Stock Market Q & A

What are stocks?

A **stock** is a share in the ownership of a corporation. The person buying the stock becomes a stockholder, or shareholder, of the corporation and earns dividends on his or her stocks, or *shares*. A **dividend** is a portion of a company's earnings that is paid to stockholders. Buying stocks is a form of investing. **Investing** is purchasing a financial product or valuable item with the goal of increasing wealth over time in spite of possible loss.

What is the stock market?

The **stock market**, or *stock exchange*, is a system and marketplace for buying and selling various securities, including stocks. The stock of public corporations is listed on a stock exchange where it can be bought and sold. Stocks are listed in two markets: the primary market and the secondary market.

The **primary market**, also called the *new-issues market*, is for corporations that are selling stock to the public for the first time. A company's first sale of stock to the public is called an **initial public offering (IPO)**. Investors who buy shares of IPO stock can later sell the stocks in the secondary market.

The **secondary market** is where brokers or investors buy securities from other brokers or investors instead of directly from the issuing corporation. The New York Stock Exchange (NYSE) and the National Association of Securities Dealers Automated Quotations (NASDAQ) are major secondary markets in the United States. The NYSE is a traditional brick-and-mortar exchange located on Wall Street in Manhattan, New York. The building contains a large trading floor where brokers conduct transactions. The NASDAQ is an American-based, electronic network for trading securities. NASDAQ lists the securities of more than 3,000 companies worldwide.

Securities and stocks of small companies that are not listed on stock exchanges can be bought and sold through OTC markets. **Over-the-counter (OTC) markets** are virtual markets where dealers and brokers conduct business through an electronic network of computers and telephones. The largest OTC markets in the United States are Over-the-Counter Bulletin Board (OTCBB) offered by the National Association of Securities Dealers and OTC Markets Group.

Are there different types of stocks?

Corporations can issue various types of stock. The most often issued types are common stock and preferred stock.

Common stock is a share in the general ownership of a corporation. The holders of common stock have voting rights in corporate matters and receive dividends. Common stockholders may vote in person at the company's annual stockholders' meeting or may vote their shares by proxy. A **proxy** is a stockholder's written authorization to have someone else cast a vote on his or her behalf.

Some corporations issue preferred stock in addition to common stock. **Preferred stock** is a type of stock that pays a regular dividend at a fixed rate. All preferred stock dividends must be paid before common stockholders receive dividends. However, preferred stockholders usually do not have voting privileges.

There are other designations for stocks in the market, such as blue-chip and speculative. **Blue-chip stock** is the stock of a large, established, financially secure company. The performance of blue-chip stocks is generally stable and the names of the associated corporations are well-known. **Speculative stock** is stock that has the potential of high returns, but comes with high risk. Typically, speculative stocks sell for a very low price per share—as low as a few cents. With such a low investment, any increase in the stock price makes the investor more money. However, the companies associated with speculative stock are often small, unproven, or unstable, which makes the stocks a risky investment.

How are stocks bought and sold?

