



Ticker's Tales

Margin the Kid

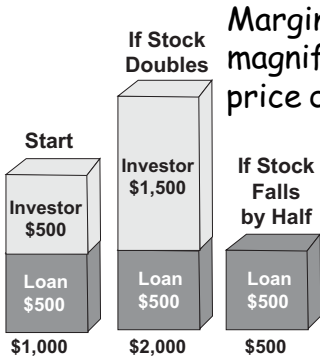
Has anyone ever kidded you by giving you a funny nickname? Well, my friends call me Margin the Kid.

It began after I opened a margin account with my broker. A margin account allows me to buy stock with money borrowed from my broker. That's called buying stock on margin. For every share I buy with my own money, I can buy an extra share with my broker's loan.

I knew I'd have to pay interest on the loan and would have to pay back the borrowed money. But I figured it was worth it. If the stock went up, I'd magnify my gains. I'd gain on the shares I bought with my own money but also on the shares I bought with my broker's loan. I could then pay back the loan and keep all the gains.

The trouble was, I overlooked the other side of the margin coin.

Margin buying can magnify losses, just as it can magnify gains. I learned that lesson when the stock's price dropped unexpectedly. I lost on the shares I



bought with my money and also on the shares I bought with my broker's loan. Instead of keeping lots of gains, I suffered huge losses. My investment shrank like a pair of jeans in a hot dryer. It was even worse. Imagine opening the dryer and discovering that your jeans had shrunk away to nothing.

A margin account initially has \$1,000, consisting of \$500 from an investor and a \$500 loan from a broker. If the stock's price doubles, the investor's stake rises to \$1,500. If the stock's price falls by half, the investor loses everything.

That's what happened to me.

The value of the account dropped so low that it covered only the loan to my broker. My broker then sent me a notice known as a margin call. It asked me to put more money into my account. You see, stock market rules require the value of your margin account to be much greater than the loan from your broker. Well, I didn't have any more money, so my broker had to sell all my stock to repay the loan. I ended up with nothing at all — except a new nickname from my friends.

Write Now

Pick a stock listed in the newspaper stock table and find its 52-week high and its last (or closing) price. Suppose you had bought the stock on margin at this 52-week high. You used \$500 of your own savings, borrowed \$500 from your broker and bought \$1,000 worth of the stock. Given its current price, how much have you gained or lost? Would your broker have sent you a margin call?