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Understanding the Factors Affecting Share Prices

2 December 2014

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Some basics...

- Two forms of capital: Equity (share) & Liability (debt/loan)
- A share represents some ownership in a company.
- Ownership in a company entitles a shareholder to:
 - Receive dividend (part of the company's profit)
 - Vote on major issues of the company
 - Receive money in case of sale of company/business/assets (e.g. M&A, liquidation)
 - Others

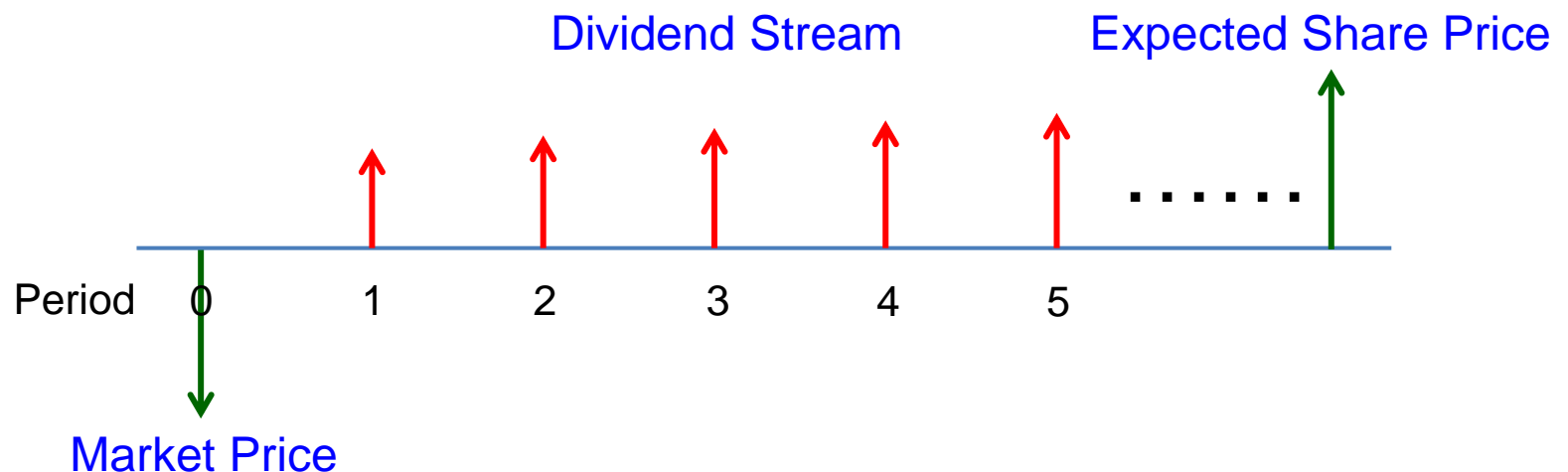
Some basics...

- Shareholders have lower priority claim on a company's assets than lenders:
 - Interest paid before dividend
 - Debts/Loans repaid first in case of company restructuring or liquidation. Shareholders get residual money
- Share price reflects the economic value of these entitlements
- Share price reflects EXPECTED FUTURE



About Share Price...

- Investors estimate the value of dividend stream and expect a future share price



- Share price is driven by estimation of dividend and expected future share price, i.e. “return”

About Share Price...

- Return

$$\text{Single Period Holding Period Return (HPR)} = \frac{CF_1 + (P_1 - P_0)}{P_0}$$