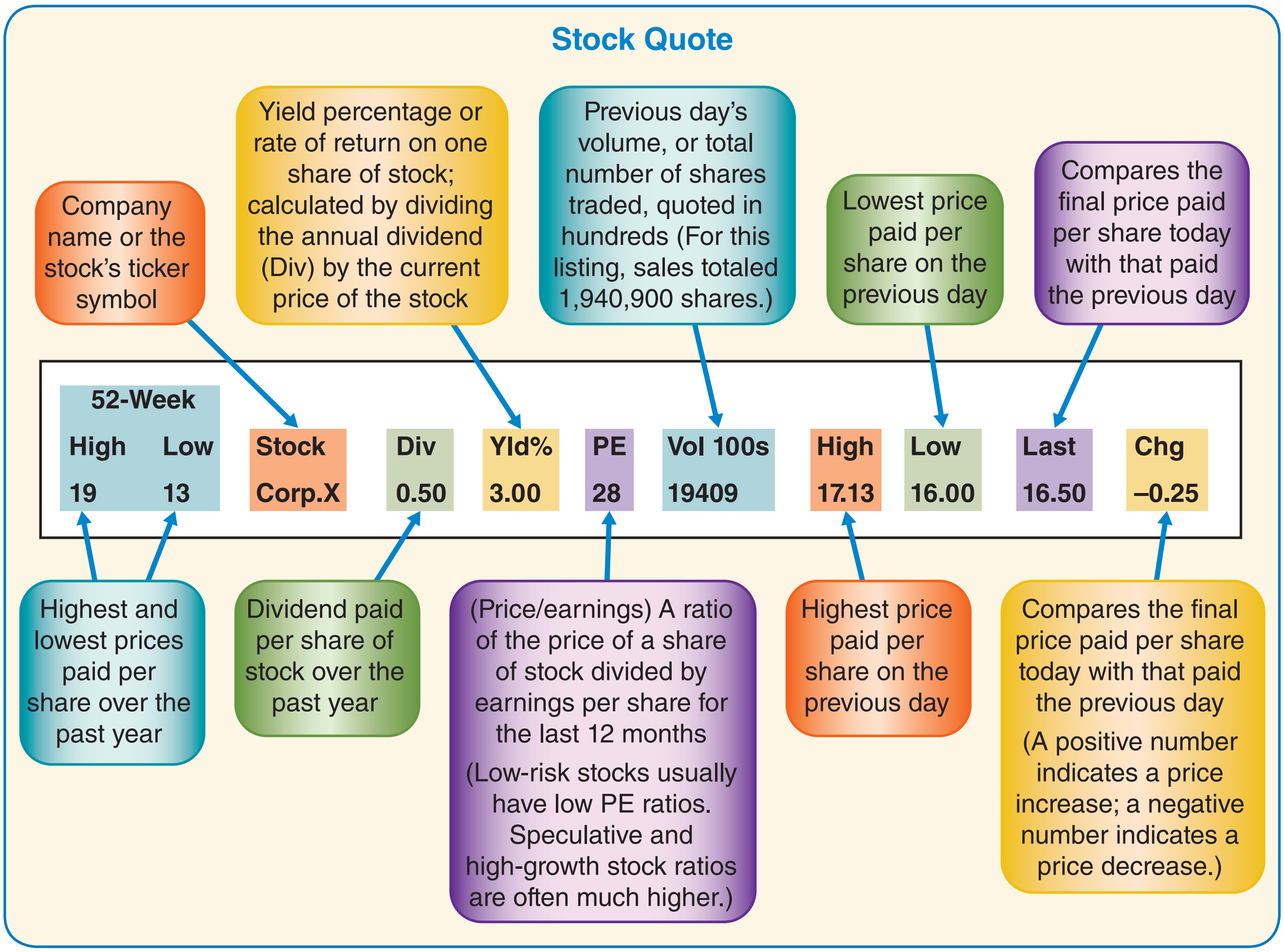
The purchase or sale of stock shares is called stock *trading*. A **stockbroker** is an agent who brings buyers and sellers together and executes stock trades for clients. Usually, stockbrokers charge a commission on both buy and sell transactions. **Commission** is a fee paid to stockbrokers for their services, which may be a flat dollar amount or a percentage of the transaction.

Different types of stockbrokers are available to investors. A **discount broker** only executes buy and sell transactions. This type of broker does not offer advice and does not research investments for his or her clients. A discount broker may be appropriate for investors who do their own research and are experienced in managing their own stock portfolios. A **full-service broker** executes buy and sell transactions and is licensed to provide other financial services, such as financial planning, portfolio management, and research.

An alternative to using a stockbroker is online trading. **Online trading** is buying and selling stocks and securities through Internet-based programs and websites. Online trading sites and services typically charge a flat fee per transaction.

What is a stock quote?

You can follow the ups and downs of stocks by checking daily stock quotes. A **stock quote** is the current price of a stock listed on a stock exchange. They can be found on various websites, as well as printed in daily newspapers and financial publications. Aside from the stock price, stock quotes contain other information, such as historical pricing and performance, the volume of the stock traded, market value, and the price/earnings ratio (PE). **Market value** refers to the current market value of a company, which considers the company's stock price and number of shares available for purchase on the stock market. A **price/earnings ratio (PE)** is the relationship between the current price of a stock and the earnings generated per share. This ratio shows the amount of investment needed for one dollar of earnings.



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How can I research stocks before I invest?

Before buying any stock, research the company, stock performance, and industry. To find a particular stock, you need to know the stock's **ticker symbol**, or *trading symbol*, which is a series of letters that identify the corporation. Stocks listed on the NYSE use one, two, or three letters as a symbol. For example, the ticker symbol for Ford Motor Company is F and the ticker symbol for Wal-Mart Stores Inc. is WMT. Companies listed on the NASDAQ use four letters as a symbol. For example, the ticker symbol of Microsoft Corporation is MSFT and the ticker symbol for Apple, Inc. is AAPL.

