The Language of the Stock Market

Family Economics & Financial Education
Why Learn About Stocks

- The stock market is the core of America’s economic system
  - Stock is a share of ownership in the assets and earnings of a company
  - Bond is a type of debt that a company issues to investors for a specified amount of time.
  - Stock market is a general term used to describe all transactions involving the buying and selling of stocks and bonds issued by a company
Why Companies Issue Stock

When a company would like to grow, it issues stocks to raise funds and pay for ongoing business activities.

- It is popular because:
  - The company does not have to repay the money
  - Paying dividends is optional

- Dividends are distributions of earnings paid to stockholders
Risk vs. Return

• On average, stocks have a high rate of return
  – The increase or decrease in the original purchase price of an investment
• Higher rate of return = greater risk
  – Uncertainty about the outcome of an investment
• Stocks provide portfolio diversification
  – Money invested in a variety of investment tools
2 Basic Types of Stock

Common Stock

Vs.

Preferred Stock
Common Stock

- **Common stock** – shares or units of ownership in a public corporation
  - Most basic form of ownership
  - One vote per share owned to determine company’s board of directors

- **Ways the stock value can change**
  - The dollar value increases or decreases
  - **Stock split** occurs – shares owned by existing stockholders are divided into a larger number of shares
  - A merger of two companies
  - Dividends are paid
Preferred Stock

• Preferred stock – shares which pay fixed dividends and have priority over common stock
  – Less risk than common stock
  – No voting rights
  – Dividends are stated as a percentage known as the par value
  • Fixed value stated on the stock certificate
Stock Classifications
Stock Classifications

• A variety of type of stocks are necessary for a diversified portfolio

• Seven basic classifications
  – Growth, Income, Value, Cyclical, Countercyclical, Speculative, Blue Chip

• Some stocks can be classified into more than one category
Growth Stock

- Growth stocks are from companies who have a consistent record of relatively rapid growth and earnings in all economic conditions
  - New companies expanding product lines
  - Usually does not pay dividends
  - Beta is 1.5 or higher
  - Examples include Coca-Cola and Wal-Mart
Income Stock

• Income stocks pay higher than average dividends
  – Company only retains small portion of profits
  – Companies with a steady stream of income such as utility companies
  – Beta is less than 1.0
Value Stock

- Value stocks are from companies which have a low market price considering historical earning records and value of assets
  - Viewed as investment bargains
  - Previous examples are Time Warner and IBM
Cyclical Stock

• Cyclical stocks are influenced by changes in the economic business cycle
  – Companies which operate in major consumer dependent industries
    • Automobiles, housing, airlines
  – Beta is generally 1.0
Countercyclical Stock

- Countercyclical stocks are companies which give consistent returns even when the economy is suffering
  - Products are always in demand
  - Good for investors who want dividends
  - Examples are utility companies and grocery stores
  - Beta is 1.0 or below, even negative
Speculative Stock

• Speculative stocks are companies with potential for substantial earnings
  – Very high risk stocks
  – Examples include internet and video game companies
  – Beta is 2.0
• Blue-chip stocks are from nationally recognized companies with long records of profit, dividend payments, and a good reputation for management
  – Less risky
  – Grow at a consistent rate
  – Examples are McDonalds, Wal-Mart and General Electric
RESEARCHING A STOCK
Book Value

- Book value is the net worth of a company

\[ \text{Assets} - \text{Liabilities} = \text{Book value} \]

- Information can be found in the company’s annual report

- Indicates what would happen if a company’s assets were sold, debts paid, and proceeds distributed to stockholders
Earnings per Share

- How much income a company has available to pay in dividends and reinvest as retained earnings on a per share basis

\[
\text{After tax annual earnings} \div \frac{\text{Total number of shares of common stock}}{= \text{Earnings per share}}
\]

- Information can be found in the business section of many newspapers
- Indicates how well a company is doing (the quality of products, customer service, and operations management)
Price/Earnings Ratio

- Price/earnings ratio is the relationship between the price of one share of stock and the annual earnings of the company (P/E ratio)

\[
\frac{\text{Price per share}}{\text{Earnings per share of stock}} = \text{P/E ratio}
\]

- Information can be found in a newspaper
- Most widely used critical measure of a stock’s price
- Represents how much an investor is willing to pay for each dollar of a company’s earnings
- Most companies have between a 5-25 P/E ratio
  - 7-10 P/E ratios are financially successful companies
  - 15-25 P/E ratios are rapidly growing companies
  - 40-50 P/E ratios are speculative companies
- Lower P/E stocks pay higher dividends and have less risk, lower prices, and slow growth
- High P/E ratios indicate the firm is expected to have a lot of growth in the future
**Beta**

