

# Understanding the Capital Markets

Derivatives

Hedge

Exchange Traded Fund

Limit Order



# Understanding the **Capital Markets**

## What are Capital Markets?

Capital markets bring together companies looking for money with investors who have money to invest. Companies need money to grow, buy equipment, build facilities, hire workers, and fund research and development. To access this public capital, companies can raise money by “going public.”

Going public refers to the process by which companies make their stock or shares available to the public. In doing so, a company sells partial ownership of its business to each investor, or “shareholder.” This method of raising money is called “equity financing.” There are other ways that companies can raise capital, such as selling debt through bonds and related securities.

Investors may be individuals (often called retail investors) or financial institutions such as banks and mutual and pension funds (usually referred to as institutional investors). The markets that facilitate the transfer of funds are known as capital markets. Organizations such as Toronto Stock Exchange, TSX Venture Exchange, Montreal Exchange and the Winnipeg Commodity Exchange are part of the Canadian capital markets. Over-the-Counter (OTC) trading and Alternative Trading Systems (ATSs) also play a role in capital markets.

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## How Capital Markets Work

The transfer of capital from investors to companies is an integral part of the Canadian economy. As a result of this transfer, businesses can grow and create jobs. At the same time, both retail and institutional investors can benefit from investing, whether they do so directly in securities such as stocks, bonds, mutual funds, ETFs (exchange traded funds) or trust units, or indirectly, through money market funds or derivative products such as equity options.

### The Primary Market: Initial Public Offering (IPO)

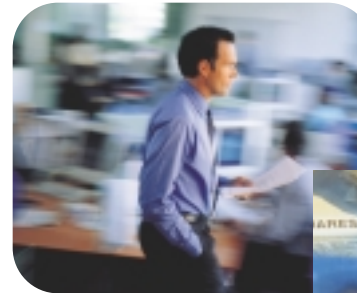
An IPO refers to the first issue of shares a company makes available to the general public. It is a one-time transaction between a company and its shareholders. When a Canadian company decides to sell shares to the public in order to raise capital, otherwise known as “listing”, it first solicits the help of an investment dealer. The investment dealer advises the company on the number of shares to offer and at what price, and assists the company in promoting the share. This sale of new shares takes place in what is called the “Primary Market.”

Companies that want to list their shares on an exchange must meet stringent financial, public distribution and management standards set by the exchange. After these standards are met, companies are listed on the exchange and shares are available to the general public.

### The Secondary Market

After a company launches its IPO, shares are bought and sold in what is called the “Secondary Market.” In Canada, senior equities trade on Toronto Stock Exchange, while junior equities trade on TSX Venture Exchange. Unlisted shares are traded “Over-the-Counter”, in a dealer market. It is in these markets that investors may buy and sell shares.

The price of securities trading in the Secondary Market may fluctuate for a number of reasons. For example, if the supply of a stock is greater than the demand from investors, the market price for that stock will likely drop. Financial news and world events can also affect the prices of shares and the secondary market as a whole. Trading and market information such as volume, opening and closing prices, bid and ask spreads and intra-day high and low prices are regularly reported in the print and electronic media.



### Bond Market

Bonds are not traded on an exchange, but sold through investment dealers in an OTC environment, such as CanDeal. The Canadian secondary debt market is comprised of government and corporate debt issues with maturities ranging from one year to perpetuity, although those starting with maturities of more than 20 years are not common. Issues that have remaining terms of more than 12 years are usually considered to form the long-term market.

### Derivatives

Derivatives are financial instruments whose value is a function of the price of another asset. In Canada, the Montreal Exchange, Canada’s oldest exchange, facilitates all equity, index and interest rate based derivatives trading, while the Winnipeg Commodity Exchange facilitates all of the agricultural futures and options trading. Both offer individual and institutional investors a wide range of derivative products.

While securities may vary with risk and return, all securities fall under these main categories:

**Equities**  
**Debt Securities**  
**Investment Funds**  
**Exchange Traded Funds (ETFs)**  
**Units and Trusts**  
**Rights and Warrants**  
**Derivatives**



# Investing

## Equities

Common and preferred shares, the two main types of equities, represent partial ownership of a company. The key difference between the two is in the holder's privileges. Common shares generally carry voting rights, whereas preferred shares entitle holders to dividends but not necessarily voting rights. In the event of bankruptcy, preferred shareholders have a claim to company assets ahead of common shareholders.

Most equities can be bought on margin and sold short. Margin refers to credit extended to the investor by the investment dealer with whom they invest. Short selling occurs when investors sell securities they do not own. A short seller believes the price of the security will drop, with the intention to buy it back at a lower price.

