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Leader: **This week:** Equity Markets

1. Name some ways the equity market performs the price discovery function.

Live pricing – HFT / Entry and exit values for investors (buy/sell prices)
Indexes that reveal general market movement – ASX200, S&P500, NASDAQ
Values companies (Market cap = no. of outstanding shares * share price)
Helps determine the value of newly listed securities – IPO

2. What is market discipline and when does it occur?

Market discipline describes situations in which the behaviour of management is influenced by fluctuations in the share price.
Leads to a decrease in agency cost because management is essentially forced to act in the best interest of the shareholders.
Low share price is bad for management and shareholders alike.

3. What are dark pools, what are they used for and why were they created?

Private exchanges for trading securities that the general public does not know about
The information about a trade is released only after the trade is made
Created so institutional investors could buy/sell large volumes of securities without impacting the security's value.

"The primary advantage of dark pool trading is that institutional investors making large trades can do so without exposure while finding buyers and sellers. This prevents heavy price devaluation, which would otherwise occur. If it were public knowledge, for example, that an investment bank was trying to sell 500,000 shares of a security, the security would almost certainly have decreased in value by the time the bank found buyers for all of their shares. Devaluation has become an increasingly likely risk, and electronic trading platforms are causing prices to respond much more quickly to market pressures. If the new data is reported only after the trade has been executed, however, the news has much less of an impact on the market." – Investopedia.

4. Name 3 of the admission rules for a company's securities.

Must pass assets test or profits test.
Number of shareholders has to be greater than 300 (ASX) non-affiliated.
Company must have a constitution: document that governs the management of the company (most companies make this when they incorporate so it's not a huge problem)

New issues cannot disadvantage existing shareholders – For existing investors, too many shares being issued can lead to share dilution, so it is important that companies do not issue too many new shares.
Free float of 20% (Free float represents the portion of shares of a corporation that are in the hands of public investors as opposed to locked-in shares held by promoters, company officers, controlling-interest investors, or governments) - ASX requires the company to make at least 20% of their shares available to the public when they IPO.
Must lodge a prospectus with ASIC.

5. Given a required return of 9%, growth rate of 6% and a P/E ratio of 12.5, the share price of this company is:
   i. $7.60
   ii. $6.00
   iii. $8.50
   iv. We don't have enough info

We don't have enough info – we don't have the dividend payment

$$P_0 = \frac{D_0(1+g)}{i_r - g}$$

6. Calculate the P/E ratio of a company with $35,500,000 earnings available to ordinary shareholders, 45,000,000 shares outstanding and a share price of $7.60

Earnings per share (E) is calculated by
earnings available to ordinary shareholders / no. of shares outstanding.

First we have to find E
E = 35500000 / 45,000,000
E = 0.7888888888 = 0.789

P/E ratio = Price / E = 7.60 / 0.789 = 9.632446134 = 9.63 (2.d.p)