

Equity Markets, Valuation, and Analysis: An Overview

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INTRODUCTION

The earliest activity resembling a stock market system took place in the late thirteenth century in Antwerp, which served as the commercial center of Belgium. The history of equity markets dates back to the early seventeenth century with the launch of the Amsterdam Exchange. In 1602, the Dutch East India Company (VOC) became the first company to continuously trade. Although the creation of the London Stock Exchange (LSE) was in 1801, restrictions on companies issuing shares in Britain did not occur until 1825, which limited the effectiveness of the LSE. The New York Stock Exchange (NYSE) was formed in 1817 and quickly became the center of U.S. trade. Electronic trading debuted in 1971 with the creation of the NASDAQ market.

World equity markets have grown steadily since the 1980s. For example, world market capitalization of listed companies reached \$79.121 trillion in 2017 from a low of \$2.501 trillion in 1980 (World Bank 2018). During this period, it fluctuated dramatically, declining almost 50 percent during the global financial crisis of 2007–2008. Among the world stock exchanges, 16 have a market capitalization greater than \$1 trillion, such as the NYSE, NASDAQ, LSE, Deutsche Börse, Euronext, and Shanghai Stock Exchange. These 16 exchanges account for 87 percent of global market capitalization. North America leads other regions with a market capitalization of more than \$28 trillion, representing 41 percent of the world total (Visual Capitalist 2016; World Federation of Exchanges 2019).

What is an equity market, and why is it important? An *equity market* is a market in which firms issue stocks to fund their operations. After issuance, investors trade shares on exchanges and over-the-counter (OTC) markets. Equity markets are an important part of a country's economy. Their primary function is to support the

growth of business and industry by channeling funds from savers to firms. These markets not only provide firms with an opportunity to access capital and raise funds to grow their business but also give investors a chance to become shareholders.

Equity markets also serve the role of a common platform for the buyers and sellers of these listed public stocks. They can also include private stocks traded through the OTC market. Common and preferred stocks constitute the two main types of stock. *Common stock* represents residual ownership in a company. *Preferred stock* is a hybrid security that typically lacks voting rights but gives its shareholders a prior claim to receiving dividends before common stockholders. Companies may also create different classes of stocks to customize voting rights. For example, Class A shareholders may have multiple voting rights for each share, while second-class B shares may have only one vote per share.

How are activities of the equity market tracked? Overall, market changes over time can be tracked by using market indices. A *market index* is a weighted average of many stocks, which is computed using the prices of the stocks included in the index. The oldest U.S. stock market index – the Dow Jones Industrial Average (DJIA) – originated in 1885 as the Dow Averages. The DJIA consists of 30 large, influential U.S. companies. Another widely used market index – the Standard & Poor's 500 index – represents 500 large U.S. stocks. Investors can use these stock indices, as well as many others, to follow market trends and compare their portfolio performance.

Equity markets allow investors to buy and sell stocks. An important issue is how investors can determine the underlying value of shares to trade. Is valuation an art or science? Stock valuation is not a simple process. In fact, some contend that stock valuation is more of an art than a science. If so, what is needed to get a reasonable estimate of a stock's intrinsic value?

Valuation and analysis involve several steps. First, investors should have a good understanding of the market and the industry in which a firm operates. Market analysis involves determining the demand for a firm's products by using consumer demographics and trends in the firm's operating sector as well as the firm's competitive position. The purpose of market analysis is to determine the opportunities available regarding developing or improving products and services that would be accepted by a firm's customers. This analysis also provides an avenue for the firm's resource planning. Industry analysis helps investors to explore potential profit opportunities for the firm by analyzing external and internal factors. An expanding industry presents ample opportunity for a firm to improve its position. A declining or contracting industry, however, would force firms to search for opportunities elsewhere. Technological advances, innovation, and changes in regulation could make an industry attractive or unattractive. Industry analysis further helps a firm to understand its position relative to its major competitors in terms of both opportunities and threats.

Second, various ways are available to value a stock. An analyst should have a good understanding of how each valuation technique works and why it can lead to a different valuation.

