**The Stock market**

**Function and purpose**

The stock market is one of the most important ways for [companies](https://en.wikipedia.org/wiki/Company) to raise money, along with debt markets which are generally more imposing but do not trade publicly. This allows businesses to be publicly traded, and raise additional financial capital for expansion by selling shares of ownership of the company in a public market. The [liquidity](https://en.wikipedia.org/wiki/Liquidity) that an exchange affords the investors enables their holders to quickly and easily sell securities. This is an attractive feature of investing in stocks, compared to other less liquid investments such as [property](https://en.wikipedia.org/wiki/Property) and other [immoveable](https://en.wikipedia.org/w/index.php?title=Immoveable&action=edit&redlink=1) assets. Some companies actively increase liquidity by trading in their own shares.

History has shown that the price of [stocks](https://en.wikipedia.org/wiki/Stock) and other assets is an important part of the dynamics of economic activity, and can influence or be an indicator of social mood. An economy where the stock market is on the rise is considered to be an up-and-coming economy. In fact, the stock market is often considered the primary indicator of a country's economic strength and development.

Rising share prices, for instance, tend to be associated with increased business investment and vice versa. Share prices also affect the wealth of households and their consumption. Therefore, [central banks](https://en.wikipedia.org/wiki/Central_bank) tend to keep an eye on the control and behavior of the stock market and, in general, on the smooth operation of [financial system](https://en.wikipedia.org/wiki/Financial_system) functions. Financial stability is the [raison d'être](https://en.wiktionary.org/wiki/raison_d%27%C3%AAtre) of central banks.

Exchanges also act as the clearinghouse for each transaction, meaning that they collect and deliver the shares, and guarantee payment to the seller of a security. This eliminates the risk to an individual buyer or seller that the [counterparty](https://en.wikipedia.org/wiki/Counterparty) could default on the transaction.

The smooth functioning of all these activities facilitates [economic growth](https://en.wikipedia.org/wiki/Economic_growth) in that lower costs and enterprise risks promote the production of goods and services as well as possibly employment. In this way the financial system is assumed to contribute to increased prosperity, although some controversy exists as to whether the optimal financial system is bank-based or market-based.

Recent events such as the [Global Financial Crisis](https://en.wikipedia.org/wiki/Global_Financial_Crisis) have prompted a heightened degree of scrutiny of the impact of the structure of stock mark, in particular to the stability of the financial system and the transmission of [systemic risk](https://en.wikipedia.org/wiki/Systemic_risk).

## Market participant

Market participants include individual retail investors, institutional investors such as mutual funds, banks, insurance companies and hedge funds, and also publicly traded corporations trading in their own shares. Some studies have suggested that institutional investors and corporations trading in their own shares generally receive higher risk-adjusted returns than retail investors.

A few decades ago, worldwide, buyers and sellers were individual investors, such as wealthy businessmen, usually with long family histories to particular corporations. Over time, markets have become more "institutionalized"; buyers and sellers are largely institutions (e.g., [pension funds](https://en.wikipedia.org/wiki/Pension_fund), [insurance companies](https://en.wikipedia.org/wiki/Insurance_companies), [mutual funds](https://en.wikipedia.org/wiki/Mutual_fund), [index funds](https://en.wikipedia.org/wiki/Index_fund), [exchange-traded funds](https://en.wikipedia.org/wiki/Exchange-traded_fund), [hedge funds](https://en.wikipedia.org/wiki/Hedge_fund), investor groups, banks and various other [financial institutions](https://en.wikipedia.org/wiki/Financial_institution)).

The rise of the [institutional investor](https://en.wikipedia.org/wiki/Institutional_investor) has brought with it some improvements in market operations. There has been a gradual tendency for "fixed" (and exorbitant) fees being reduced for all investors, partly from falling administration costs but also assisted by large institutions challenging brokers' oligopolistic approach to setting standardized fees.

