy Byrnes. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 750-4470, or on the web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993 or fax (317) 572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books. For more information about Wiley products, visit our web site at www.wiley.com.

Library of Congress Cataloging-in-Publication Data:

Byrnes, Tracy

Break down your money : how to get beyond the noise to profit in the markets / Tracy Byrnes.

p. cm.

Includes bibliographical references and index.

ISBN 978-0-470-22680-3 (cloth)

1. Stocks. 2. Bonds. 3. Portfolio management. 4. Investments.
5. Saving and investment I. Title. II. Title: Profit in the markets.

HG4661.B97 2008

332.63-dc22

2008002737

ISBN-13 978-0-470-22680-3

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

*To my angels,
David, Julia, and Celia,
I love you more than peanut butter.*

Contents

| | | |
|------------------------|---|----------|
| Foreword | xi | |
| Introduction | xiii | |
| Acknowledgments | xv | |
| PART I | Be An Owner, Not an Employee | 1 |
| Chapter 1 | To Market to Market, to Buy a . . . What? | 3 |
| | So What Exactly <i>Is</i> the Stock Market? | 3 |
| | Buy a Stock and Become a Restaurateur | 7 |
| | Look to the Indexes for the Market Scoop | 10 |
| | Wrap-Up | 16 |
| Chapter 2 | The Lamborghini Murciélago LP640 Roadster: A Lifetime of Dividends | 19 |
| | The Derivation of Dividend | 21 |
| | Dissecting a Dividend's Date | 23 |
| | Rev the Engine with Some Ratios | 25 |
| | Drive through the Financials | 25 |
| | It's All About the Little Things | 26 |
| | Get To Know a DRIP (Dividend Reinvestment Program) | 28 |
| | What's a DRIP? | 28 |
| | Of Course, the Company Benefits, Too | 30 |
| | So How Do You Find a DRIP? | 31 |
| | DRIP Downers | 32 |
| | Wrap-Up | 33 |

| | | |
|------------------|----------------------|----|
| Chapter 3 | Bond, James Bond | 35 |
| | Bond with the Family | 36 |
| | The Mature Bond | 37 |
| | A Bond's Yield | 38 |
| | Wrap-Up | 39 |

| | | |
|------------------|--|----|
| Chapter 4 | Mutual Funds and ETFs: For Folks on the Go | 41 |
| | Mutual Funds: Funds for Kegs | 41 |
| | Mixing in Exchange-Traded Funds | 53 |
| | Wrap-Up | 59 |

PART II Look under the Hood 61

| | | |
|------------------|---|----|
| Chapter 5 | Navigating the Financial Statement: Your "Just Get to the Good Stuff" Guide | 63 |
| | Find the Financials (Hint: They're in the Annual Report) | 64 |
| | Where to Begin | 66 |
| | Wrap-Up | 68 |

| | | |
|------------------|--|----|
| Chapter 6 | Auditing Your Potential Investment | 69 |
| | Open the Company Checkbook: The Balance Sheet | 69 |
| | Check the Company Report Card: The Income Statement | 77 |
| | Wrap-Up | 85 |

| | | |
|------------------|--|----|
| Chapter 7 | Cash Is the Real Deal. Earnings Reports Are Not. | 87 |
| | Find Your Two Dollars on the Cash Flow Statement | 87 |
| | Earnings Release: The Ultimate Optimist | 93 |
| | Wrap-Up | 99 |

| | | |
|------------------|--|-----|
| Chapter 8 | Breakfast with the Federal Reserve: Getting the Economic Porridge "Just Right" | 101 |
| | Where Did the Fed Come from and Why Do We Need It? | 102 |
| | Inflation: Bad for the Porridge and the Economy | 103 |

| | |
|---|------------|
| Recession: Bad for Your Hairline and the Economy | 104 |
| How the Fed Keeps the Porridge “Just Right” | 106 |
| Adjusting Interest Rates: The Long, Slow Simmer | 108 |
| Testing the Porridge | 113 |
| Wrap-Up | 115 |
| | |
| PART III Decisions, Decisions | 117 |
| | |
| Chapter 9 Will You Still Love Me Tomorrow?: Growth, Value, and Momentum Stocks | 119 |
| Growth Stocks: Hidden Gems | 120 |
| Value Stocks: Till Death Do Us Part | 122 |
| Momentum Stocks: One Night Stands | 123 |
| Wrap-Up | 125 |
| | |
| Chapter 10 Evaluating Cars and Stocks | 127 |
| Price-to-Earnings Ratio | 127 |
| Price-to-Book Ratio | 130 |
| Growth Rate | 132 |
| Knowing What’s Important: A Case-by-Case Decision | 135 |
| Hard to Get Good Help | 136 |
| Wrap-Up | 136 |
| | |
| Chapter 11 The Ins and Outs of IPOs | 139 |
| Pop Goes the IPO | 140 |
| A Beneficial Blow | 143 |
| Knowing When to Make the Move from Public to Private | 146 |
| Take That IPO on the Road | 147 |
| Sorting through the S-1 | 149 |
| Getting a Ticket to the Hottest Party in Town | 152 |
| Leave the Stock, Take the Fund | 156 |
| Wrap-Up | 157 |
| | |
| Chapter 12 Options and Futures | 159 |
| An Introduction to Options | 159 |
| Check the Expiration Date: Options Expiration Week | 165 |
| Use the Futures Market to Foresee Market | 167 |
| Wrap-Up | 172 |