where HPR : Holding Period Return

P_1 : Ending Price

P_0 : Beginning Price

CF_1 : Cash Flow (Dividend) during Period One

Component 1: Income

$$\frac{CF_1}{P_0}$$

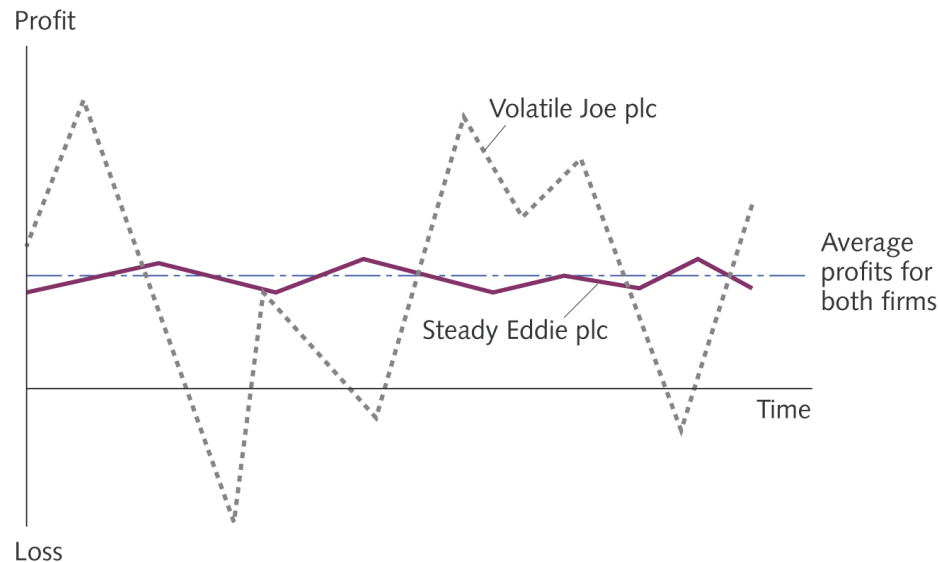
Component 2: Capital Appreciation

$$\frac{(P_1 - P_0)}{P_0}$$

About Share Price...

Risk

- Most investors are risk averse, thus prefer “Steady Eddie” to “Volatile Joe”
- Investors demand higher return for stocks with volatile business performance



About Share Price...

Stock valuation

- Common matrixes: price/earnings ratio (P/E), price/book ratio (P/B)
- P/E: If earnings/per share = \$1, share price = \$12, $P/E = \$12/\$1 = 12x$
- Factors affecting valuation of stock:
 - Business prospects / growth
 - Profitability
 - Size of company
 - Stability and predictability
 - Management quality and corporate governance



