THE EVALUATION OF THE PRIMARY FINANCIAL SECURITIES ON THE CAPITAL MARKET

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Abstract:
Capital market is where supply meets demand and stocks, bonds, future contracts and other stock products. Is the market that is traded real estate?
This study intends to argue the importance of financial instruments on the capital market, and especially its evaluating process. On such market is very important when an investor wants to sell or buy a portfolio. Hence the numerous questions that an investor puts: Should I buy today? Should I wait? What will be the price trend these days? To be able to handle any situation is necessary to carry out calculations on the evaluation indicators of financial instruments.

Key words: *capital market shares, bonds, yield return*

JEL classification: *G1, G11*

1. Capital market and financial instruments

From an economic perspective, market is where the economic agents meet and act, buyers and sellers and various categories of intermediaries also, in order to satisfy everyone's desires. Thus through the market, sellers and buyers inform each other on what they have, on what they need and the about the required or proposed price when the transaction is performed. Market is the place where supply and demand meets and the economic agents are characterized by competition.

There are several classification criteria depending on which we are differentiating the markets; so if we are referring to the venue will meet local, regional, global market etc; by number of participants we meet broad market, respectively restricted. Most important criteria is market classification after the transaction subject; we encounter these types of markets: labor market, the currency market, financial markets, banking market, insurance market, capital market and other.

Capital market is the place where the securities are traded on medium and long term. It's where supply meets demand of instruments (securities) accounts. Capital Market has two divisions: primary market - being that market where financial instruments are sold, bought, traded for the first time, basically making the connection between the issuing companies and the investors; secondary market - financial instruments in this market are starting to form the object of transactions, finally producing benefit for an investor namely, profit-loss, or vice versa.

On the capital market any financial instrument, any tenure can be any time transferred, so is negotiable. Capital markets works with two major categories of financial instruments:

- primary financial instruments;
- financial derivatives

Primary financial headlines include stocks, bonds, subscription rights, rights award and warrants.

Financial derivative instruments include main forward and future contracts.

Financial titles are expressed in a document, on material form or electronic registration, are negotiable instruments can be transmitted through the demand – supply mechanism and give their holders rights and obligations.

2. Assessment of actions on Capital Market

Shares are base financial instruments on capital market. The stock is a security, which is a part of social capital of issuing corporation. Depending on the number of shares, a shareholder has various rights and obligations of assets and liabilities of the issuing company. Thus, if a shareholder holds a specified number of actions, he has these categories of rights:

- the right to vote - in the General Meeting of Shareholders;
- right to information, the company's financial situations;
- dividends rights - that part of the company's net profit that is for the shareholders, depending on the number of owned shares;
- right on the assets of the company- if the company enters into liquidation

Unlike other financial instruments, shares have an unlimited life, offer their holders different rights but in case of an investment the risks in such instruments are higher. In the table below (Table 1) are presented the main differences between the basic tools of the capital markets: stocks and bonds.

Table No. 1: The main differences between stocks and bonds.

EXAMINED CRITERIA	ACTION	BONDS
Definition	Part of a company's capital stock. Shares assembly represent social capital.	Fraction of a loan made by a company, a public community or by the state.
The owner role the managed by the issuing authority	The right to vote in General Meeting of Shareholders	Basically, no role.
Revenues for the title holder	Dividends (about company results)	Interest whose sum is necessarily paid by the issuer
Risks covered by title owner	Higher risks: – risk of unfavorable evolution of the firm's business (not receiving dividends); – risk of losing the invested funds in case of company liquidation	Lower risks: - default risk (disappears if a state guarantees); -In case of company liquidation, creditors have precedence over shareholders.
Lifetime	Unlimited	Limited, to due date

Source: Ionescu Eduard – „Management of the porofolio", publishing by "Romania de Maine Foundation", Bucharest 2009, pag.40

There are several types of classification criteria, according on which actions can be distinguished as follows:

1) after presentation form, there are:
   - nominative shares - have registered owner's name on it;
   - shares in materialized form - on paper;
   - shares in dematerialized form - in the account;
   - bearer shares - one who owns property
2) by the rights given the possessor, shares may be:
   - common - gives shareholders rights in proportion to the number of the owning shares;
   - preferred - these are divided into: cumulative, non-cumulative, participating.

Stock assessment is an important activity that must be taken into account by each investor. The evaluation is generally based, at the beginning, on the financial indicators of the issuing company. Thus, in the following are presented the main indicators of the stock assessment.

The nominal value (VN) of a share is the ratio of company social capital and the shares number. The nominal value is simply a "unit" according to which the capital is divided among the shareholders, and is determined using the formula:

$$VN = \frac{CS}{N}$$

where: CS is the capital,
N - number of shares issued.

When we speak about share as a financial instrument,or as a part of company capital, its registration must be considered and its effects in accounting, so the *book value (VCT) of a share* is the ratio of net wealth (net asset) and the total number of shares (N).

$$V_{ct} = \frac{An}{N}$$

Where: Year-net assets (net assets)
N - total number of shares.