- *Dividend discount method.* Dividend discount valuation uses the present value of future dividend payments to compute a stock's fundamental value. This model requires estimating the growth patterns for dividends, cost of capital, and the last dividend paid. Some models, such as the Gordon constant growth model, assume

that the historical dividend growth rate continues in the future, whereas others make different assumptions.

- *Free cash flow method.* If a firm does not pay dividends, an alternative valuation technique, called free cash flow valuation, uses a firm's free cash flow, which is the cash flow available in a company after considering investment in fixed capital, working capital, and other expenses to keep the company going. Although positive free cash flow is desirable and an optimistic sign for a firm's financial health, negative free cash flow is not necessarily an unfavorable signal as it may indicate that a firm is making substantial investments.
- *Comparables method.* Market-based valuation focuses on comparing similar businesses to value a firm's stock. This valuation is known as comparables or comps valuation and can be based on the type of business, transaction, or industry averages. The key element of the approach is to find a value-based characteristic relative to the value of the business.
- *Other valuation methods.* Additional valuation techniques include residual income valuation, which focuses on excess income above the costs measured relative to the equity used, and technical analysis, which values a firm or stock using the data from trading activities, including price and volume changes.

Equity investment models and strategies also play an important role in investing activities and their success. An investor may choose active investing and try to time the market with an objective of short-term gains. A passive investor may choose to invest for the long term by tracking an index. This strategy reduces the risk through diversification. Furthermore, investors can strategically focus on certain types of stocks. For example, one may choose to invest in stocks whose earnings are expected to grow faster than others (growth strategy) or may look for undervalued stocks that are expected to increase in value (value strategy).

Equity markets also accommodate special cases of investing, including activist investing and socially responsible investing, as well as investing in emerging markets, private equity, and crowdfunding investments. For example, activist investors invest in companies to influence their activities through pressuring management with specific agenda items such as changing the compensation plans, forcing the firm to merge or divest certain assets, and changing a company's product lines. Socially responsible investing involves applying nonfinancial social screens to a universe of investment alternatives to identify investment candidates. A *social screen* is the expression of an investor's social, ethical, or religious concern in a form that enables an investment manager to apply it in the investment decision-making process, along with other screens.

ABOUT THIS BOOK

This section discusses the book's purpose, its distinguishing features, and its intended audience.

Purpose of the Book

The primary purpose of this book is to provide an objective look into the dynamic world of equity markets, valuation, and analysis. The coverage extends from

discussing basic concepts and their application to increasingly intricate and real-world situations. This volume spans the gamut from theoretical to practical while attempting to offer a useful balance of detailed and user-friendly coverage. Discussion of relevant research permeates the books. Readers can gain an in-depth understanding about this subject from experts in the field, both academics and practitioners. Readers interested in a broad survey will benefit as will those looking for more in-depth presentations of specific areas within this field of study. In summary, this book provides a fresh look at this intriguing but often complex subject.

Distinguishing Features

Several features distinguish *Equity Markets, Valuation, and Analysis* from others in the market.

- The book provides an introduction to this broad, complex, and competitive field. It skillfully blends the contributions of a global array of academics and practitioners into a single review of some of the most important topics in this area. The varied backgrounds of the contributors assure different perspectives and a rich interplay of ideas. The book also reflects the latest trends and research in a global context and discusses several controversial issues as well as the future outlook for this field.
- While retaining the content and perspectives of the many contributors, the book follows an internally consistent approach in format and style. Similar to a choir that contains many voices, this book has many contributing authors, each with their separate voices. A goal of both a choir and this book is to have the many voices sing together harmoniously. Accomplishing this task for the book requires skilled editing by the co-editors to assure a seamless flow when moving from chapter to chapter. Hence, the book is collectively much more than a compilation of chapters from an array of different authors.
- The book presents theory without unnecessary abstraction, quantitative techniques using basic mathematics, and conventions at a useful level of detail. It also incorporates how investment professionals analyze and manage equity portfolios.
- The book places a strong emphasis on empirical evidence involving equity markets, valuation, and analysis. When discussing the results of various studies, the objective is to distill them to their essential content and practical implications so they are understandable to a wide array of readers.
- The end of each chapter contains four to six discussion questions that help to reinforce key concepts. The end of the book provides guideline answers to each question. This feature should be especially important to faculty and students using the book in classes.

