

Contents

ABOUT THE SERIES 65 EXAM	XXI
ABOUT THIS BOOK	XXV
ABOUT THE TEST BANK	XXVII
ABOUT THE SECURITIES INSTITUTE OF AMERICA	XXIX
CHAPTER 1	
EQUITY SECURITIES	1
What Is a Security?	1
Equity = Stock	2
Common Stock	2
Corporate Time Line	2
Values of Common Stock	4
Book Value	4
Par Value	5
Rights of Common Stockholders	5
Preemptive Rights	5
Characteristics of a Rights Offering	6
Determining the Value of a Right Cum Rights	7
Determining the Value of a Right Ex Rights	7
Voting	8

Limited Liability	9
Freely Transferable	9
The Transfer Agent	10
The Registrar	10
CUSIP Numbers	11
Inspection of Books and Records	11
Residual Claim to Assets	11
Why Do People Buy Common Stock?	11
Income	11
What Are the Risks of Owning Common Stock?	12
How Does Someone Become a Stockholder?	12
Preferred Stock	14
Features of All Preferred Stock	14
Types of Preferred Stock	15
Callable Preferred	17
Types of Dividends	17
Dividend Distribution	18
Taxation of Dividends	20
Selling Dividends	20
Dividend Disbursement Process	21
Warrants	21
How Do People Get Warrants?	21
American Depositary Receipts (ADRs)/American Depositary Shares (ADSs)	22
Currency Risks	22
Functions of the Custodian Bank Issuing ADRs	23
Real Estate Investment Trusts/REITs	23
Direct Participation Programs and Limited Partnerships	23
Limited Partnerships	24
Tax Reporting for Direct Participation Programs	27
Limited Partnership Analysis	28
Tax Deductions vs. Tax Credits	28
Other Tax Considerations	28
Dissolving a Partnership	29
Pretest	31

CHAPTER 2	
CORPORATE AND MUNICIPAL DEBT SECURITIES	35
Corporate Bonds	35
Types of Bond Issuance	36
Bond Pricing	37
Par Value	38
Discount	38
Premium	38
Corporate Bond Pricing	38
Bond Yields	39
Yield to Maturity: Premium Bond	40
Yield to Maturity: Discount Bond	41
Calculating the Yield to Maturity	41
Calculating the Yield to Call	42
Realized Compound Yield Returns	42
Yield Spreads	43
The Real Interest Rate	43
Bond Maturities	43
Series Issue	44
Types of Corporate Bonds	44
Guaranteed Bonds	46
Convertible Bonds	46
Converting Bonds into Common Stock	47
Parity Price	47
Advantages of Issuing Convertible Bonds	48
Disadvantages of Issuing Convertible Bonds	48
Convertible Bonds and Stock Splits	48
The Trust Indenture Act of 1939	49
Bond Indenture	49
Ratings Considerations	49
Exchange Traded Notes (ETNs)	50
Euro and Yankee Bonds	50
Variable Rate Securities	51
Retiring Corporate Bonds	51

Municipal Bonds	53
Types of Municipal Bonds	54
Taxation of Municipal Bonds	58
Tax-Equivalent Yield	58
Purchasing a Municipal Bond Issued in the State in Which the Investor Resides	59
Triple Tax Free	59
Original Issue Discount (OID) and Secondary Market Discounts	59
Amortization of a Municipal Bond's Premium	60
Bond Swaps	60
Analyzing Municipal Bonds	60
Analyzing General Obligation Bonds	61
Duration	61
Convexity	62
Bond Portfolio Management	62
Pretest	65

CHAPTER 3

GOVERNMENT AND GOVERNMENT AGENCY ISSUES **69**

Series EE Bonds	69
Series HH Bonds	70
Treasury Bills, Notes, and Bonds	70
Purchasing Treasury Bills	70
Treasury Notes	71
Treasury Bonds	71
Treasury Bond and Note Pricing	71
Treasury STRIPs	72
Treasury Receipts	72
Treasury Inflation Protected Securities (TIPS)	73
Agency Issues	74
Government National Mortgage Association (GNMA)	74
Federal National Mortgage Association (FNM)	75
Federal Home Loan Mortgage Corporation (FHLMC)	75
Federal Farm Credit System	76

Collateralized Mortgage Obligation (CMO)	76
CMOs and Interest Rates	76
Types of CMOs	77
Pretest	79

CHAPTER 4

INVESTMENT COMPANIES

Investment Company Philosophy	81
Types of Investment Companies	82
Open End vs. Closed End	83
Diversified vs. Nondiversified	84
Investment Company Registration	85
Registration Requirements	85
Investment Company Components	87
Mutual Fund Distribution	89
Selling Group Member	89
Distribution of No-Load Mutual Fund Shares	90
Distribution of Mutual Fund Shares	90
Mutual Fund Prospectus	90
Characteristics of Open-End Mutual Fund Shares	91
Mutual Fund Investment Objectives	92
Other Types of Funds	94
Bond Funds	94
Valuing Mutual Fund Shares	96
Sales Charges	97
Other Types of Sales Charges	99
Calculating a Mutual Fund's Sales Charge Percentage	99
Finding the Public Offering Price	100
Sales Charge Reductions	100
Breakpoint Schedule	101
Letter of Intent	101
Breakpoint Sales	102
Rights of Accumulation	102

