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Mr StockTip

Classifying Stocks

Classifying Stocks: Income, Value & Growth

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If you want to understand the stock market, you should learn the different ways in which people classify and identify stocks, including: Income, Value, and Growth.

Income Stocks

The first category of stocks is income stocks, which include shares of corporations that give money back to shareholders in the form of dividends (some people call these stocks dividend stocks).

Examples: AGNC, NLY, CMO

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Some investors, usually older individuals who are near retirement, are attracted to income stocks because they live off the income in the form of dividends and interest on the stocks and bonds they own. In addition, stocks that pay a regular dividend are less volatile. They may not rise or fall as quickly as other stocks, which is fine with the conservative investors who tend to buy income stocks. Another advantage of stocks that pay dividends is that the dividends reduce the loss if the stock price goes down.

There are also a number of disadvantages of buying income stocks. First, dividends are considered taxable income, so you have to report the money you receive to the IRS. Second, if the company doesn't raise its dividend each year—and many don't—inflation can cut into your prof-its. Finally, income stocks can fall just as quickly as other stocks. Just because you own stock in a so-called conservative company doesn't mean you will be protected if the stock market falls.

Value Stocks

Value stocks are stocks of profitable companies that are selling at a reasonable price compared with their true worth, or value.

Examples: CXDC, BRLI, JOY

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The trick, of course, is determining what a company is really worth—what investors call its intrinsic value. Some low-priced stocks that seem like bargains are low-priced for a reason.

Value stocks are often those of old-fashioned companies, such as insurance companies and banks, that are likely to increase in price in the future, even if not as quickly as other stocks. It takes a lot of research to find a company

Growth Stocks

Growth stocks are the stocks of companies that consistently earn a lot of money (usually 15 percent or more per year) and are expected to grow faster than the competition.

Examples: HXM, MGM, CAT

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They are often in high-tech industries. The price of growth stocks can be very high even if the company's earnings aren't spectacular. This is because growth investors believe that the corporation will earn money in the future and are willing to take the risk.

Most of the time, growth stocks won't pay a dividend, as the corporation wants to use every cent it earns to improve or grow the business. Because growth stocks are so volatile, they can make sudden price moves in either direction. This is ideal for short-term traders but unnerving for many investors. During the 1990s, when growth stocks were all the rage, even buy-and-hold investors couldn't resist investing in growth companies like Cisco, Sun Microsystems, and Dell Computer.

What is a dividend? (Click for Video)

Some stocks, especially blue chips, pay dividends. This means that for every share you own, you are paid a portion of the company's earnings. For example, for every share of AT&T you own, you will get sent $0.15 every year. Most companies pay dividends quarterly (four times a year), meaning at the end of every business quarter, the company will send a check for 1/4 of $0.15 for each share you own.

This may not seem like a lot, but when you have built your portfolio up to thousands of shares, and use those dividends to buy more stock in the company, you can make a lot of money over the years.

What is the P/E Ratio? (Click for Video)

A valuation ratio of a company's current share price compared to its per-share earnings.

(Market Value per Share) / (Earnings per Share (EPS))

For example, if a company is currently trading at $43 a share whose price is a bargain compared to its value. Investors who are attracted to value stocks have a number of fundamental tools (Ex: Low P/E ratios - Price Per Share divided by the Earnings Per Share) that they use to find these bargain stocks.

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and earnings over the last 12 months were $1.95 per share, the P/E ratio for the stock would be 22.05 ($43/$1.95).

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