Intended Audience

Given its broad scope, this practical and comprehensive book should be of interest to various groups. The primary market consists of academics, researchers, investors, and financial professionals/practitioners. Students, policymakers, libraries, and

anyone curious about equity markets, valuation, and analysis make up the secondary market. For academics and researchers, the book provides the basis for gaining a better understanding of various aspects of equity markets, valuation, and analysis and as a springboard for future research. Academics can also use the book as a stand-alone or supplementary resource for advanced undergraduate or graduate courses in investments as well as a PhD seminar, given the book's research orientation. Investors, financial professionals, and practitioners should also find the book to be a valuable resource in gaining a better understanding of equity markets, valuation, and analysis. Students, policymakers, and libraries should find this book suitable as a reference. Thus, this book should be essential reading for anyone who wants a better understanding of these important topics.

STRUCTURE OF THE BOOK

The remainder of this book consists of 23 chapters divided into four main parts. A brief synopsis of each part and chapter follows.

Part One: Background

This part contains four chapters (Chapters 2–5) that provide important background information that sets the stage for the remaining sections. These chapters examine ownership structure and stock classes, equity markets and performance, securities regulation, and investor psychology and equity market anomalies.

Chapter 2 Ownership Structure and Stock Classes (Christopher J. Barnes, Ehsan Nikbakht, and Andrew C. Spieler) This chapter examines different ownership structures and stock classes. Several exceptions are available to the widely held belief that a share of common stock is the same as any other share. The most common exception is multiple-class common stock (dual-class stock), which offers some shareholders superior voting rights relative to shareholders in a separate class. Even for companies with only a single class of common stock, several types of shares may be available. For example, investors in tracking stock have no direct claim, as their investment targets the financial performance of a subdivision of a larger corporation. Cross-listings and depositary receipts each facilitate investment in corporations whose primary listings are in other countries. Although cross-listings represent a direct listing on a foreign stock exchange, depositary receipts are indirect ownership vehicles in which an intermediary institution holds shares directly and offers receipts certifying ownership for the investor. Another single-class ownership structure is that of dual-listed companies, which may arise when two companies combine business operations without merging the respective legal entities. This structure enables two separate and distinct classes of shares, and therefore shareholders, to survive the merger. These dual-listed companies try to equalize ownership such that a share of one twin equals a share in the other, but each twin's shares correspond to different underlying legal entities. Each of these structures falls under the umbrella of common stock but exemplifies the potential differences among shares of common stock from a single company.

Chapter 3 Equity Markets and Performance (Jay T. Brandi and Xudong Fu) Equity markets and performance develop the connections among the economy, financial markets, employment, profitability, and the value of corporate securities – specifically equity securities. This chapter presents various approaches to segmenting the financial markets by issue type, issue size, and other characteristics and discusses using equity indices as economic indicators. It also discusses the efficient market hypothesis and its three forms along with the characteristics of marketability and liquidity and how they relate to the economy, financial markets, equity performance, and valuation.

Chapter 4 Securities Regulation (Douglas Cumming and Sofia Johan) This chapter summarizes securities regulation pertaining to trading on stock exchanges in most countries around the world. It identifies different types of trading rules for different forms of misconduct, including but not limited to insider trading (such as front-running and client precedence), price manipulation (such as ramping/gouging and prearranged trades), volume manipulation (such as spoofing and switching), and broker-agency misconduct (such as violation of trade-through rules and know-your-client rules). The chapter reviews research on how cross-sectional and time-series differences in rules across countries and over time affects market liquidity. It also explains how rules are enforced with computerized surveillance technology and how differences in enforcement across countries and over time substantially affect market efficiency and integrity.

Chapter 5 Investor Psychology and Equity Market Anomalies (Hunter M. Holzhauer) This chapter examines investor psychology and equity market anomalies. It begins with a brief synopsis of the differences between behavioral finance and traditional finance. It examines investor psychology using foundational ideas behind behavioral finance like bounded rationality and prospect theory to explore why investors are not always rational. Although these two foundational ideas are certainly related, they showcase several different issues and biases that are relevant to investors. The final section uses equity market anomalies to discuss different violations of the efficient market hypothesis. The chapter concludes by explaining the importance of behavioral finance and its role in investor psychology and choice behavior.