Automatic Reinvestment of Distributions	103
Other Mutual Fund Features	103
Dollar Cost Averaging	104
Mutual Funds Voting Rights	106
Mutual Fund Yields	107
Portfolio Turnover	107
Pretest	109

CHAPTER 5

VARIABLE ANNUITIES AND RETIREMENT PLANS **113**

Annuities	113
Bonus Annuity	115
Equity-Indexed Annuity	116
Annuity Purchase Options	117
Accumulation Units	118
Annuity Units	118
Annuity Payout Options	119
Factors Affecting the Size of the Annuity Payment	120
The Assumed Interest Rate (AIR)	120
Taxation	121
Types of Withdrawals	121
Annuitizing the Contract	121
Sales Charges	122
Investment Management Fees	122
Variable Annuity vs. Mutual Fund	122
Retirement Plans	122
Individual Plans	123
Individual Retirement Accounts (IRAs)	123
Corporate Plans	131
Types of Plans	132
Rolling Over a Pension Plan	134
Employee Stock Options	134
Employee Retirement Income Security Act of 1974 (ERISA)	135

ERISA 404C SAFE HARBOR	136
Life Insurance	137
Pretest	141

CHAPTER 6 FUNDAMENTAL AND TECHNICAL ANALYSIS **145**

Fundamental Analysis	145
Balance Sheet	146
Capitalization	148
Changes in the Balance Sheet	148
The Income Statement	152
Industry Fundamentals	154
Top Down and Bottom Up Analysis	154
Dividend Valuation Models	155
Technical Analysis	155
Market Theories and Indicators	159
Efficient Market Theory	160
Statistical Analysis	161
Market Capitalization	162
Pretest	163

CHAPTER 7 ECONOMIC FUNDAMENTALS **165**

Gross Domestic Product	165
Recession	167
Depression	167
Economic Indicators	167
Schools of Economic Thought	169
Economic Policy	170
Tools of the Federal Reserve Board	170
Reserve Requirement	170
Changing the Discount Rate	171
Federal Open Market Committee	171

Money Supply	172
Disintermediation	172
Moral Suasion	173
Fiscal Policy	173
International Monetary Considerations	175
Pretest	177

CHAPTER 8

RECOMMENDATIONS, PROFESSIONAL CONDUCT, AND TAXATION 181

Professional Conduct by Investment Advisers	182
The Uniform Prudent Investors Act of 1994	182
Fair Dealings with Clients	183
Recommending Mutual Funds	187
Periodic Payment Plans	187
Disclosure of Client Information	188
Borrowing and Lending Money	188
Developing the Client Profile	188
Types of Advisory Clients	189
Investment Objectives	194
Capital Asset Pricing Model (CAPM)	196
Risk vs. Reward	196
Alpha	198
Beta	198
Expected Return	199
Time Value of Money	200
Weighted Returns	202
Modern Portfolio Theory	204
Predicting Portfolio Income	204
Tax Structure	206
Investment Taxation	207
Calculating Gains and Losses	207
Cost Base of Multiple Purchases	208
Deducting Capital Losses	209

Wash Sales	209
Taxation of Interest Income	209
Inherited and Gifted Securities	210
Donating Securities to Charity	210
Trusts	211
Gift Taxes	212
Estate Taxes	213
Withholding Tax	213
Corporate Dividend Exclusion	214
Alternative Minimum Tax (AMT)	214
Taxes on Foreign Securities	214
Pretest	215

CHAPTER 9

SECURITIES INDUSTRY RULES AND REGULATIONS **219**

The Securities Act of 1933	219
The Prospectus	220
The Final Prospectus	220
SEC Disclaimer	221
Misrepresentations	221
The Securities Exchange Act of 1934	221
The Securities Exchange Commission (SEC)	222
Extension of Credit	223
Public Utilities Holding Company Act of 1935	223
Financial Industry Regulatory Authority (FINRA)	223
The Trust Indenture Act of 1939	224
Investment Advisers Act of 1940	224
Investment Company Act of 1940	224
FINRA Member Communications with the Public	225
FINRA Rule 2210 Communications with the Public	226
Corporate Websites	228
Blind Recruiting Ads	229
Generic Advertising	229

Tombstone Ads	229
Testimonials	230
Free Services	231
Misleading Communications	231
Securities Investor Protection Corporation Act of 1970 (SIPC)	231
Net Capital Requirement	232
Customer Coverage	232
Fidelity Bond	233
The Securities Acts Amendments of 1975	233
The Insider Trading and Securities Fraud Enforcement Act of 1988	233
Firewall	234
The Telephone Consumer Protection Act of 1991	234
Exemption from the Telephone Consumer Protection Act of 1991	235
National Securities Market Improvement Act of 1996	235
The Uniform Securities Act	236
Currency Transactions	236
The Patriot Act	237
Pretest	239