x Contents

| | |
|--|----------------|
| Chapter 13 Bringing It All Together | 175 |
| 1. Be Specific about Your Goals | 176 |
| 2. Spread the Risk Around | 176 |
| 3. Don't Marry Your Holdings | 179 |
| 4. Do Your Homework | 181 |
| 5. Don't Forget to Pay Uncle Sam | 184 |
| Wrap-Up | 186 |
| Appendix | 189 |
| About the Author | 193 |
| Index | 195 |

Foreword

In a perfect world, investing in the stock market would be a fair competition, like running onto a level playing field to engage in a game of football where neither team has the opening advantage. But investing, you may have already learned, is anything but fair.

Unless you're one of the savvy Wall Street insiders, joining the investment game can be like getting thrown onto the field with a couple of cracked ribs, bruised knees, no shoulder pads . . . and no team behind you.

Enter Tracy Byrnes. With this book, Tracy has done something few writers have been successful at accomplishing: helping the rest of us understand, maneuver around, enter into, and profit from the smashmouth game known as successful investing.

Since 1930, the stock market has returned an average of 11 percent per year. On a good day, your basic bank account or money market will cough up, at best, 4 to 5 percent. So as scary as it might be with all its confusing terminology and often frightful news swirling around on a daily basis, the stock market will, over the long term, get you the most bang for your buck. Tracy, an accomplished certified public accountant and shrewd financial journalist, has picked apart the insider's playbook and has turned it inside out, translating the lexicon and explaining the way things *really* work so that you can get to work putting your money in the game.

No other book about the markets provides the kind of sweeping insights, comprehensive explanations, and analogies that Tracy has formulated.

Whether we're facing a consumer or banking credit crunch, mortgage woes, a dot-com implosion, a real-estate crisis, a savings and loan disaster, or something akin to the Tulip Mania of the 1600s, every decade may bring uncertainty, risk, and loss. That is what makes Tracy's book so valuable, not just to the novice investor, but even to the experienced few who think they've already made it to the Super Bowl of investing. History has proven that even the savviest investor can get sucked into beguiling market games, only to get beaten badly on the field.

We all deserve a fair shot at saving for our future, for our retirement, for our children's college education, for our hopes and dreams. By turning the pages of this book, you've already scored a touchdown. Get ready for that level playing field, with Tracy Byrnes as your winning quarterback.

LIZ CLAMAN
New York, NY
April 2008

Introduction

So, have you checked the stock market today?
Stop laughing.

I know. In between 10-hour workdays, your kid's soccer games, and your constantly sabotaged attempts to get to the gym, who has the time to care about whether Microsoft's earnings release moved the stock price up or down?

Who even knows what that means? What exactly is an "earnings release" and why is it moving the stock? Market pros have created their own professional lingo, and if you're not in the know, it's just gibberish. But it's important gibberish that can make you some serious money, so it's high time you learned the language.

That's where this book comes in.

The stock market is the cornerstone of everything we do. Whether you're an artist, a dentist, or a stay-at-home mom, you need to understand how the economy and the stock market play together. Odds are good you're saving for a house, retirement, or your next vacation; so why not learn how to make that money work for you? The S&P 500 is up about over 26 percent over the last five years. This means that if you invested \$10,000 in the market on January 1, 2002, you would have earned an extra \$2,600 by the end of 2007!

Movements in the market also determine how much money comes into your home on a daily basis. When stocks are doing well, that usually means the underlying companies are doing well. That could equate to new job opportunities or raises for people who work for those companies. That's all good news for your household.

I'm not asking you to start spending your free time investing. Who has free time? Nor do I expect you to quit your job and

start trading stocks for a living. This book is here so that when you turn on the TV in the morning, you'll know what it means when the talking heads report that the S&P futures were down overnight, or that the market might start the day off a bit shaky. If you glance at a newspaper headline and it says that Coca-Cola increased its quarterly dividend, you will know that means the company has some extra cash on hand and has decided to give it back to the shareholders. If you happened to find a little time and have the inclination to dive in and play, you'll then be armed with enough knowledge to compete with the professionals.