From a financial standpoint, *the financial value (Vf)* of an action is the financial gain made by a shareholder, after obtaining a profit, compared with average market interest rate.

$$Vf = \frac{D}{Rmd}$$

where: D - Dividend
MIR - The average interest rate

For a shareholder to realize that his investment was profitable or not, if the shares owned in *the company's capita*l reached its calculations, should take into account the performance of a share. (η). Analyzing the share flow, must take into account any adjustments to the share course. Thus, the share flow can be calculated as follows:

$$\eta = \frac{Da + C_1 - C_0}{C_0} * 100$$

where: η - the share flow;
Da – dividend per share;
C_1 – share rate at time t_1;

C_0 - share rate at time t_0

Another indicator that must be analyzed is the coefficient of market capitalization (PER), which represents the ratio between the shares rate (V) and earnings per share (Pa). This indicator expresses the number of years needed to cover the value of profit undertaking.

$$PER = \frac{V}{Pa}$$

where V – represents the market value of shares (its rate);

- Pa = profit per share

The share assessment is undertaken by an investor in order to estimate the profit that it could obtain. An income form based on shareholding is the dividend got by the investor. Thus, when we analyze a share in terms of financial earning which we will get after the transaction or its possession, we must consider the following indicators:

a) dividend per share – represent the produced revenue by the shareholder investment in shares. Represent the ratio of net profit distributed to the shareholders and the number of shares outstanding in the market;

b) dividend distribution rate - shows the part of a financial period profit who returns at the shareholders, it is determined as:

$d = \frac{Dn}{Pn} * 100$, where Dn - represents net dividends and Pn - Net Profit

3. Bond rating on capital markets

Another increasingly used financial instrument in the capital market is bond.

The bond is a negotiable financial instrument, a security issued with interest rate the issuer must pay the owner from time to time a certain amount of money. Unlike stocks, a bond does not confer the right to vote in general meetings, and their lifespan is limited.

According to the legislation in this field there are several types of bonds:

- bonds guaranteed by certain assets;
- debentures;
- nominal bonds;
- bearer bonds;
- bonds convertible into shares;
- Mortgage bonds.

A bond may be issued, generally in two ways:

- issuing bonus - it is paid at the beginning and is calculated as the difference between nominal value and issue price;
- repayment bonus – it is paid when part of the loan is discharged.

In order to analyze the modalities to repay the funds, the remunerations levels, efficiency investment in bonds and how risky is an investment; in this case are used the following indicators:

Annual income (V_a) – represent the annual gain that bond holder obtain it according to the contract interest rate (D) and by nominal value.

Va = Vn * D,

where Vn - nominal value of the bond, the value per bond, D- interest rate in the contract;

Coupon - shows the amount paid annually for each bond owned and can be expressed in two forms:

- percentage - $C_i = \frac{r_n \times n_z}{365}$ where Ci% = annual percentage coupon;

rn = nominal interest rate, nz = number of days that have elapsed since the last detachment of the coupon.

- in absolute terms - Ci = Vn * Ci%

Real value of bonds (VF) is influenced by the methods of repayment of loan because the flows generated by the repayment come in the account of real value.

$V_r = \sum_{t=1}^{T} \frac{A_t}{(1+k)^t}$, where

T = loan operating life
r = update rate
At t = annuity year (year t + interest rate repayable in year t);
c = amount in coupon payment on each due date
N = the date of redemption

In terms of risk is to maintain an investment in bonds is less risky than the stock; this is because the main risks they may face a bond is the risk of default, but it disappears when the bonds issued by the State; and the company liquidation risk for the bonds issued by the companies, but in this case those who bought the bonds have precedence over shareholders.

The risks of a bond express the relationship between coefficient β and bond profitability (O):

$E(R_0) = R_F + \beta_O[E(R_M) - R_F]$

B = B = a coefficient which measures the systematic risk, when it is positive, resulted in interest rate fluctuations (dk)
O = bond;
M = market portfolio (stocks, bonds)

Bonds and stocks should be always analyzed and depending on a primary indicator for investor and namely profitability. Profitability represents the profit got by an investor as a result of holding a security for a certain period of time.

If we are dealing with a long period of time (T) profitability of a stock or a bond includes annual cashed dividends (DT) and the rate difference between the future market price (PT) and the initial price (P0). Thus, absolute profitability (XT) and the rate profitability (RT) is obtained as:

$X_T = \sum D_T + P_T - P_0$ where ,

X_T - Absolute profitability
$\sum D_T$ – the amount of annual cashed dividends;
P_T - future price;
P_0 - initial price of the securities

$R_T = [(\sum D_T + P_T - P_0) / P_0] * 100$

Profitability of a security varies from one period to another, so for an optimal evaluation is necessary to take into account the profitability of average assets.

The average return of an asset is influenced by the profitability of financial security (X) of all economic statuses, and a certain probability (pi), with i= 1.....n, şi $\sum p_i = 1$.

Thus, the average profitability of a X title, (Rix), is calculated taking into account the probability of an economic state (i = 1 ... n), and profitability for these states (Rix) as follows:

$R_{average} = \sum p_i * R_{ix}$

4. Conclusions

Romanian Capital Market comprises two fundamental institutions: Bucharest Stock Exchange and Financial Monetary and Commodities Exchange in Sibiu. The main categories of securities that covered by the Stock Exchange trading are stocks and bonds. Evaluation process of these tools is an important step in establishing its investment strategy. This evaluation process tries to anticipate changes in the cost of the security which is particularly important for investors because it's good to be constantly one step ahead of the others.

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