

The first module in the series is entitled 'Understanding the Capital Markets'.

Before you invest, Be sure you know what you are investing in and the rules that surround that investment. The topics to be covered in this session include what a capital market is and how it works, a description of the different types of securities, the basic steps to begin investing, what kind of research you should do, and an overview of the rules that exist to protect your investment.

Let's begin...

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.

Organizations such as the 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.

How do capital markets work?

The capital markets include; the Primary Market, the Secondary Market, the Bond Market and Derivatives.

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. 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 the Toronto Stock Exchange, while junior equities trade on the TSX Venture Exchange. Certain shares that are not listed on a stock exchange (often called 'unlisted shares') are traded "Over-the-Counter", in a dealer market. It is in these markets that investors may buy and sell shares.

Bond Market

Bonds are not traded on an exchange, but sold through investment dealers in an Over the Counter environment. The Canadian secondary debt market is comprised of government and corporate bonds 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 be part of the long-term market.

Derivatives

Derivatives are a special kind of financial instrument. Their value is based on the characteristics and value of some other asset, including commodities, bonds, equities or currency. In Canada, the Montreal Exchange facilitates all equity, index and interest rate based derivatives trading. 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.

What types of securities are there?

It is important to remember that the risk and return will vary greatly no matter what the type of security. The greater the potential return, the greater the risk. The main categories of securities are the following:

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

Equities

There are two main types of stock:

- Preferred stock
- Common stock.
- Preferred stock and common stock are also referred to as equity shares or equity securities.

Both common and preferred stock represent partial ownership of a company. The key difference between the two is in the holder's additional 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.

Debt Securities

The most common form of debt securities are bonds. Companies and governments use bonds to raise money. When you buy a bond, you are lending your money to a company or a government for a set period of time. The amount of time you lend the money can be shorter than one year or as many as 30 years. When that time comes to an end, it is called the bond's 'maturity date'. On the maturity date, the company or government that borrowed your money, pays back the money it was loaned.

This amount is called the 'face value' of the bond.

People who own bonds are called 'bondholders'. In return for buying the bond, the bondholders get the face value returned at maturity and also get paid interest at a known amount, sometimes by way of coupons.

There are many different kinds of bonds. For instance, you can buy:

- federal government bonds
- bonds of a government agency (such as the Farm Credit Corporation)
- provincial government bonds
- bonds sold by a city (called municipal bonds)
- bonds sold by corporations.

Note: Savings bonds, such as Canada Savings Bonds, do not work the same way as other government bonds and corporate bonds. You can link to the Canada Savings Bond website from the website link available from the web address you see on the screen.

http://www.csb.gc.ca/eng/bonds_csb.asp

Investment funds

Mutual funds are the most common type of investment fund. When you put your money in a mutual fund along with many other people, it creates a large pool of money that can be invested. The company that runs the mutual fund puts a professional in charge of investing the money. These 'fund managers' decide where to invest the money and manage it for all of the investors. They buy a range of investments depending on the objective of the fund – likely a broader range than you could buy on your own.

You put money into a mutual fund by buying 'units' of the fund. You can only buy mutual funds from people who are trained and licensed to sell them. This can include mutual fund sales representatives, bank employees, life insurers, stockbrokers, and others. Each fund has a unit price. The price will go up if the investments in the fund do well, and you will make money if you sell them. If the investments are not doing well, the price falls. You lose money if you decide to sell your units at that point.

Every mutual fund must have a 'prospectus' to tell investors about the fund. The prospectus describes the fund, its objectives, the kinds of investments it will make, and the fees that will be charged. You will get a copy of the prospectus for a fund when you buy it for the first time.

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 are priced intraday (meaning that they experience price changes throughout the day as they are bought and sold).

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.

Income Trusts

An income trust is an entity that holds an underlying asset or group of assets. Most of the income these assets generate is distributed to unit holders. In contrast, publicly listed companies usually retain and re-invest their earnings, and sometimes pay out a small portion of earnings to their shareholders as dividends.

An income trust structure is formed when, instead of offering its securities directly to the public, an operating entity creates a trust. The trust offers units to the public and uses the proceeds to buy the common shares and high-yield debt of the operating entity. The combination of the

trust's equity and debt holdings allows the income to flow through to unit holders essentially tax-free.

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 stock 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 and options.

What are the steps to begin investing?

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

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. There are individuals who hold themselves out to be financial planners but who do not have the qualifications to give advice; therefore, you need to ask what professional qualifications the person has to give financial planning advice. You can find out more about financial planners and the variety of qualifications they may have in Module 3 of this program.

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.

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.

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 uses 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. *Borrowing money to leverage an investment will increase the risk, and leveraging is not suitable for all investors*

How do I get the investment information I need?

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 and www.m-x.ca

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 where you live to check if an individual or company is registered to trade or offer advice and in which jurisdictions.

TSX.com

TSX Group (tsx.com) supplies up-to-date market information to retail and institutional investors.

SEDAR

The System for Electronic Document Analysis and Retrieval (SEDAR) was developed in Canada for the Canadian Securities Administrators (CSA) and makes available Canadian securities information collected in the securities filing process such as prospectuses, financial statements and news releases.

The web site (www.sedar.com) provides a listing of filings that became publicly accessible in the SEDAR database as of the most recently completed business day.

Annual Reports

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.

What are the rules and how is my money protected?

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.

Investor Protection

All equity trading is monitored by trained Market Regulation Services Inc. staff (www.rs.ca). Other regulators include the Regulation Division of the Montreal Exchange, the Mutual Fund Dealers Association and the Investment Dealers Association of Canada.

I hope that you have found the presentation both interesting and informative. You can review this information at any time. Now that you have an understanding of the capital markets, you can move on to Module 2 and learn the Basics of Investing. Thank you for watching.