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Preferred Stock Vs. Common Stock -- Which Is Right For You?

By *Tina Orem*
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Not all stocks are created equal. Here's your guide to five of the most common types of stocks.

Practically every zoo has a giraffe, and they all look alike: long neck, tan spots, four legs. Until around 2007, scientists thought there was just one kind of giraffe.

But then a team of geneticists at UCLA discovered that there are actually at least six and maybe even 11 different species of giraffes. Those different species, it turns out, really are different, and some are quite rare -- a finding that has helped scientists and conservationists rearrange their giraffe priorities.

#-ad_banner-#It just goes to show the dangers of thinking "They're all the same."

It's a common misperception investors have when it comes to stocks, too: Many people think a stock is a stock is a stock. But actually, there are several different kinds, and you ought to know how to tell them apart so that you too can get your priorities straight.

Here are five types of stocks to know about before you invest.

Common Stock

Common stock is the most popular kind of stock. Its most prominent characteristic is that it entitles the shareholder to vote on corporate matters, such as whether the company should acquire another company, who the board members should be, and other big decisions. (Typically, the shareholder gets one vote for every share he or she owns.)

Common stock also often comes with pre-emptive rights, which means the shareholder has a "right of first refusal," or first dibs on buying any new stock the company issues.

Perhaps the most well-known attribute, however, is that common stockholders are last in line for getting their money back. If the company goes belly-up and has to sell its assets, the cash first goes to pay off lenders, preferred stockholders, employees and lawyers. The shareholders get whatever is left (which is usually nothing, or just a few pennies for every dollar they invested).

Preferred Stock

This pecking order is why preferred stock exists. Although preferred stock owners don't usually have voting rights, they usually receive steady, guaranteed dividends, and their claim to the company's assets outranks the common stockholders' claims. As a result, preferred stocks often behave similarly to bonds, which means you'll have to consider how bonds trade when investing.

Preferred stock is a good alternative for risk-averse investors wanting to buy equities. In general, they are less volatile than common stock and provide a better stream of income. Most preferred shares are also callable, meaning the issuer can redeem the shares at any time, so they provide investors with more options than common shares.

Blue-Chip Stock

"Blue-chip stock" sounds flashy, but the phrase is just slang for stocks from companies that are nationally recognized, older and (usually) financially sound. IBM, AT&T, General Electric, Coca-Cola and DuPont are examples. The term comes from blue poker chips, which have the highest value in the game.

Blue-chip companies have several other characteristics besides age and brand name:

- They are usually large companies.
- They generally sell widely used products or services.
- They perform relatively well during economic downturns.
- They have records of long-term, stable growth.
- They usually pay regular dividends, and those dividends usually grow over time.
- They are usually very creditworthy.

People often assume blue-chip stocks are good long-term investments because they tend to offer consistent returns. However, higher stock prices and lower yields generally balance this perceived lower risk.

Many people regard the performance of blue-chip stocks as proxies for the performance of the broader market, which is one reason the Dow Jones industrial average is the most popular list of blue-chip stocks.

Growth Stock

Growth stocks are fast-growing, young companies. Their values usually jump around more than blue-chip stocks, so conservative investors tend to avoid growth stocks. Tech stocks are generally good examples of growth stocks -- they tend to reinvest all excess cash into their businesses and rely heavily on research and development of products that can be very lucrative (but can quickly become outdated).

Growth stocks may be riskier than some other types of stocks, but they also offer a chance at very high returns. These returns are often in the form of capital gains rather than dividends, though, so investors who want a quarterly dividend check might need to look elsewhere.

Penny Stock

Penny stocks, also called micro-caps, are extremely speculative stocks that have small market capitalizations and trade on the over-the-counter bulletin board (OTCBB), the pink sheets or on foreign exchanges in low volumes rather than on major American exchanges. Typically, they

trade for less than $5 per share.

Penny stocks don't trade as often as or in quantities that larger stocks do, which means they're much less liquid and thus more susceptible to bigger changes in price. That's both the trouble and the temptation; after all, when you're talking about a 50-cent stock, a 50-cent increase means doubling your money.

It can be hard to understand a penny stock's company sales, products, management, profit and costs. Though companies with less than $10 million in assets generally do not have to file reports with the Securities and Exchange Commission, some penny stock companies voluntarily register with the SEC, and that is generally a good sign.

When an OTCBB company fails to file its financial reports on time to either the SEC or its banking or insurance regulator, however, the Financial Industry Regulatory Authority (FINRA) tacks the letter "E" onto the end of the ticker symbol. Also, investors should ask their broker-dealers for the "Rule 15c2-11" file on their companies, which will contain important information.

Fraud is also a major concern. Pump-and-dump schemes and boiler-room tactics are the biggest of those concerns. Fraudsters also play on ignorance, arguing, for example, that a particular company is "a Nasdaq company" because its penny stock is listed on the OTCBB, which is overseen by FINRA.

The Investing Answer: If you own one, 100 or 1 million shares of stock in a company, you're an owner of that company. But there are a number of different kinds of stocks, and their classifications largely depend on the rights they confer on the holder. Investors evaluate these categories based on their investment objectives, and they look for stocks that meet those objectives.

It's important to note that a company's stock can fall into more than one category. For example, blue-chip stocks can also be common stocks and growth stocks.

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