Part Two: Valuation and Analysis

This part consists of nine chapters (Chapters 6–14) dealing with valuation and analysis. This section begins with a discussion of financial statement analysis and forecasting followed by chapters on fundamentals of equity valuation, company analysis, and technical analysis. The discussion then turns to examining various valuation methods including discounted dividend valuation, free cash flow valuation, market-based valuation, residual income valuation, and private company valuation.

Chapter 6 Financial Statement Analysis and Forecasting (Somnath Das and Shailendra Pandit) This chapter discusses using financial statements for forecasting in financial markets. Based on a common stock valuation formula, the chapter focuses on forecasting future stock prices and earnings for a business entity. Evidence on the predictability of stock prices or earnings has important implications for both asset pricing models and investment strategies. The chapter provides a brief survey of the literature on

using technical analysis, fundamental analysis, and time series analysis for forecasting stock prices and earnings while highlighting the challenges faced by forecasters as well as strategies for improving the forecasts. The discussion primarily focuses on forecasts, including a discussion of earnings forecasts, concerning U.S. firms using financial statements. The chapter also discusses some limitations of using financial statement analysis in forecasting.

Chapter 7 Fundamentals of Equity Valuation (Emmanuel Boutron, Alain Coën, and Didier Folus)

Equity valuation refers to a key economic metric that represents a company's net worth. Numerous practitioners and academics use and study equity valuation. The main stakeholders involved in a company's net worth are stockholders, banks, and bondholders, who are directly interested in the company's intrinsic value. Financial executives and clients are indirectly concerned. Different approaches are available to evaluate a company's equity, including discounted cash flow (DCF)-based valuation, market-based valuation, and option-based valuation. The DCF approach is based on the firm's expected free cash flow or on futures dividends. Using the DCF approach implies using fundamental analysis of the company's business and financial statements to forecast its cash flow, which should be discounted at a risk-adjusted rate of return. Investors and analysts can use various asset pricing models, such as the capital asset pricing model, to calculate the required rate of return used in the equity valuation process. Practitioners often use market-based approaches, including multiples and ratios, because such approaches are cost-effective and enable making comparisons among companies. This chapter highlights the crucial role of equity valuation in modern finance for both academics and practitioners.

Chapter 8 Company Analysis (David Craig Nichols) Company analysis refers to the analysis of a company's financial statements and other information to better understand its profitability, growth, and risk. This chapter develops a company analysis in the context of a three-step framework for understanding the relation between business activities and stock prices. The first step maps business activities into financial statements through the financial reporting process. The second step maps financial statements into forecasts and estimates of share value through the fundamental analysis process. The third step maps equity values into share prices through the trading process. The chapter focuses on accounting analysis and ratio analysis, including profitability, growth, liquidity, solvency, and financial distress, but describes the role of financial statements in equity valuation more generally.

Chapter 9 Technical Analysis (David Lundgren) This chapter demonstrates the underappreciated philosophical link between technical analysis and fundamental analysis illustrated using Dow Theory. Specifically, the linkage between the two types of analysis on the relative performance of a company's share price is mainly dependent on the company's fundamental strength. This chapter also investigates several technical strategies, including trend following and cross-sectional momentum, used today by technical and fundamental investors alike, to improve their stock selection and timing decisions. Further, it also examines techniques for determining the health of broad market trends, thus equipping investors with the skills needed to assess the overall risk environment.

Chapter 10 Discounted Dividend Valuation (Elif Akben-Selçuk) This chapter explores the dividend discount model (DDM), which defines the value of common stock as the present value of expected future dividend payments. It investigates both the constant growth model (also called the Gordon model), which assumes a steady-state rate for the firm forever. The chapter also examines multi-stage models, including the two-stage model, H-model, and three-stage model, which assume a multiple-stage growth for dividends and earnings. Besides these traditional models, the chapter considers binomial and trinomial stochastic DDMs and the uses of DDMs. Finally, it discusses the results of empirical studies testing the relevance and practical significance of DDMs.