### Types of Common Shares

Common shares are generally classified in one of three ways:

**Blue Chip Shares** are usually issued by large, well-established companies. They are considered high quality and typically low-risk, and often have a record of continuous dividend payments.

**Growth Shares** are normally considered more risky than blue chip shares. They typically have the potential for capital gains rather than income, usually do not pay dividends, and are issued by companies generally considered to have potential for profitability and rapid growth.

**Penny Shares** present a much higher degree of risk than blue chip or growth shares, but the returns can often be significant if the company becomes successful. They are often issued by newly formed companies and are characterized by lower-priced shares that usually trade for under \$1. Only in rare cases do penny shares offer dividends.

Most equities are traded on a stock exchange. In Canada, all equities trade on Toronto Stock Exchange, TSX Venture Exchange, or Over-the-Counter (OTC).

## Debt Securities

The most common form of debt securities are bonds. Bonds represent a loan of funds by the investor to an organization seeking capital, usually corporations or the government. By purchasing bonds, an investor becomes a creditor to the bond issuer. Holders of debt securities have a higher claim on assets than that of shareholders. The bondholder, however, does not share in the profits if a company does well—he or she is entitled only to the principal plus interest. When purchasing a bond, the interest rate, sometimes known as the coupon rate, is always specified along with the term to maturity.

Similar to bonds, debentures represent a non-secured claim to the assets of a company, and therefore are more risky. Some debentures trade on Toronto Stock Exchange.

Treasury bills (T-bills) are debt securities issued by the federal government and some provincial governments. T-bills generally have a time to maturity of less than one year, and are bought and sold by investment dealers and banks.

Guaranteed Investment Certificates (GICs) are deposit securities generally issued by financial institutions and usually pay fixed rates of return, although returns can be based on a benchmark, such as the S&P/TSX 60 Index.

## Investment Funds

Mutual funds are the most common type of investment fund. When you invest in a mutual fund, you are essentially pooling your money with that of other investors. A professional money manager uses that money to buy many different securities. These securities form the mutual fund's investment portfolio. As an investor, you are a part owner of this basket of securities.

Mutual funds can be open ended, with shares being bought and sold continuously, or closed-ended, meaning only a finite amount of shares are issued, and shares are not issued and redeemed on an ongoing basis. Closed-ended funds may trade on an exchange.

Segregated funds, offered by mutual fund and life insurance companies, are similar to mutual funds but offer a limited guarantee, often protecting part of the original investment.

Labour-sponsored funds are a type of investment fund structured similarly to a mutual fund, but with a specific mandate to invest in small- and medium-sized Canadian businesses. To encourage this mandate, both the federal and provincial governments offer tax credits to investors who invest in these funds. Like segregated funds, labour-sponsored funds do not trade on an exchange.

## Exchange Traded Funds (ETFs)

Exchange Traded Funds, commonly known as ETFs, allow an investor to buy an entire basket of stocks through a single security that tracks and matches the returns of a stock market index. ETFs are considered to be a special type of index mutual fund, but they are listed on an exchange and trade like a stock. ETFs typically have lower costs than conventional mutual funds and are generally more tax efficient. ETFs are priced intraday, and can be bought on margin and sold short.

## Units and Trusts

Limited partnership units represent ownership in a partnership between a manager and those with investment capital. Liability is limited to the amount of money invested, should the company go bankrupt.

Trust units represent equity investments in the net assets and net income of operating businesses. These securities are generally set up to invest in assets such as real property, royalties or income.

Limited Partnership Units and Trust Units may list on a stock exchange.

## Rights and Warrants

As the name suggests, rights provide the common shareholder with the "right" to buy additional shares at a specified price for a specified time. Warrants also provide the holder with the same right. Rights generally have a shorter time to expiry, whereas warrants are usually issued along with a new issue, serving as an incentive to invest in the issuing company.



## Derivatives

As the name implies, derivative contracts derive their value from the performance of an underlying security. In their most basic form, a derivative contract represents the right to buy or sell a security at a specified price. Derivatives are generally used as a hedging tool to guard against market fluctuations.

The features of derivative contracts, such as size, purchase or sale price and expiry date, are all predetermined. In Canada, all derivative contracts trade on the Montreal Exchange, Winnipeg Commodity Exchange or Over-the-Counter.