Stock market indices are often used as market performance indicators. A **stock market index** compiles statistics on a segment of the stock market, which is used to indicate performance of the market as a whole. Common stock market indices include the Dow Jones Industrial Average, Standard and Poor's 500 (S&P 500), and NASDAQ Composite Index. Each market index includes different statistics in its performance calculation. For example, the Dow Jones Industrial Average includes stock data on the 30 largest US companies. However, the S&P 500 includes data on the 500 most commonly traded stocks in the US market.

There are many stock market research tools online, including the websites of the New York Stock Exchange and NASDAQ. Additionally, there are many financial publications that provide information and insights about the stock market, economy, and industry activity. Reputable and experienced financial professionals can be valuable resources, as well.

What are the advantages and disadvantages of investing in the stock market?

Simply put, the greatest advantage of investing in the stock market is the potential to build wealth. Every investor hopes for high yields. A **yield** is the financial return on an investment. Ideally, buying stock at a low price and selling the stock for a higher price provides a return on the investment, or a capital gain. A **capital gain** is income that results from selling an asset for more than the purchase price.

Another advantage is that stocks are generally very liquid investments. A **liquid investment** is an asset or security that is easily turned into cash. Depending on the performance, stocks usually sell quickly when offered in the secondary market.

The largest disadvantage to investing in the stock market is the potential of losing money. A **capital loss** is a loss of money that occurs when the selling price of an investment is less than the purchase price. The strength and performance of a stock is the result of many factors that are out of the investor's control, such as changes in the economy, company profits, and activity within the related industry. Every stock purchase is a risk.

Stock Market Activities

1. One of the most important factors in choosing a stock to purchase is the stock history. Choose a corporation listed in the NYSE or NASDAQ. Find the record of that corporation's stock on an online stock ticker for the previous five business days. Record the previous stock activity.
2. Using the same stock you chose in the previous activity, follow and record the activity of that stock for the next five business days. Create a chart that shows the activity of the stock you chose over the ten-day time period.
3. There are many tips, guidelines, and resources available for investing in the stock market. Research the tips and advice offered for first-time investors. Summarize the advice you find and indicate which of the tips and pieces of advice you would follow.

Glossary

blue-chip stock. Stock of a large, established, financially secure company.

capital gain. Income that results from selling an asset for more than the purchase price.

capital loss. Loss of money that occurs when the selling price of an investment is less than the purchase price.

commission. Fee paid to stockbrokers for their services.

common stock. A share in the general ownership of a corporation that includes voting rights in corporate matters.

discount broker. Stockbroker who executes buy and sell transactions only.

dividend. A portion of a company's earnings that is paid to stockholders.

full-service broker. Stockbroker who is licensed to provide other financial services, such as financial planning, portfolio management, and research.

initial public offering (IPO). Company's first sale of stock to the public.

investing. Purchasing a financial product or valuable item with the goal of increasing wealth over time in spite of possible loss.

liquid investment. An asset or security that is easily turned into cash.

market value. The current market value of a company, which considers its stock price and number of shares available on the stock market.

over-the-counter (OTC) market. Virtual markets where dealers and brokers conduct business through an electronic network of computers and telephones.

preferred stock. Type of stock that pays a regular dividend at a fixed rate, but does not include voting privileges.

price/earnings (PE) ratio. Relationship between the current price of a stock and the earnings generated per share.

primary market. When a corporation first sells stock to the public. Also called the *new-issues market*.

proxy. Stockholder's written authorization to have someone else cast a vote on his or her behalf.

secondary market. When brokers or investors buy securities from other brokers or investors instead of directly from the issuing corporation. Also called *securities exchange*.

speculative stock. Stock that has the potential of high returns, but comes with high risk.

stock. A share in the ownership of a corporation.

stock market. A system and marketplace for buying and selling securities.

stock market index. Statistics on a segment of the stock market used to indicate performance of the market as a whole.

stock quote. The current price of a stock listed on a stock exchange.

stockbroker. An agent who brings buyers and sellers together and executes stock trades for clients.

ticker symbol. Series of letters that identify a corporation listed in the stock market. Also called a *trading symbol*.

yield. Financial return on an investment.