Chapter 11 Free Cash Flow Valuation (Tom Barkley) Valuation analysis lies at the heart of finance. It tries to ascertain the true worth of assets, securities, companies, and projects. Absolute valuation approaches rely on fundamental analysis to estimate a firm's intrinsic value based only on its characteristics. By contrast, relative valuation methods rely on multiples associated with comparable companies, based on a firm's characteristics relative to its peers. Regarding the former approaches, the most commonly used is a discounted cash flow (DCF) analysis, which forecasts a firm's future cash flows and discounts them at an appropriate rate to obtain their present values, whose sum is then the firm's value. This chapter highlights four special cases of DCF analysis: (1) the weighted average cost of capital approach; (2) the adjusted present value method; (3) the capital cash flow model; and (4) the free cash flow to equity technique.

Chapter 12 Market-Based Valuation (Sang Hoon Lee) The purpose of this chapter is to introduce a valuation method using market-based multiples and discuss the advantages and challenges of using this method. Practitioners widely use market multiples such as equity-related or enterprise value (EV)-related multiples. This valuation method has distinctive benefits over the fundamental valuation approach, offering a potential reduction of biases from estimating future cash flows and discount rates. The rationale for using market multiples for valuation is the principle of substitution for equally valuable assets. Therefore, selecting comparable companies that closely match the target company is the key to success for improving valuation accuracy as the benchmark multiples are drawn from these companies. Since different multiples and value drivers produce dissimilar valuation estimates, choosing the most effective multiples or a combination of them with theoretically consistent measures in the composition of a multiple is essential. Equity researchers and practitioners often propose using a harmonic mean of different multiples to minimize valuation errors. Also, forward performance measures usually produce more accurate value estimates. However, controversy remains about the efficacy of various multiples.

Chapter 13 Residual Income Valuation (Shailendra Pandit and Somnath Das) This chapter reviews the concept of residual income (RI) and its application in equity valuation. RI is surplus profits generated by a project after accounting for the cost of capital invested in the project. RI has its roots in the concept of opportunity cost: To create value for investors, an investment project must generate returns above the opportunity cost of the invested capital. From its roots in the emergence of modern economic thought, RI evolved as a formal valuation approach in the twentieth century. The impetus for broader adoption of RI came not only from accounting

and finance scholars but also from valuation and strategy consultants who played a crucial role in popularizing the concept among business organizations. Computing RI involves using a clean surplus relation to adjust and remove potential biases from financial statement numbers, forecast growth in those amounts, and compute the opportunity cost of equity. Today, RI is widely used in capital budgeting, operational planning, performance evaluation, executive compensation, and equity valuation.

Chapter 14 Private Company Valuation (Onur Bayar and Yini Liu) This chapter reviews the application of different valuation methods for evaluating investment opportunities in private companies. It focuses on the underlying fundamentals of each method, when each technique is appropriate, and how some applications differ between privately held and publicly traded companies. The chapter also discusses the following valuation methods in the context of private equity (PE): discounted cash flow, comparable firm valuation, the venture capital method, and option pricing. A thorough understanding of these methods enhances the ability to make value-increasing decisions in a PE setting. Although the chapter discusses some strengths and weaknesses of each method in private company valuation, it also highlights the connections among them and how they can complement each other to help entrepreneurs, investors, and analysts make better investment decisions and evaluations.

Part Three: Equity Investment Models and Strategies

This part consists of six chapters (Chapter 15–20) focusing on equity investments strategies including factor investing, smart beta versus alpha, activist and impact investing, and socially responsible investing. The final chapter in this section deals with pooled investment vehicles: open-end mutual funds, closed-end mutual funds, exchange-traded funds, and unit investment trusts.

Chapter 15 Equity Investing Strategies (Nicholas Biasi, Andrew C. Spieler, and Raisa Varejao) This chapter provides a discussion of popular and emerging trends in equity strategies. An entire spectrum of equity investing strategies is available, ranging from passive indexing to active management, stable income to growth, and everything in between. Value investing can trace its roots back to Benjamin Graham and seeks to identify companies that are trading a substantial discount to their intrinsic values. Conversely, growth investing involves identifying firms that have expected high earnings growth. Still other strategies are designed to provide stable income. A variety of exchange-traded fund (ETF) structures allow investors to design diversified equity portfolios to meet their desired risk and return characteristics. Quantitative strategies exploit computing power to identify trends or mispricings and thus remove human emotion from the trade. Options allow investors to increase, decrease, and tailor their exposure based on their view of the underlying equity position.

