

Key Statistics

Name: _____ Date: _____

Directions: Read the following summaries of three key statistics to give you an idea of what information they contain. Keep in mind however, if markets are truly efficient, these ratios may be of little help. Perhaps you will find the relationship that others have not.

Price/Earnings (P/E) ratio:

This ratio describes how much one is paying for every dollar a company earns. For example, if a company's stock price is \$15 per share, and it earned \$1 per share over the preceding year, its P/E ratio would be 15. To give you some historical perspective, the average P/E ratio over the last 80 years has been 15.7. As of 4/15/2002 the average P/E for the largest 500 stocks was 25. All else being equal, the lower the P/E ratio, the less expensive stock prices are.

Dividend Yield:

Many stocks pay dividends. Dividends are payments to shareholders from the company's earnings. The dividend yield is the dividend divided by the share price. As an example, suppose you buy stock at \$10 a share and the company pays \$1 per share in dividends. In this case, the dividend yield would be $\$1/\$10 = 10$ percent. For historical perspective, consider that the average dividend yield over the last 80 years has been 4.39 percent. At the end of the year 2001, it was 1.5 percent. All else being equal, the higher the dividend yield, the more attractive stocks are.

Interest Rate:

The one-year interest rate tells you how much you can expect to earn on bonds over the next year. Bonds are fixed-income instruments that guarantee a fixed return. Think of them as savings bonds that you may have. The higher the interest rate, the more bonds pay and the less attractive stocks will be. Thus, as interest rates rise, stock prices generally fall as investors move money out of stocks and into bonds. Conversely, as interest rates decline, investors move wealth from bonds and into stocks. For the P/E ratio and dividend yield, the preceding five-year average will be given. This will give you a historical context in which to judge these two statistics so that you can at least make an educated guess as to whether the statistics are relatively high or low.