- Beta measures a stock's volatility compared to overall changes in the stock market
  - If a stock has a beta of +1.5 and the market went up 10%, the value of the stock is expected to rise 15%
  - Average beta is between +0.5 - +2.0
  - Information can be found by doing an internet search for “Stock ticker symbol + beta”
  - A higher beta indicates more risk because the stock price change will be more drastic
Reading Stock Quotes
Year to Date Percent Change

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- Year to date percent change is the stock price percent change from January 1st of the current year
  - If a stock was $43.00 on January 1st and $36.00 on July 30th, the percentage change would be -16.3%
# 52-Week High & Low

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52-Week High & Low shows the highest and lowest prices the stock was sold per share during the last 52 weeks.
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**Stock – Each company’s stock is provided with an abbreviated trading symbol name**
### Dividends per Share

Dividends per share is the total cash paid to common stockholders per share annually:

- Helpful when determining the type of stock
- If a company paid $10,000 in dividends for 30,000 shares, the dividends per share would be $0.33

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- **Dividend yield percentage is the dividend expressed as a percentage of the price of the share**
  - If a company paid $1.25 in dividends for a stock with a market price of $50.00, the dividend yield percentage would be 2.5% (1.25/50)
  - Helpful to know how much income to expect. A company paying high dividends is not reinvesting money to grow.
Price/Earnings Ratio

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- Price/earnings ratio is the closing price of the share compared to the annual earnings per share
  - If the stock’s market price is $50.00 and the earnings per share is $2.25, the P/E ratio is 22.2
    - For every dollar the company earns, the stock’s market price is worth $22.00
  - A high number indicates people are optimistic about the company and health of the market.
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- **Vol 100’s** is the number of transactions to the share on the reported day
  - Represented in hundreds (take the number and add two zeros)
High and Low entries represent the high and low selling price of one share for the previous day.
### Close

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- Close is the price of the last share sold for the day
### Net Change

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- **Net change is the difference between the closing price of the share from the prior day and the current day**
How Well the Stock Market is Doing Overall
3 Basic Indicators

- **Dow Jones Industrial Average ("DOW")**
  - Lists the 30 leading industrial blue chip stocks
- **Standard and Poor’s 500 Composite Index**
  - Covers market activity for 500 stocks
  - More accurate than DOW because it evaluates a greater variety of stock
- **National Association of Security Dealers Automated Quotations ("NASDAQ")**
  - Monitors fast moving technology companies
  - Speculative stocks, show dramatic ups and downs
• The term bull market means the market is doing well because investors are optimistic about the economy and are purchasing stocks

• The term bear market means the market is doing poorly and investors are not purchasing stocks or selling stocks already owned
Purchasing Stock
Brokers

• A Broker is a person who is licensed to buy and sell stocks, provide investment advice, and collect a commission on each purchase or sale
  – Purchases stocks on an organized exchange (stock market)
  – Over ¾ of all stocks are bought and sold on an organized exchange
Organized Exchanges

- Minimum requirements for a stock to ensure only reputable companies are used
- Each exchange has a limited number of seats available which brokerage firms purchase to give them the legal right to buy and sell stocks on the exchange
New York Stock Exchange

• New York Stock Exchange (NYSE)
  – Oldest and largest, began in 1792
  – 1,366 seats available
  – 2,800 companies
  – Average stock price is $33.00
  – Strict requirements
American Stock Exchange

- Began in 1849
- 2nd largest exchange
- It’s requirements are not as strict as NYSE allowing younger, smaller companies to list
- Average stock price is $24.00
Regional Stock Exchanges

- Stocks are traded to investors living in a specific geographical area
  - Including Boston, Cincinnati, Philadelphia, Spokane
• National Association of Securities Dealers Automated Quotations
  – Stocks are traded in an over the counter electronic market
  – 4,000 small companies
    • Company requirements are not as strict
  – More volatile because companies are young and new
  – Average stock price is $11.00
Supply vs. Demand

- The stock exchange is organized based upon the laws of supply and demand
  - Supply is the relationship of prices to the quantities of a good or service sellers are willing to offer for sale at any given point in time
  - Demand is the relationship of prices to the quantities and the corresponding quantities of a good or service buyers are willing to purchase at any given point in time.