Chapter 16 Factor Investing (Aaron Filbeck) This chapter reviews factor investing as an equity investment strategy. Factors are measurements of systematic risk used to explain returns for diversified portfolios. The chapter begins by providing a brief history of factor investing, starting with the capital asset pricing model. This single-factor model assumes that the market (beta) is the only factor affecting returns. Next, the chapter examines some other prominent factors, including

value, size, momentum, low volatility, and quality/profitability. Finally, the chapter introduces some portfolio management considerations in practice, which include multi-factor portfolio construction and active management benchmarking.

Chapter 17 Smart Beta Strategies versus Alpha Strategies (Timothy A. Krause) This chapter reviews the academic literature and articles in the financial press on the performance of this relatively new investment paradigm and provides an analysis of the empirical performance of these smart beta exchange-traded funds (ETFs). Smart beta investing strategies have gained increased attention from both academics and practitioners in recent decades. Between 2014 and 2018, growth in smart beta ETFs averaged almost 30 percent annually. These strategies are based on the concept of “factor” investing, which has existed for decades. Now, however, ETF providers use the term *smart beta* to indicate various factor-based strategies. The empirical evidence on smart beta performance is generally positive, but it does have its detractors. The empirical analysis in this chapter indicates that, in recent years, smart beta strategies outperform alpha-seeking strategies on both absolute and risk-adjusted-performance measures, but not passive capitalization- or equal-weighted indices.

Chapter 18 Activist and Impact Investing (Michael Sinodinos, Andrew Siwo, and Andrew C. Spieler) This chapter examines activist investing and impact investing. Activist investing is when an investor seeks to make changes to corporate strategies or policies by owning shares of a public company. Activists can be wealthy individuals, pension funds, hedge funds, or even gadflies. Activists may engage management privately, submit proposals via the proxy statement, engage in proxy fights, or seek board representation. Recent trends include increased hedge fund activism and coordinated efforts. Impact investing is when an investor seeks to make investments that have the objective of obtaining a social or environmental benefit alongside a financial return. The integration of environmental, social, and governance (ESG) factors into investing is an approach that has captured the attention of institutional investors globally and brings nonfinancial factors, such as diversity, carbon emissions, and board structure, to the fore.

Chapter 19 Socially Responsible Investing (Randolph D. Nordby) Earning money while doing good for society is the typical goal for socially responsible investing (SRI). However, does achieving this goal require compromising financial returns? Can investors achieve their financial goals while still being true to their values and principles? SRI has become part of mainstream investing and is being integrated into the investment decision-making process at many firms. Yet, no single agreed-upon definition of SRI – or even a consensus on what constitutes best practices for using these factors to make informed investment decisions – exists. This chapter discusses the evolution of SRI investing into today’s more traditional environmental, social, and governance (ESG) investing. It also explores the best practices being promoted by top global associations of investment professionals using ESG factors for equity valuation. From a practitioner’s perspective, a critical challenge of using ESG data for asset valuation is properly integrating these nonstandardized factors into an asset’s valuation process. This area has attracted much attention, but little clarity. Thus, this chapter focuses

on providing both a better understanding of the multiple methods of SRI investing and an overview of the best practices for integrating ESG metrics into the equity valuation process.

Chapter 20 Pooled Investment Vehicles (Joseph McBride, Michael Pain, and Andrew C. Spieler)

This chapter discusses the four major pooled investment vehicles (PIVs) that dominate the market today: open-end mutual funds (MFs), closed-end mutual funds (CEFs), exchange-traded funds (ETFs), and unit investment trusts (UITs). It also discusses the overall structure and related benefits, drawbacks, and risks of each structure. Additional discussion focuses on the creation and redemption process, net asset value (NAV), premium/discount, tradability, liquidity attributes, tax efficiency, and leverage, as well as indirect and direct costs. The chapter also provides a brief history and general trends involving PIVs and the need to follow a disciplined investment process when evaluating these types of investments.

Part Four: Special Equity Topics

Part Four of the book contains four chapters (Chapters 21–24) that examine special equity topics. These issues include investing in private equity, investing in emerging markets, disclosure regulations in emerging economies, and equity crowdfunding investments.