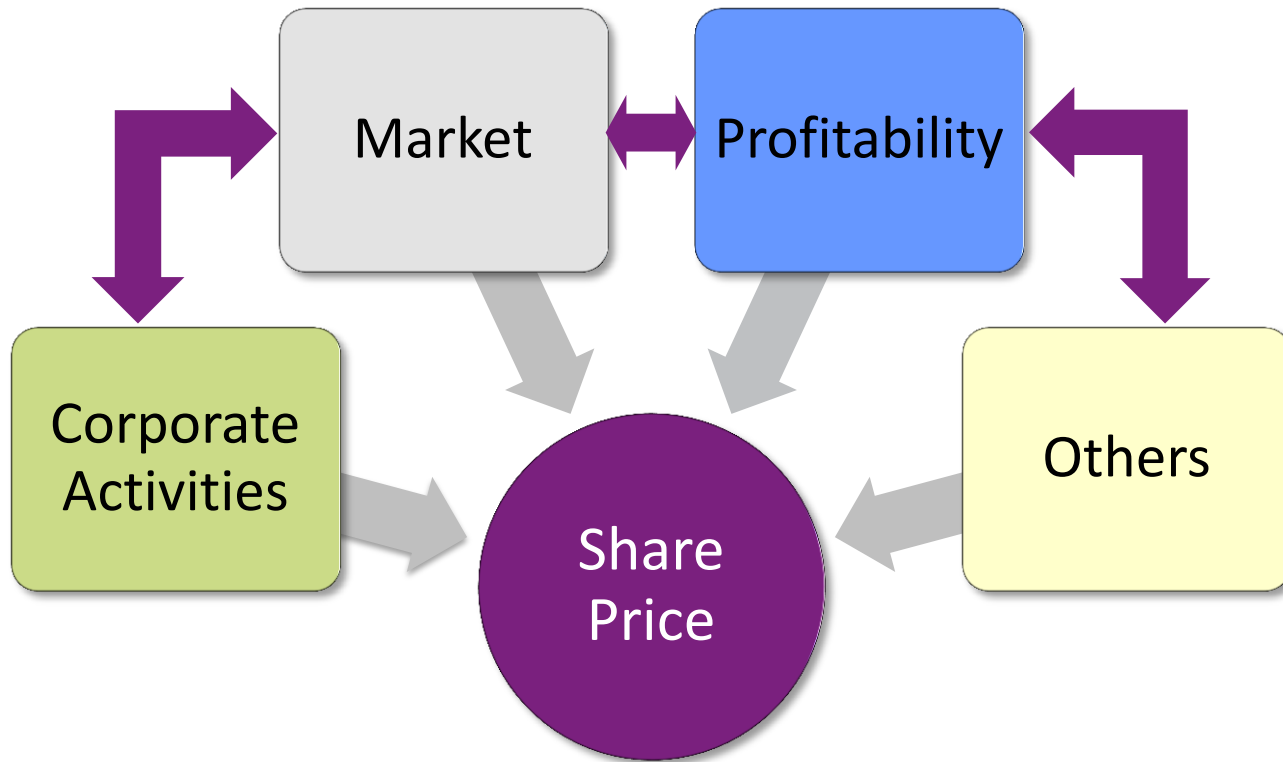
Factors Affecting Share Prices

- Supply vs Demand

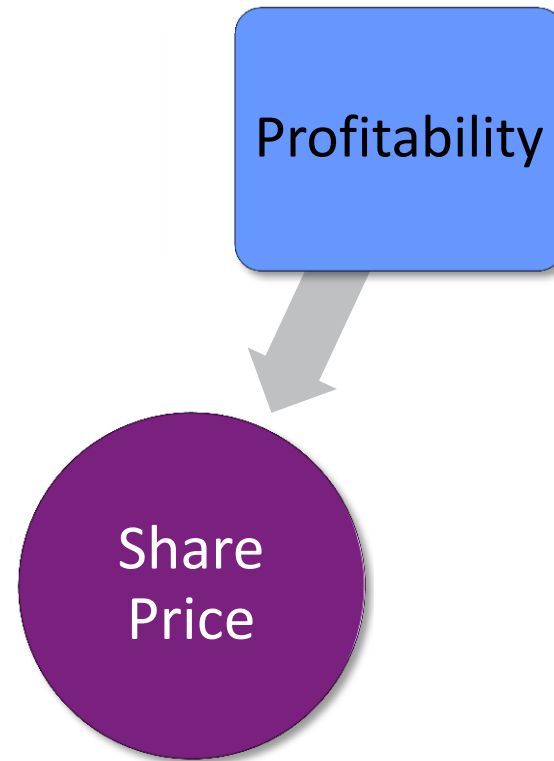
Scenario	share price
buying power < selling power	↓
selling power > buying power	↑

- Why buying power \neq selling power?
 - Different investors have different estimates
 - Different investors require different returns
 - Investor-specific reasons, e.g. liquidity needs

Factors Affecting Share Prices



Factors Affecting Share Prices



Profitability – Company Performance

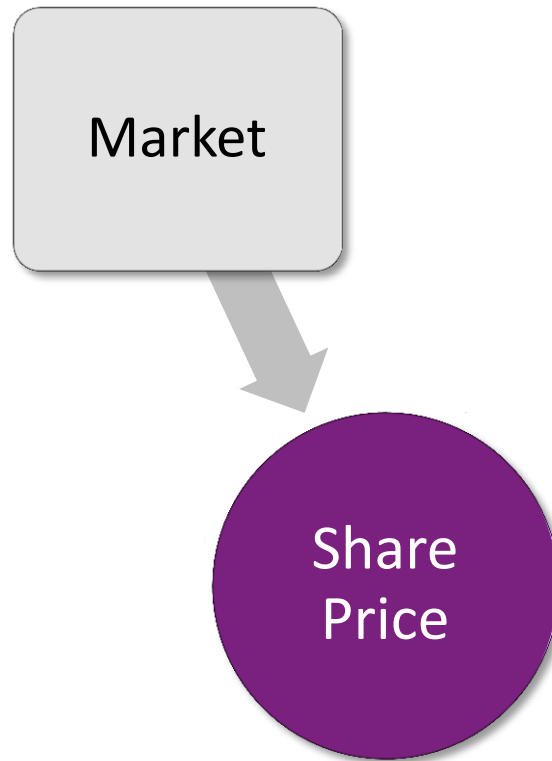
- **Improved Profitability (Sales / Costs)**
- **Competition (Business / Capital Market)**
- Corporate Governance
- Red Flag



Profitability – Macro Factors

- **General Economy / Business Environment**
- Government (**Political** / Legal / Economics)
- **Overall Political Environment**
- Social Changes
- Costs of Input
- **Sector Business Prospects**