### Two common types of derivatives are:

**Futures** A futures contract is an agreement to buy or sell an underlying asset in the future, at a pre-determined price. The buyer in this transaction is obliged to take delivery of a specific quantity of an underlying asset at a specific date and price determined at the time of the transaction. Conversely, the seller agrees to deliver a specific quantity of an underlying asset at a specific date and price determined at the time of the transaction.

**Options** An option contract is an agreement between two parties for a specified time period (up to the expiry date), which gives the holder the right, but not the obligation, to buy or sell a specified number of shares, at a pre-determined price (the exercise or strike price). Options can be bought and sold just like shares.

There are two types of options:

**Call** A call option gives its holder the right, but not the obligation, to purchase a specific quantity of an underlying asset, at a given price (strike price) for a specified time period (expiration date). In order to obtain that right, the holder must pay a premium to the seller. The writer (the seller of the call option) has the obligation to sell a specific quantity of an underlying asset (such as shares in a company, for example) at the strike price indicated, if the holder exercises his right. Against this obligation, the writer receives the premium paid by the buyer.

**Put** A put option gives the holder the right, but not the obligation, to sell a specific quantity of an underlying asset, at a given price (strike price), by a specific date (the expiration date). In order to obtain this right, the holder must pay a premium to the buyer. The buyer has the obligation to purchase a specific quantity of the underlying asset at the strike price indicated, if the writer (holder) exercises his right. Against this obligation, the writer receives the premium paid by the buyer.

## Characteristics of Investing

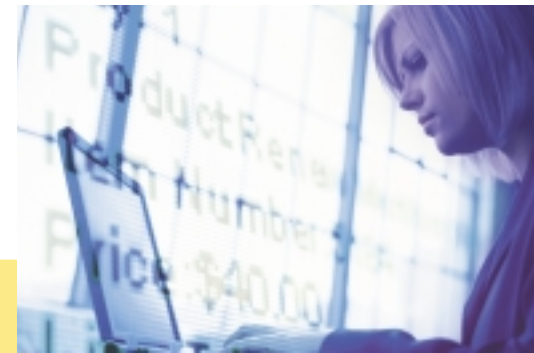
Before deciding to invest in a particular security, you should understand the risks. An investment advisor or financial planner can provide you with more information to help determine your risk-tolerance level.

**Risk** is the possibility that you could lose some, all, or more than your principal investment, or that you could earn less return from the investment than you expected. Lower risk investments include government T-bills and Canada Savings Bonds. At the higher end of the risk spectrum are investments such as futures and shares of junior venture companies. Bonds, equities, ETFs and mutual funds have a wide range of risk profiles.

**Expected Return** refers to the amount of interest, dividends or capital gains that you expect to receive from your investment. (Actual returns may, of course, be quite different.) As noted before, there is a direct correlation between expected return and risk, that being the higher the expected return, the greater the risk.

**Marketability** (or 'liquidity') refers to whether you can sell or redeem your investment quickly at or near the current market price. Term deposits are an example of an illiquid investment, since you generally can't withdraw your money before the end of the term without paying a significant penalty. Many other investments, such as mutual funds or listed securities, are very marketable because they can be quickly sold or redeemed on short notice and at low cost. Marketability is an important factor to be considered when selecting your investments.

For more information on the basics of investing, visit the Investor e-ducation Fund's website [www.investorED.ca](http://www.investorED.ca)



## Investing Concepts

### Setting Objectives

Before investing, you should think about how each investment you make will affect your other financial goals and decisions. Professional advisors and financial planners can help you better examine your knowledge of financial markets, your financial assets, your tolerance for risk, the amount of money you have to invest, and your investment goals and aims.

Asking questions is part of taking a big-picture approach to all of your financial decisions. A big-picture approach will help you determine your goals and how long it may take to reach those goals. And it will also encourage you to consider the consequences of your investment decisions. These decisions should be made within the context of a financial plan that is revisited regularly. When in doubt about your finances or investing, it is a good idea to get professional advice.

Qualified financial planners consider their clients' goals, stage in life, personal circumstances and risk tolerance. They make recommendations for growing and preserving wealth, minimizing tax, estate planning, insurance – and more. In some cases, these same planning professionals will be involved in executing the recommendations they make (e.g. selling specific investment products). In other cases, these transactions will be executed separately with other professionals. It is this big-picture approach to meeting financial goals that sets planners apart from all other financial advisors.

There are many designations that distinguish the various services financial professionals are qualified to deliver. For example, for financial planning the CFP™ or Certified Financial Planner™ designation ensures a professional who has met the highest standards in education, examination, experience and ethics relating to financial planning.



