



The Stock Market Game™ Maximum Equity Rule

The **Maximum Equity Rule** was instituted to encourage *diversification* in a portfolio. The SMG Program is a learning activity intended to encourage students to learn about sound investment strategies, even though the simulation is of short duration. Putting all one's eggs in one basket is not usually sound investment practice.

The Maximum Equity rule states that **teams can invest no more than 30%** of their total equity in any one stock. This affects both buys and short sells because both positions put their equity at risk (yes, there is risk in investing!).

If a stock in which the team has invested increases in value, to more than 30% of their total equity, no action will be taken by The SMG Program to reduce the number of shares held; it just means the team can't buy or short sell more of the stock at that time.

When placing a trade, if the requested buy or short sell is above the current 30% equity maximum, the *Enter a Trade* screen will give an error message stating that order exceeded the maximum equity. The attempted trade will not go through and will immediately move into the *Transaction Notes* report with the error message. Students will need to re-enter the trade at a smaller amount.

To calculate:

- Check the *Account Summary* portfolio report for today's **Total Equity**.
- Multiply **Total Equity** times 2. (because the teams have 50% margin, or may borrow an additional \$100,000 at 7% interest)
- Multiply that value times 30% (Illinois' Maximum Equity).

The resultant value indicates the maximum value of any security in the team's portfolio.

For new purchases, teams can closely determine how many shares they can purchase by dividing the above final value by yesterday's closing price. All rounding of shares should be down, as rounding up may prevent the trade from being executed.

On a stock already in their portfolio, if teams do not have that maximum invested, they can buy or short sell additional shares, depending on the current value of the stock (and remembering the 100 share minimum).

To calculate how many more shares teams could buy or short sell, divide the remaining amount by yesterday's price. That will give a ball-park figure of the number of shares they can purchase, remembering to round shares down.

Teachers can use this rule to encourage students to invest in stocks from different industries or sectors, as an investment professional might encourage them to do.