Factors Affecting Share Prices



Market – Macro

- Market Liquidity
- **Market Interest Rate**

Market – Intermediaries

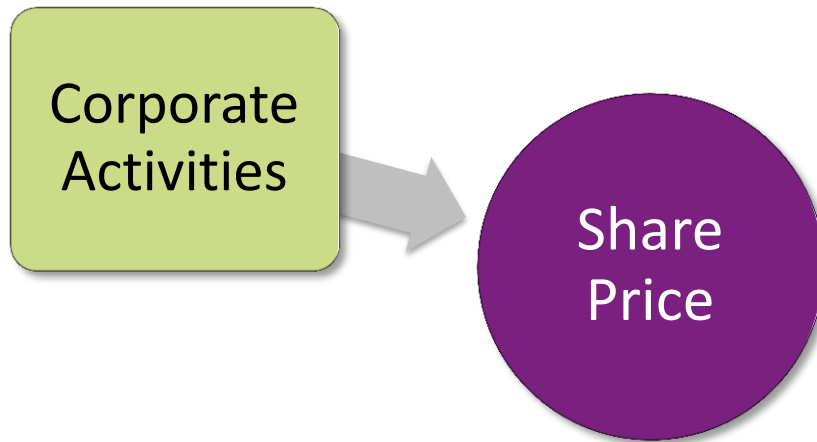
- Addition to / Removal from Stock Index
- Investment rating by research analysts

Market – Investors

- Movements by Substantial Investors
- Market Sentiment
- **Speculation**
- Insider Trading
- Stock Manipulation
- Derivative Products



Factors Affecting Share Prices

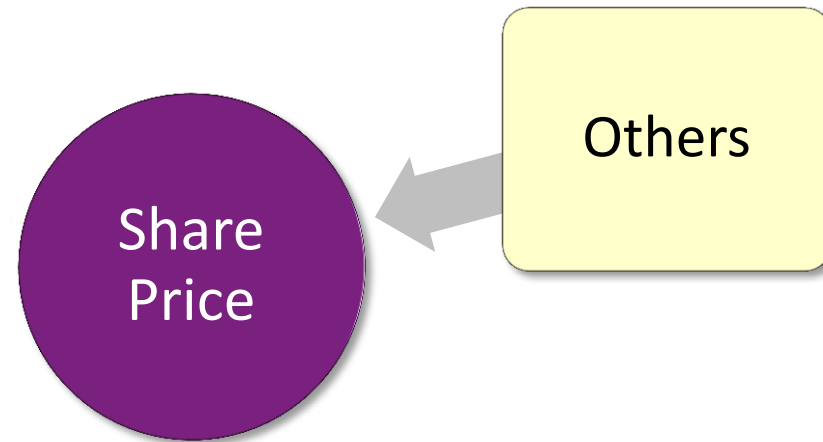


Corporate Activities

- **Unexpected Dividend Payout / Change in Dividend Policy**
- **Ex-dividend**
- **Scrip Dividend / Bonus Share**
- Share Split / Consolidation / Buy-back
- Privatization
- Mergers and Acquisitions
- Spin-offs



Factors Affecting Share Prices



Others

- Natural disasters

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The screenshot displays the IEC website interface. At the top, there is a search bar and navigation links for EN and AAA. Below this is a horizontal menu with categories: 財務策劃, 財富管理, 銀行及信貸, 保險, 投資, 退休, 生活事件與你, and 工具及資源. The main banner features the title "負責任的投資態度" (Responsible Investment Attitude) and a video player showing four men in traditional Chinese attire. Below the banner are four content tiles: "伊斯蘭基金的主要特點" (Key features of Islamic funds), "參與眾籌活動的主要風險" (Main risks of participating in crowdfunding activities), "投資人民幣產品的風險提示" (Risk提示 for investing in RMB products), and "虛擬商品的相關風險" (Related risks of virtual goods). A search bar contains the text "了解市場上金融罪案的慣用欺騙技術。" (Learn about common fraud techniques in financial crimes on the market). Below the search bar are two featured content blocks: "新出版小冊子" (Newly published booklet) and "多媒體創作比賽" (Multimedia creation competition). On the right side, there are social media sharing icons (YouTube, Facebook, etc.) and a "生活事件與你" (Life events and you) section with icons for 學生 (Students), 留學/失業退休 (Study/Unemployment/Retirement), and 認識香港 (Get to know Hong Kong). At the bottom right, there is a "工具及資源" (Tools and resources) section.

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