Finding the right financial planner to serve your particular needs will take some legwork and investigation. Interview more than one advisor or planner and talk to other investors for possible references.



For more information on financial planning and how to find help, visit the Financial Planners Standards Council website at [www.cfp-ca.org](http://www.cfp-ca.org)

**In order to begin trading, investors need to open an account with a brokerage firm. A brokerage firm is a registered dealer who buys and sells securities from their own inventory. The term broker and dealer are interchangeable.**

# trading

## Opening an Account

There are two basic types of trading accounts: cash accounts and margin accounts.

**A Cash Account** is a basic account through which an investor can buy and sell securities. When an investor initiates a trade, the investor is expected to make full payment on or before the settlement date, which is generally three business days after the transaction date.

**A Margin Account** utilizes a line of credit granted by the brokerage firm. Investors can leverage the investment, using borrowed funds by paying only part of the investment up front, the balance being paid by the brokerage firm. In margin accounts, the shares are held by the broker as collateral for the loan. To trade derivative products, such as equity options, investors need a separate account.

There are two types of brokerage firms: Discount and Full-service.

Investors who are comfortable with making their own trading decisions may choose a **Discount Broker**. A discount broker typically charges less commission, but does not offer investment advice. **Full-service Brokers** charge more commission, but provide investment advice, analyze financial reports, and publish research on companies. Commissions vary depending on the broker and the value of the trade but are normally charged as a percentage of the trade.

Before you place an order, there are several decisions to make. You must decide which security or securities you want to purchase based on your investment objectives. There are three basic categories of investment products or assets: equity investments, debt investments, and cash or cash equivalents. The combination of these three types of products in a portfolio is called the asset mix. The asset mix you choose will be important in establishing the overall risk and the expected returns.

The number of shares or units you purchase will depend on how much money you are willing to spend. Shares are normally, but not necessarily, purchased in board lots. (For example, shares trading over \$1.00 are sold in a board lot of 100 shares.) An equity options contract also represents a board lot of the underlying equity. Units, such as mutual funds or trust units, are associated with a certain dollar amount, depending on the investment. Investors will want to consider the maximum price they are willing to pay, and take into account the current market price.

Next, you will have to decide what type of order to place. For an equity order, you have choices such as:

**Day Order** – only valid for the day the order was placed with your broker.

**At-the-Market Order** – specifies a number of shares to be bought or sold at the best available price at the time of the trade.

**Limit Order** – allows you to buy or sell a specific stock at a specified maximum or minimum price.

**Stop Loss** – an order placed to buy or sell a specific number of shares, at a specific price (or better) after a given stop price has been reached or passed.

## How to Find a Broker

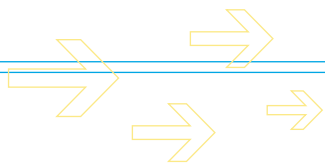
First, decide if you want a discount broker or a full-service broker; there is plenty of choice for each category in Canada. If you want to find an individual investment advisor with whom to develop your portfolio, you could speak to friends or family who have experience working with brokers, or you could contact individual brokerage firms. If you are using a financial planner, he or she should be able to recommend one.

To be registered to sell securities in Canada, brokers must have passed:

- The Canadian Securities Course;
- An exam on rules and regulations, conduct and ethics;
- A brokerage firm training course;
- An advanced course in financial planning within two and a half years of being licensed.

To trade equity options and other derivative products, brokers must also meet further specific requirements.





## Financial Information and How to Read It

### Newspapers

Each security trading on Toronto Stock Exchange, TSX Venture Exchange, the Montreal Exchange and Over-the-Counter has a one to three letter symbol that identifies it to the public. The financial section of any newspaper will contain up to date information on most securities. Information such as closing prices, intra-day high and low prices, and interest and exchange rates are available on a variety of securities, including equities, options, mutual funds, ETFs, and trust units. Other information is also available on financial websites such as [www.tsx.com](http://www.tsx.com) and [www.me.org](http://www.me.org)

### On-line Research

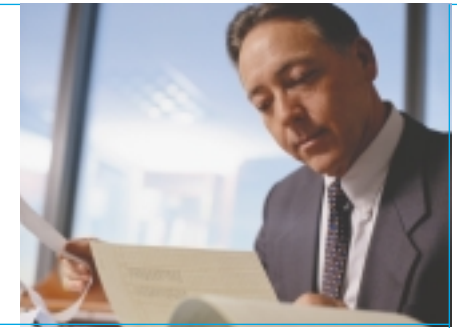
The Internet can be an invaluable tool for investors and offers a wealth of information about financial markets and personal investing.