CHAPTER 10
TRADING SECURITIES **243**

Types of Orders	243
The Exchanges	247
Priority of Exchange Orders	247
The Role of the Specialist/DMM	247
The Specialist/DMM Acting as a Principal	248
The Specialist/DMM Acting as an Agent	248
Crossing Stock	250
Do Not Reduce (DNR)	251
Adjustments for Stock Splits	251
Stopping Stock	252
Commission House Broker	253
Two-Dollar Broker	253

Registered Traders	253
Super Display Book (SDBK)	253
Short Sales	254
Regulation of Short Sales/Regulation SHO	254
Rule 200 Definitions and Order Marking	254
Rule 203 Security Borrowing and Delivery Requirements	255
Over the Counter/Nasdaq	256
Market Makers	257
Nasdaq Subscription Levels	257
Nasdaq Quotes	258
Nominal Nasdaq Quotes	259
Nasdaq Execution Systems	259
Nasdaq Market Center Execution System (NMCES)	259
Nasdaq Opening Cross	260
Non-Nasdaq OTCBB	260
Pink Sheets	260
Third Market	260
Fourth Market	261
Broker vs. Dealer	261
FINRA 5% Markup Policy	262
Markups/Markdowns when Acting as a Principal	262
Riskless Principal Transactions	263
Proceeds Transactions	264
Arbitrage	264
Pretest	265

CHAPTER 11

OPTIONS

269

Option Classification	269
Option Classes	270
Option Series	270
Bullish vs. Bearish	270
Possible Outcomes for an Option	271

Characteristics of All Options	272
Managing an Option Position	272
Buying Calls	273
Maximum Gain Long Calls	273
Maximum Loss Long Calls	273
Determining the Breakeven for Long Calls	274
Selling Calls	274
Buying Puts	276
Selling Puts	277
Option Premiums	279
In-the-Money Options	279
At-the-Money Options	279
Out-of-the-Money Options	280
Intrinsic Value and Time Value	280
Using Options as a Hedge	281
Long Stock Long Puts/Married Puts	281
Long Stock Short Calls/Covered Calls	283
Short Stock Long Calls	285
Short Stock Short Puts	288
Futures and Forwards	291
Correlation	291
Pretest	293

CHAPTER 12**DEFINITION OF TERMS****297**

Security	297
Person	299
Broker Dealer	300
Agent	301
Issuer	301
Nonissuer	302
Investment Adviser	302
Pension Consultants	302

Form ADV	303
Investment Adviser Representative	304
Solicitor	304
Access Person	304
Institutional Investor	304
Accredited Investor	305
Qualified Purchaser	305
Private Investment Company	306
Offer/Offer to Sell/Offer to Buy	306
Sale/Sell	306
Guarantee/Guaranteed	306
Contumacy	307
Federally Covered Exemption	307
Power of attorney	307
Negotiable Certificate of Deposit	308
Pretest	309

CHAPTER 13 REGISTRATION OF BROKER DEALERS, INVESTMENT ADVISERS, AND AGENTS

315

Registration of Broker Dealers and Agents	315
Changes in an Agent's Employment	319
Mergers and Acquisitions of Firms	319
Renewing Registrations	319
Canadian Firms and Agents	320
Investment Adviser Registration	320
Advertising and Sales Literature	324
Brochure Delivery	325
The Role of the Investment Adviser	325
Additional Compensation for an Investment Adviser	325
Agency Cross Transactions	326
Disclosures by an Investment Adviser	326
Investment Adviser Contracts	328

Additional Roles of Investment Advisers	328
Private Investment Companies/Hedge Funds	328
Fulcrum Fees	329
Wrap Accounts	329
Soft Dollars	329
Pretest	333

CHAPTER 14
SECURITIES REGISTRATION, EXEMPT SECURITIES,
AND EXEMPT TRANSACTIONS **339**

Exempt Securities	339
Securities Registration	340
Exempt Securities/Federally Covered Exemption	343
Exempt Transactions	344
Private Placements/Regulation D Offerings	344
Transactions with Financial Institutions	345
Transactions with Fiduciaries	345
Transactions with Underwriters	345
Unsolicited Orders	346
Transactions in Mortgage-Backed Securities	346
Pledges	346
Offers to Existing Securities Holders	346
Preorganization Certificates	346
Isolated Nonissuer Transactions	347
Nonissuer Transactions	347
Pretest	349

CHAPTER 15
STATE SECURITIES ADMINISTRATOR:
THE UNIFORM SECURITIES ACT **353**

Actions by the State Securities Administrator	353
Cancellation of a Registration	354
Withdrawal of a Registration	355

Actions Against an Issuer of Securities	355
Rule Changes	355
Administrative Orders	355
Interpretive Opinions	356
Administrative Records	357
Investigations	357
Civil and Criminal Penalties	358
Jurisdiction of the State Securities Administrator	358
Administrator's Jurisdiction over Securities Transactions	359
Right of Rescission	361
Statute of Limitations	362
Pretest	363
ANSWER KEYS	369
GLOSSARY OF EXAM TERMS	383
INDEX	449

<http://www.pbookshop.com>

<http://www.pbookshop.com>