

Financially Speaking

With Trisha Arndt, CFP®

The ABC's of Stocks

My oldest child has entered the second grade, which I'm learning is a big transition. In second grade the kids move to the "big" school, get their own lockers and, to my surprise, are introduced to assignment notebooks and daily homework assignments.

Parent's all know that second grade homework assignments really amount to assignments for both the child and the parent(s). While the child has to do the work, that work often involves reading to a parent or some other type of interactive activity. The result is that I find myself revisiting very basic academic concepts that I have taken for granted for many years – but that are completely new pieces of information to my seven year old.

I was reading an article about the just wrapped Federal Reserve meeting this morning and it occurred to me that I take much of my knowledge of investing for granted in a very similar way to the concepts taught in primary school. The more I thought about it the more I realized that knowledge of basic investment concepts are taken for granted across the board. Because the people writing about these topics are engrossed in them every day, they forget that their audience isn't – and may not fully understand the information being reported.

In the same way that my eyes glaze over every time a computer tech starts talking gigabytes and fire walls, many people reading my columns may not fully understand what I'm talking about when I wax on about investing. With this in mind, I've decided to correct my error and write a series of columns that get back to basics.

For many, the term investing is synonymous with stocks. While there are many other types of assets that can be invested in, stocks are a good place to start.

Every for-profit company has an owner, or multiple owners. For example, if a sixteen year old starts a lawn-mowing business that young person owns a company. As the business owner she is entitled to any profits that the business generates, responsible for paying any taxes related to them and can determine what to do with whatever is left.

She can choose to take the profits and spend them personally, or she may choose to use a portion of those profits to print flyers and mail them to her neighbors in hopes of gaining more customers. If the business grows and she finds that she can't keep up with demand she may decide to recruit her younger brother as an employee. Or, if things go well enough, she may choose to borrow money to buy a professional grade mower of her own, in which case she has added both an asset and a liability.

If that young entrepreneur were to continue her business after finishing school and expand into snow removal and landscaping it may become a full time endeavor. As her business continues to grow she may elect to incorporate – which means that the business

itself will become its own legal entity able to enter into contracts and responsible for filing its own tax return. She would still be the owner but her ownership interest would now have a new name – stockholder.

Over time she may learn of an opportunity to expand into another city, an opportunity that would require an upfront cash investment that she may not be able to make on her own. To fund the expansion she could offer a portion of the ownership in the company to another person in exchange for a cash infusion in the business. In exchange for that investment the new individual would be given shares of stock which would entitle them rights to a proportionate share of the decision making and profits of the company.

If that company were to grow big enough multiple investors could be brought in, each buying a portion of the company (represented by stock). Eventually the stockholders could vote to become publically traded (i.e. make stocks in the company available for purchase by the general public). Going public could provide a significant cash infusion for expansion and would provide a means of liquidity if the initial stockholders want to sell a portion of their ownership.

Once the stock in the company is publically traded you or I could buy it, just as we can buy shares of Pepsi or Nike today. Each share of stock represents partial ownership of the company and entitles the owner to certain rights, including the rights to help determine how the company is run and share in any profits it makes.

In practice, each stockholder is given an opportunity to vote to elect the Board of Directors to represent their interests in the company's management. The Board of Directors determines what to do with company profits. They may choose to hold onto that money and use it for expansion or they may choose to distribute a portion of those profits to stockholders – better known as dividends.

So you see, when you buy a stock you are actually buying a portion of a business. And while this story may seem far-fetched, it is actually more realistic than you might imagine. Bill Gates started Microsoft in his parent's garage and Nike shoes were first sold out of the trunk of a car. Maybe the next big idea is right here in Verona.

Trisha Arndt, CFP[®], is president of Wealth Strategies of Wisconsin Ltd, 535 Half Mile Road, Ste 5B, Verona, 848-2400. Securities and Advisory Services offered through Commonwealth Financial Network, member FINRA/SIPC, a Registered Investment Adviser