Investors who venture into the on-line world, however, should keep in mind that the power of the internet is also being exploited by investment con artists. Regulators in Canada and the United States have mounted important new programs to stop cyber-fraud, but there are still many places on the internet for crooks to set up shop.

The law in Canada requires that people in the business of trading or advising in securities be registered (licensed) in each province and territory in which they do business.

Evaluate the information found on-line in the same way as a "hot tip" from a stranger. Exercise healthy skepticism and remember how easy it is for people to disguise their identity on-line. Keep in mind that investment schemers will often talk up projects in remote corners of the globe that can't be easily checked out, or use endless technical jargon that can only be understood by experts.

Securities regulations designed to protect investors from fraud and abuse do apply in cyberspace. The failure of companies, dealers or advisors to comply with regulations is often a red flag highlighting a potential investment scam. Contact securities regulators in the province in which you live to check if an individual or company is registered to trade or offer advice and in which jurisdictions.



### Annual Reports

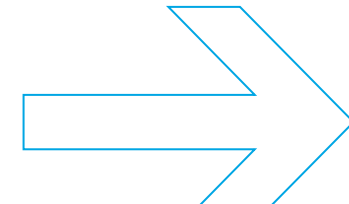
A company's financial fitness is the most important thing to consider. There are many places to find financial information: on-line, books, newspapers, analyst and investment reports, and a company's annual report.

Annual reports are valuable sources of information that can help people make more informed investment decisions. In addition to a company's website, prospectus, and continuous disclosure documents, the annual report (and quarterly reports) offers investors the most comprehensive picture of a company's financial status, describing the company's current activities, future opportunities and how it is performing compared to its competitors.

The first step in making sense of an annual report is to understand the major sections and what kind of information to expect from each. An annual report will contain an overview of the business, financial highlights, and a management discussion and analysis (MD&A).

Financial statements are an essential part of an annual report. The principal components of the financial statements are: the balance sheet; income statement; statement of changes in shareholders' equity; statement of cash flows; and footnotes:

- The balance sheet portrays the financial strength of the company by showing what the company owns and what it owes on a certain date. It can be thought of as a snapshot since it states a financial position as at the end of the statement period;
- The income statement, on the other hand, is like an entire movie since it reports on how the company performed during the period and shows whether operations have resulted in a profit or loss;
- The statement of changes in shareholders' equity reconciles the activity in the equity section of the balance sheet from period to period. Changes in equity are commonly the result of company profits or losses, dividends, or stock issuances;
- The statement of cash flows reports on the movement of cash by the company for the reporting period;
- The footnotes provide more detailed information on the balance sheet and income statement.



## Making the Trade

Before making a trade, find out the current price of the security. For equities, the bid price is the highest price someone is willing to pay for a specific amount of shares. The ask price is the lowest price at which someone is willing to sell their shares. A broker, or a discount broker, will know current bid and ask prices prior to placing the order.

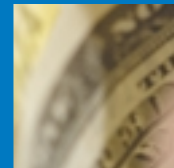
### Placing an Order

**Step 1:** Contact the broker – either discount or full-service – and place an order for shares.

**Step 2:** Buy and sell orders are matched electronically by the exchange's computer system.

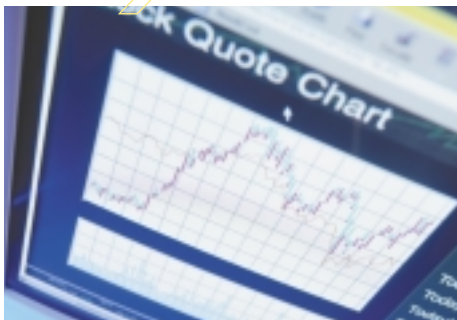
**Step 3:** When a match is found, the broker executes the trade at the specified price and charges a commission. Investors have three business days to pay for the transaction.

All equity trading is monitored by trained Market Regulation Services Inc. staff ([www.regulationservices.com](http://www.regulationservices.com)) (see 'Investor Protection' section) to ensure the market is fair for all investors. TSX Group ([tsx.com](http://tsx.com)) also supplies up-to-date market information to retail and institutional investors.



# investor protection

trading



## Who are the Regulators?

In Canada, the regulation of securities markets is a provincial and territorial responsibility. The Canadian Securities Administrators (CSA) is a forum for the 13 securities regulators of Canada's provinces and territories to coordinate and harmonize regulation of the Canadian capital markets.

