

THE INVESTMENT OBJECTIVE

The world of investing looks much like a jungle to the uninitiated—a dangerous and exotic place, and definitely unfamiliar territory. Competent and intelligent professionals from other fields such as medicine and law react to this prospect in a perfectly rational way; just as they are hired for their expertise, they expect to need a professional financial advisor to guide them around the pitfalls. With a thorough understanding of the concepts in this book, they would find themselves quite capable of an enlightened discussion with such an advisor. By contrast, a representative of the accounting or financial profession would be far less comfortable discussing a legal case or operating procedure with the benefit of a single text on law or medicine.

This chapter introduces the environment of investing. Capital investment, with its need for funds, gives rise to capital markets. Fortunately, individuals have excess funds and regularly provide them to institutions that require those funds. The process is complex and highly organized. Capital markets exist for a complex array of financial instruments that meet the precise needs of investors and users of capital; each of those instruments, starting with stocks and bonds, has evolved in response to those needs. We examine this system from all angles, the individuals and the institutions and their respective requirements, and the financial intermediaries which serve to bring the two together.

We begin with a short presentation of the turbulent history of North American markets. This is followed by an examination of the markets and their participants—the process of capital formation, the economic sectors that form the market, and individual investors and their investment-consumption patterns. After this, we describe the system of financial intermediaries and how these have created instruments responsive to the needs of the participants. Finally, we discuss how the market turbulence represents a failure of the financial system to fulfill its purpose—determining the value of financial assets through the sale and purchase of financial instruments.

