The Stock Market 11.3

- **What are the benefits and risks of buying stock?**
- **How are stocks traded?**
- **How is stock performance measured?**
- **What were the causes and effects of the Great Crash of 1929?**

Buying Stock 11.3

- Corporations can raise money by issuing stock, which represents ownership in the corporation. A portion of stock is called a share. Stocks are also called equities.

- Stockowners can earn a profit in two ways:

  1. Dividends, which are portions of a corporation's profits, are paid out to stockholders of many corporations. The higher the corporate profit, the higher the dividend.

  2. A capital gain is earned when a stockholder sells stock for more than he or she paid for it. A stockholder that sells stock at a lower price than the purchase price suffers a capital loss.

Types of Stock

Dividend Differences

- Income stock pays dividends at regular times during the year.
- Growth stock pays few or no dividends. Instead, the issuing company reinvests earnings into its business.

Decision-Making Differences

- Investors who buy common stock are voting owners of the company.
- Preferred stock owners are nonvoting owners of the company, but receive dividends before the owners of common stock.

Stocks may be classified either by whether or not they pay dividends or whether or not the stockholder has a say in the corporation's affairs.

Stock Splits and Stock Risks

Stock Splits

- **A stock split is the division of a single share of stock into more than one share.**
- **Stock splits occur when the price of a stock becomes so high that it discourages potential investors from buying it.**

Risks of Buying Stock

- **Purchasing stock is risky because the firm selling the stock may encounter economic downturns that force dividends down or reduce the stock's value. It is considered a <u>riskier investment than bonds</u>.**

How Stocks Are Traded

- A **stockbroker** is a person who links buyers and sellers of stock.
- Stockbrokers work for **brokerage firms**, or businesses that specialize in trading stock.
- Some stock is bought and sold on **stock exchanges**, or markets for buying and selling stock.

Stock Exchanges

The New York Stock Exchange (NYSE)

- The NYSE is the country's largest stock exchange. Only stocks for the largest and most established companies are traded on the NYSE.

NASDAQ-AMEX

- NASDAQ-AMEX is an exchange that specializes in high-tech and energy stock.

The OTC Market

- The OTC market (over-the-counter) is an electronic marketplace for stock that is not listed or traded on an organized exchange.

Daytrading

- Daytraders use computer programs to try and predict minute-by-minute price changes in hopes of earning a profit.

Futures and Options

- **Futures** are contracts to buy or sell at a specific date in the future at a price specified today.

- **Options** are contracts that give investors the option to buy or sell stock and other financial assets. There are two types of options:

  1. **Call options** give buyers the option to buy shares of stock at a specified time in the future.

  2. **Put options** give buyers the option to sell shares of stock at a specified time in the future.

Measuring Stock Performance

Bull and Bear Markets

- When the stock market rises steadily over time, a **bull market** exists. Conversely, when the stock market falls over a period of time, it's called a **bear market**.

Stock Performance Indexes

- The Dow Jones Industrial Average
  - **The Dow** is an index that shows how stocks of 30 companies in various industries have changed in value.
- The S & P 500
  - The **S & P 500** is an index that tracks the performance of 500 different stocks.

The Great Crash

Causes of the Crash

- **Many ordinary Americans were struggling financially: many purchased new consumer goods by borrowing money.**
- **Speculation, or the practice of making high-risk investments with borrowed money in hopes of getting a big return, was common.**

Effects of the Great Crash

- **The Crash contributed to a much wider, long-term crisis — the Great Depression during which many people lost their jobs, homes, and farms.**
- **Americans also became wary of buying stock. As recently as the early 1980s, only about 25 percent of households in the United States owned stock.**

The collapse of the stock market in 1929 is called the Great Crash.

Section 3 Assessment

1. A share of stock represents
   (a) debt that the government or a corporation must repay to an investor.
   (b) a portion of ownership in a corporation.
   (c) a system that allows the transfer of funds between savers and borrowers.
   (d) a collection of financial assets.
2. Which of the following represents a way to profit from buying stock?
   (a) capital gains
   (b) portfolios
   (c) speculation
   (d) capital losses

Want to connect to the PHSchool.com link for this section? Click Here!

Section 3 Assessment

1. A share of stock represents
   (a) debt that the government or a corporation must repay to an investor.
   (b) a portion of ownership in a corporation.
   (c) a system that allows the transfer of funds between savers and borrowers.
   (d) a collection of financial assets.

2. Which of the following represents a way to profit from buying stock?
   (a) capital gains
   (b) portfolios
   (c) speculation
   (d) capital losses

Want to connect to the PHSchool.com link for this section? Click Here!