Provincial and territorial securities legislation sets out the rules and regulations for the securities industry. The purpose of these regulations is to provide protection for investors from unfair, improper or fraudulent practices; foster fair and efficient capital markets; and promote confidence in the marketplace.

These goals are achieved by:

- mandating full disclosure of information and material important to investment decisions;
- educating investors about the risks and responsibilities of investing;
- authorizing persons who provide investment services to the public and supervising market intermediaries;
- ensuring investors have fair access to market facilities and market price information through regulation that can detect, deter and penalize market manipulation and unfair trading practices;
- reducing the risk of failure of market intermediaries, and, when it cannot be avoided, seeking to reduce the impact on investors and other market participants;
- ensuring market intermediaries are competent, trustworthy and financially sound.

For a listing of securities administrators in Canada, visit the CSA's website [www.csa-acvm.ca](http://www.csa-acvm.ca)

All equity trading activity in Canada is monitored by Market Regulation Services Inc (RS). RS was created as a joint initiative of TSX Group and the Investment Dealers Association of Canada (IDA). The mandate of RS is to foster investor confidence in the Canadian capital markets and to safeguard investor protection through the administration, interpretation and enforcement of a common set of equity trading rules consistently in all markets in Canada.

The Regulation Division of the Montreal Exchange monitors trading activity in the derivatives market. The Regulation Division was created to ensure separation of the for-profit activities of the Montreal Exchange and its role as a self-regulatory organization (SRO).

The IDA is the Canadian investment industry's national trade association and largest SRO. One of the primary functions of the IDA is to regulate the conduct of member firms; for example, ensuring that brokers deal fairly with their clients. The IDA, in partnership with the Canadian Banking Ombudsman (CBO), the Investment Funds Institute of Canada (IFIC), and the Mutual Fund Dealers Association of Canada (MFDA), operates the Ombudsman for Banking Services and Investments (OBSI) where investors can call to ask questions and register complaints about their dealings with brokers. The Regulation Division of the Montreal Exchange plays a similar role relative to the conduct of participant firms and can also receive, directly from clients, requests for information or deal with any complaints they may have.

Each exchange has set minimum public distribution and listing requirements to help provide a liquid market and maintain a level of market integrity. TSX Group has contracted with RS to develop and enforce trading rules over and above the rules administered by the Ontario Securities Commission and actively promotes the protection of investors and the public interest.

## Disclosure Standards

One of the ways that the industry ensures a level playing field for all investors is through disclosure standards. A Listed Company is required to inform the public if there has been any significant, material change in its affairs that could affect the market value of its stock. Typically, companies do this through a press release issued on national newswires. This disclosure helps ensure that all investors have access to new information in a timely manner.

Company information can also be found on SEDAR (System for Electronic Document Analysis and Retrieval), an online database of documents filed with securities regulators which provides information on all publicly traded companies in Canada. SEDAR profiles more than 6500 companies and mutual funds and is available free of charge to the public at [www.sedar.com](http://www.sedar.com)

# investor protection

# glossary

**Auction Market:** A market where buyers and sellers are brought together to trade with each other and prices are set by supply and demand. Toronto Stock Exchange and TSX Venture Exchange are examples of auction markets.

**Arbitrage:** The simultaneous purchase of a security on one exchange and sale of the same security or an equivalent of that security on the same or another exchange which can result in a profit.

**Assets:** Everything a company or person owns or is owed, such as money, securities, equipment and buildings. Assets can be intangible (goodwill) or tangible (physical).

**Ask Price:** The lowest price anyone will accept to sell a stock.

**At-the-Market Order:** An order to buy or sell stock immediately at the best price available.

**Bear Market:** A market in which stock prices are falling.

**Bid Price:** The highest price anyone will pay to buy a stock.

**Blue Chip Shares:** A security issued by a well-established, financially-sound, and stable company that has demonstrated its ability to pay dividends.

**Board Lot:** A regular trading unit. The board lot size of a stock on Toronto Stock Exchange and TSX Venture Exchange could be 1000, 500, or 100 shares, depending on the price of the stock. For stocks trading at over \$1.00 in value, the board lot is 100 shares. Generally, an investor buying or selling a board lot pays less commission than an investor buying or selling an odd lot – an amount not equal to a board lot.

**Bond:** A loan of funds to an organization seeking capital. The investor becomes a creditor to the issuer, and has a higher claim to assets than a shareholder.

**Broker/Dealer:** An individual or firm in the business of buying and selling securities on behalf of clients, sometimes operating as a broker and a dealer, depending on the transaction.