This book is broken down into three parts. The first covers the basics: an overview of the market, definitions of stocks, bonds, mutual funds, and so on. The second part dives into the financial statements and provides an understanding of the Federal Reserve and how it influences the markets. The final part gives you some great metrics to help you understand how your favorite stocks are doing compared to their peers. This is also where we pull it all together and help you establish a game plan so that you can create a sound investment portfolio.

We're covering a lot of ground, but the chapters are short because you and I don't have the time or attention span for long-winded anything. The chapters and different topic sections are short enough to read during coffee breaks, bathroom breaks, time-outs, or on the sidelines of your kid's soccer game. So keep it with you, pick it up when you can, and start to get smart about the market.

And did I mention we'll be talking about cars, James Bond, and beer, too? I told you—we're going to have fun.

Acknowledgments

Never in a million years did I think I'd write a book. If it weren't for the people listed below, I probably would've never done it. With that, I send my heart and my thanks to:

Tricia Davey, my agent, for believing in me enough to peddle my book proposal all over town.

Laura Walsh, editorial program coordinator at John Wiley & Sons, for actually buying it.

Emilie Herman, my editor, for keeping me and my book focused and calm.

Dan Colarusso for being my Dalai Lama.

My girlfriends for, well, you know.

My "strategic advisor," Pierre Swart, for, well, you know, too.

My children, David, Julia, and Celia, for inspiring me to do fabulous things for them. I just hope they're proud of me someday.

My brother, Paul, for being my ever-faithful rock and best friend.

My stepfather, Jim, for wholeheartedly taking on the role of father and grandfather.

And most importantly, my mother. I'm sorry it took me 35 years to get it. You will never know how much I admire you and how hard I have tried to emulate you throughout the years. Your constant encouragement and choruses of *Climb Every Mountain* are the reason I am who I am today. *Ti amo.*

Finally, I send my heart and my thanks to God, for blessing me with all of the above the people.

PART
I

**BE AN OWNER,
NOT AN EMPLOYEE**

CHAPTER 1

To Market to Market, to Buy a . . . What?

These days the stock market is everywhere. From newspaper headlines to cocktail conversation, it's as ubiquitous as Paris Hilton. And it's talked about just like Paris. "Paris Wants a New TV Show." "The Market Wants the Fed to Cut Rates."

Who or what is this "market" and how dare he (or she?) make such demands?

Let's clear things up. This omnipresent "market" is not human. (It does act like my three-year-old at times, but we'll get to that in a bit.) Nor is it a place where you can buy blueberries or sweet corn in the middle of your town square on a beautiful Saturday afternoon. However, there *will* be a bunch of buyers and sellers at this market and you will need money if you plan on taking something home. But you're not taking home fresh produce or a handmade wicker basket. Instead, you're going to buy and sell stocks, bonds, options, and exchange-traded funds.

Way more fun than a wicker basket.

So What Exactly *Is* the Stock Market?

The *stock market* refers to a place where you can buy or sell stocks. There are three big stock exchanges in the United States:

4 Break Down Your Money

- *The New York Stock Exchange (NYSE)*. The NYSE is the oldest and most popular organized stock exchange in the United States. It is kind of like the Bergdorf Goodman of stock exchanges. Most of the big-time companies such as General Motors, Johnson & Johnson, and Nordstrom (naturally) are all here on the NYSE.
- *The American Stock Exchange*. You might know this exchange as the *Amex*. It is smaller than the NYSE and the companies that you can trade there also tend to be smaller and sometimes more risky than those listed on the NYSE. You can buy exchange-traded funds here, which are fabulous, and we'll delve into those later in the book.
- *The Nasdaq*. The name of this exchange (pronounced naz-dack) stands for the National Association of Securities Dealers. Technology stocks have found a home here. So, at the Nasdaq, you'll find Microsoft, Google, and Yahoo!.

Companies that are traded on these exchanges are abbreviated with a special *ticker symbol*, an abbreviation that may not always clue you in on what stock is meant. For example, Microsoft, which is traded on the Nasdaq, is MSFT. Its competitor, Apple, is AAPL, which is also traded on the Nasdaq. These symbols can be used, as well as the company names, to get stock quotes and other information at various online resources. We will learn more about ticker symbols—and online resources—later in this chapter and throughout this book.

There are also additional smaller exchanges in other major U.S. cities such as Chicago and San Francisco. But most of the action happens on the three listed above.

Overseas, London and Tokyo are some of the big cities that also have major stock exchanges, which are important no matter where you call home. Just like we take our fashion cues from the catwalks of Paris, what happens in London and Tokyo overnight helps us gauge our markets when we wake up. We'll tackle how those markets affect us later in the book.

But here's the catch: You can't actually go to these markets.

What? Can't go to the store? Can't wander the aisles? Sample the perfume? Test drive the car?