

Mini-case6: Capital Markets, Comparing Weighted Average Returns Versus Money Markets

CONCEPTS IN THIS CASE

capital markets
capital structure
primary market
secondary market
initial public offering (IPO)
NASDAQ

In Chapter 9 you invested your inheritance in the money market for one year; you are now prepared to make a commitment to longer-term instruments. To make the best-informed decision, you have started to study the capital markets alternatives in Canada and the United States.

1. You begin your analysis by defining the following terms (include risk and return factors where appropriate):

- a. Capital markets
- b. TSX
- c. Montreal Exchange
- d. OTC
- e. NASDAQ
- f. Bonds
- g. Stocks
- h. Mortgages
- i. Strips
- j. Agency bonds
- k. Municipal bonds
- l. Corporate bonds
- m. Call and sinking fund provisions
- n. Junk bonds
- o. Common stock
- p. Preferred stock
- q. Investment bankers and underwriting
- r. General obligation municipal bonds
- s. Revenue bonds

2. Your inheritance has grown to \$1.2 million, and you are prepared to make long-term investment decisions. After considering the alternatives in the capital markets, you decide to divide the funds equally among the following financial instruments: Medium-term Canada bonds (2-year maturity), long-term Canada bonds (20-year maturity), NHA MBSs, provincial bonds from your province (10-year maturity), corporate bonds from your company (nonconvertible 20-year maturity), junk bonds (10-year maturity), common stock, and preferred stock. You obtain one-year returns with beginning prices and rates from the first business day of the calendar year, and all ending prices and rates from the last business day of the calendar year, using library resources, the Internet, or other databases. (If you use the Internet, good sites for Canada bills and bonds are: www.royalbank.com, www.cibcwn.com, and www.scotiacapital.com. Good web sites for information on stocks are: www.tsx.ca, www.nasdaq.com, www.international.nasdaq.com, www.cnnfn.com, www.money.cnn.com, www.smartmoney.com, www.amex.com, and www.morningstar.com)

- a. What is the return on the medium-term Canada bonds?
- b. What is the return on the long-term Canada bonds?
- c. What is the return on the NHA MBSs?
- d. What is the return on the provincial bonds?
- e. What is the return on the corporate bonds?
- f. What is the return on the junk bonds?

- g. What is the return on the common stock?
- h. What is the return on the preferred stock?
- i. What is the weighted-average return for the capital market portfolio?
- j. How does this weighted average return compare to the money market portfolio in Chapter 9?

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