**Bull Market:** A market in which stock prices are rising.

**Call:** An option that gives the holder the right, but not the obligation, to buy a specified amount of a certain stock at a specified price within a specified time.

**Capital:** Money, assets, securities, and inventory.

**Capital Market:** A market that brings together users and providers of capital.

**Commission:** The fee charged by investment brokers for trades done on behalf of clients.

**Common Shares:** Securities that represent part ownership in a company and generally carry voting privileges.

**Day Order:** An order that is valid only for the day it is entered.

**Dealer Market:** A securities market in which transactions are between principals acting as dealers for their own accounts rather than between brokers acting as dealers for buyers and sellers.

**Debenture:** An unsecured debt security representing a claim to the assets of the borrowing institution, backed only by the credit worthiness of that institution.

**Derivative:** A financial instrument whose value is a function of the price of another asset.

**Dividend:** A payment, either in the form of cash or stock, made to the owner of a stock by the issuer of the stock.

**Equities:** Common and preferred shares, which represent a share in the ownership of a company.

## Exchange Traded Funds (ETFs):

Investment products that allow an investor to buy an entire basket of stocks through a single security which tracks and matches the returns of a stock market index.

**Expected Return:** The total profit expected from an investment. Returns may be in the form of income, interest, dividends, or as capital gains.

**Future:** A financial contract, or agreement, to buy or sell financial instruments or physical commodities for future delivery.

**Going Public:** The process of selling shares to the public. When a company "goes public," it is the first time the general public has the ability to buy shares. Otherwise known as an initial public offering (IPO).

**Growth Shares:** Shares in a company whose earnings are expected to grow at an above average rate relative to the market. A growth stock usually has a high P/E ratio and does not have a track record of paying a dividend.

**Hedge:** A trade designed to reduce risk arising from another position held by the investor.

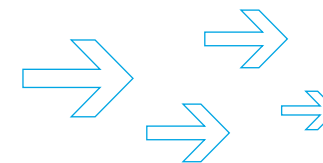
**High Risk Security:** Shares issued by newly formed companies and/or those without a proven financial track record.

**Index:** A statistical compilation that represents the current market value of a group of securities.

**Initial Public Offering (IPO):** A company's first issue of shares to the general public.

**Insider:** A director or senior officer of a company, its parent and subsidiaries, and anyone owning more than 10 percent of the voting shares in a company.

**Insider Trading:** Legal insider trading occurs when stock transactions are made by insiders of a company and reported to the appropriate securities



commissions. Illegal insider trading occurs when trades are made by anyone with knowledge of material information that is not public knowledge.

**Leverage:** Seeking magnified returns on an investment by using borrowed funds or margin accounts.

**Limit Order:** An order to buy or sell stock at a specified price.

**Market Capitalization:** A measure of a company's size based on the total dollar value of all outstanding shares. It is calculated by multiplying the number of shares times the current market price. This term is often referred to as market cap.

**Market Maker:** A registered trader who provides continuous bid and ask prices in order to maintain liquidity for a particular equity or derivative instrument.

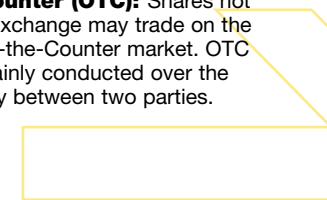
**Material Change:** A change in a company's affairs that is expected to have a significant effect on the market value of its securities.

**Minimum Guaranteed Fill (MGF):** Registered traders guarantee a complete fill of orders placed by investors in most stocks (up to a certain amount of shares) at the current market price.

**Money Market:** The securities market dealing in short-term debt and monetary instruments. Money market instruments are forms of debt that mature in less than one year and are very liquid.

**Option:** A financial contract sold by one party to another that offers the buyer the right, but not the obligation, to buy (call) or sell (put) a security at an agreed-upon price during a certain period of time or on a specific date.

**Over-the-Counter (OTC):** Shares not listed on an exchange may trade on the OTC, or Over-the-Counter market. OTC trades are mainly conducted over the phone directly between two parties.



## glossary continued

### **Participating Organizations:**

Investment dealers (companies) who are granted access to trade on a particular stock exchange.

**Penny Shares:** A stock that sells for less than \$1 a share, rarely offers dividends, and is usually issued by newly formed companies. Penny shares present a much higher degree of risk than growth or blue chip stocks.

**Preferred Shares:** Shares that may carry dividends that must be paid before any dividends are paid to common shareholders. These generally do not come with voting rights.

**Primary Market:** The market in which investors have the first opportunity to buy a newly issued security.

**Put:** An option which gives the holder the right, but not the obligation, to sell a fixed amount of a certain stock at a specified price within a specified time.