Chapter 21 Investing in Private Equity (Gaurav Gupta, Tianqi Jiang, and Zhao Wang)

Private equity (PE) is an alternative asset class in which a direct investment exists in the equity of a private or a public company. Equities and bonds are traditionally traded in the secondary markets, whereas private equity is a private dealing between an investor or PE fund manager and the issuer company. The term *private* in PE signifies that the deal occurs in private rather than in public. The risk–reward profile of PE investments tends to be higher than for some other asset classes, resulting in potentially higher rewards. This chapter provides an overview of PE investments dealing with venture capital (VC) and buyouts as well as private investment in public entity (PIPE). It also discusses the long-term investment horizon, illiquidity, capital commitment, capital commitment period, capital call, portfolio diversification, performance, and risk factors involving PE investments.

Chapter 22 Investing in Emerging Markets (Xiaohau Diao, Shantanu Dutta, and Peng Cheng Zhu)

Emerging markets offer expanded investment opportunities for global investors. Although emerging market returns are becoming more correlated with developed market returns, reducing the attractiveness of the diversification rationale, emerging markets are still distinct enough to appeal to global investors. Emerging markets offer higher return potential. However, to realize better returns and manage associated risks, investors need to have coordinated investment strategies. They also need to understand various factors associated with capital flows to emerging markets, market characteristics, political dynamics, and valuation challenges. Further, investors should pay close attention to legal protection, asset valuation techniques, corporate governance, and the regulatory environment that may substantially affect

investment returns. The goal of this chapter is to examine issues related to capital market integration in an emerging market setup and to discuss various institutional strategies for making better investment decisions.

Chapter 23 Disclosure Regulations in Emerging Economies and Their Impact on Equity Markets (Xiaohu Diao, Shantanu Dutta, and Peng Cheng Zhu) Corporate disclosure and financial reporting convey valuable information to shareholders and market participants. Although financial reporting is routinely done, mostly in a regular interval, according to regulatory requirements, corporate disclosures could be voluntary or mandatory depending on the nature of the information. This chapter focuses on emerging markets corporate disclosure-related regulations such as environmental and corporate social responsibility (CSR) disclosure, private meeting disclosure, and insider trading-related disclosure that attract interest among regulators, practitioners, and academics. The empirical evidence shows that implementing these regulations is not particularly effective. In many instances, authorities fail to identify or take adequate actions against violators. However, the regulatory bodies appear to have become more careful in recent years, which is likely to enhance the effectiveness of these disclosure regulations.

Chapter 24 Equity Crowdfunding Investments (Dianna Preece) This chapter examines equity crowdfunding, which was an innovation introduced in the Jumpstart Our Business Startups (JOBS) Act of 2012 that many expected to be a boon for startups. Signed into law with bipartisan support, the JOBS Act intended to enable Americans to invest in new companies and their founders. However, the Securities and Exchange Commission (SEC) took years to create regulations to govern equity crowdfunding. After being launched in May 2016, equity crowdfunding has grown more slowly than expected. Early-stage investments are risky, and many nonaccredited investors may lack the sophistication to assess risks. JOBS 3.0 is expected to fix any existing problems but has yet to pass the U.S. Senate. Despite these roadblocks, equity crowdfunding is on the rise in both the United States and abroad, though investors are, so far, less plentiful than expected. Research on U.S. equity crowdfunding risks and returns is scant.

SUMMARY AND CONCLUSIONS

Equity securities are an important component in the portfolios of both individual and institutional investors. Including an equity component has several benefits, including portfolio diversification and potentially higher long-term returns in terms of capital gains and dividends. However, owning equity securities involves risk, given the volatility of these markets. To achieve their portfolio objectives, investors need to know how to analyze and value equity securities if they are selecting stocks themselves or how to select an appropriate pooled investment vehicle with professional managers. *Equity Markets, Valuation, and Analysis* provides the foundation for making sound investment decisions in equities. Contributions by both scholars and practitioners provide an in-depth survey of the role of equity securities, including the background of equity securities, an understanding of issues related to valuation and analysis, and various equity investment models and strategies, as well as special topics involving equity investments.

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