**Registered Representative (Trader):** An individual employed by an investment dealer who provides investment advice to clients and executes trades on their behalf.

**Right:** A privilege granted to a company's existing common shareholders to acquire additional common shares directly from the company at a stated price.

**Risk:** The chance that an investment's actual return will be different than expected. This includes the possibility of losing some or all of the original investment.

**Risk Tolerance:** An investor's ability to accept the possibility of losing capital.

**Secondary Market:** The market in which the buying and selling is done between retail and institutional investors. Shares on this market have by definition already gone through the Primary Market for Initial Public Offerings (IPO).

### **Self-Regulatory Organization (SRO):**

An organization that mandates the enforcement of fair, ethical and efficient practices in the securities industry.

**Short Selling:** The sale of a security which the seller does not own.

**Small Cap:** Companies that have smaller market capitalization, typically are less established, often faster growing and usually more volatile.

**Stop Limit Order:** An order placed with a broker to buy or sell at a specified price (or better) after a given stop price has been reached or passed.

**Stop Loss Order:** An order placed with a broker to buy or sell when a certain price is reached. It is designed to limit an investor's loss (or lock in profit) on a security position. This is sometimes called a stop market order.

**Strike Price:** Also known as the exercise price. It is the price at which the underlying asset may be purchased (for a call option) or sold (for a put option).

**Ticker:** An electronic record of trading activity.

**Trust Unit:** Trust units represent interests in the net assets and net income of trust companies. These trusts are generally set up to invest in assets such as real property (real estate investment trusts), royalties from oil and gas production (royalty trusts) or the income generated by one or more businesses (income trusts). Many are designed to offer tax advantages to investors.

**Warrant:** A privilege giving the holder the right to purchase securities at a stipulated price within a specified time limit.

**Writing an Option:** Selling an option.

**Yield:** The return provided by an instrument over a certain period.

## About the Sponsors

The creation of this document would not be possible without the generous support of the following organizations:



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### The Derivatives Institute

The Derivatives Institute is a fully integrated educational service created by the Montreal Exchange in April 2001 to provide investors with the training necessary to understand and use derivative instruments.

The Institute's mission is to inform, educate and provide specialized training to the general public and finance professionals on the use and value of derivatives in portfolio and risk management.

The Institute offers a full range of high-quality courses, workshops and seminars, both in class and online. The courses use interactive teaching methods to provide practical and useful education in a stimulating and engaging environment. Courses are available at all levels, ranging from introductory to advanced.

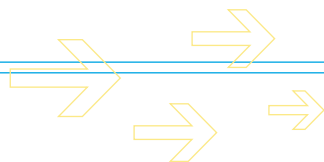
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### Financial Planners Standards Council (FPSC)

Incorporated on November 10, 1995 as a not-for-profit organization, FPSC benefits the public and the financial planning profession by establishing and enforcing uniform professional standards for financial planners who choose to earn the internationally recognized CFP™ designation. These standards include requirements in areas of education, examination, experience and ethics, known collectively as the 4Es of professionalism.

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## Investor e-education Fund

The Investor e-education Fund was established by the Ontario Securities Commission (OSC) in 2000 to develop and support initiatives that educate investors.

These initiatives range from programs that introduce young children to the concepts of savings and personal finance right through to initiatives dealing with the markets, market regulation, investing and retirement planning for adults.

The Investor e-education Fund is dedicated to providing investors with easy-to-use, relevant and reliable financial information. Its website, **www.investorED.ca**, offers unbiased financial information consumers can trust.



Canadian Foundation  for Investor Education

## Canadian Foundation for Investor Education

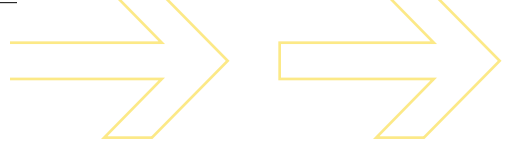
The Canadian Foundation for Investor Education is a national, educational charitable organization dedicated to increasing interest, knowledge and understanding of issues important to Canadian investors and capital markets.

The Foundation seeks to create a forum for the exchange of ideas and information, bringing together experts, practitioners and the investing public to develop a dialogue that will assist investors distill greater meaning from these issues. CFIE also seeks to advance the education of investors and others interested in Canada's capital markets through direct dialogue, informed debate, publications, select educational grants, and commissioned research. The achievement of this ambition will ensure that Canadian investors have the information they need to be informed, confident participants in Canada's capital markets.

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