### Trends in market participation

Stock market participation refers to the number of agents who buy and sell equity backed securities either directly or indirectly in a financial exchange. Participants are generally subdivided into three distinct sectors; households, institutions, and foreign traders. Direct participation occurs when any of the above entities buys or sells securities on its own behalf on an exchange. Indirect participation occurs when an institutional investor exchanges a stock on behalf of an individual or household. Indirect investment occurs in the form of pooled investment accounts, retirement accounts, and other managed financial accounts.

### Irrational behavior

Sometimes, the market seems to react irrationally to economic or financial news, even if that news is likely to have no real effect on the fundamental value of securities itself. But, this may be more apparent than real, since often such news has been anticipated, and a counter reaction may occur if the news is better (or worse) than expected. Therefore, the stock market may be swayed in either direction by press releases, rumors, [euphoria](https://en.wikipedia.org/wiki/Euphoria) and [mass panic](https://en.wikipedia.org/wiki/Mass_panic).

Over the short-term, stocks and other securities can be battered or buoyed by any number of fast market-changing events, making the stock market behavior difficult to predict. Emotions can drive prices up and down, people are generally not as rational as they think, and the reasons for buying and selling are generally obscure. Behaviorists argue that investors often behave 'irrationally' when making investment decisions thereby incorrectly pricing securities, which causes market inefficiencies, which, in turn, are opportunities to make money. However, the whole notion of EMH is that these non-rational reactions to information cancel out, leaving the prices of stocks rationally determined.

**Crashes**

[Robert Shiller](https://en.wikipedia.org/wiki/Robert_Shiller)'s plot of the S&P Composite Real Price Index, Earnings, Dividends, and Interest Rates, from [Irrational Exuberance](https://en.wikipedia.org/wiki/Irrational_Exuberance_(book)), 2d ed. In the preface to this edition, Shiller warns, "The stock market has not come down to historical levels: the price-earnings ratio as I define it in this book is still, at this writing [2005], in the mid-20s, far higher than the historical average... People still place too much confidence in the markets and have too strong a belief that paying attention to the gyrations in their investments will someday make them rich, and so they do not make conservative preparations for possible bad outcomes."

Price-Earnings ratios as a predictor of twenty-year returns based upon the plot by [Robert Shiller](https://en.wikipedia.org/wiki/Robert_Shiller). The horizontal axis shows the [real price-earnings ratio of the S&P Composite Stock Price Index](https://en.wikipedia.org/wiki/File:IE_Real_SandP_Price-Earnings_Ratio,_Interest_1871-2006.png) as computed in Irrational Exuberance(inflation adjusted price divided by the prior ten-year mean of inflation-adjusted earnings). The vertical axis shows the geometric average real annual return on investing in the S&P Composite Stock Price Index, reinvesting dividends, and selling twenty years later. Data from different twenty-year periods is color-coded as shown in the key. See also [ten-year returns](https://en.wikipedia.org/wiki/File:Price-Earnings_Ratios_as_a_Predictor_of_Ten-Year_Returns_(Shiller_Data).png). Shiller states that plot” confirms that long-term investors—investors who commit their money to an investment for ten full years—did do well when prices were low relative to earnings at the beginning of the ten years. Long-term investors would be well advised, individually, to lower their exposure to the stock market when it is high, as it has been recently, and get into the market when it is low."

A stock market crash is often defined as a sharp dip in [share prices](https://en.wikipedia.org/wiki/Share_price) of [stocks](https://en.wikipedia.org/wiki/Stock) listed on the stock exchanges. In parallel with various economic factors, a reason for stock market crashes is also due to panic and investing public's loss of confidence. Often, stock market crashes end speculative [economic bubbles](https://en.wikipedia.org/wiki/Economic_bubble).

There have been famous [stock market crashes](https://en.wikipedia.org/wiki/Stock_market_crash) that have ended in the loss of billions of dollars and wealth destruction on a massive scale. An increasing number of people are involved in the stock market, especially since the [social security](https://en.wikipedia.org/wiki/Social_security) and [retirement plans](https://en.wikipedia.org/wiki/Retirement_plan) are being increasingly privatized and linked to [stocks](https://en.wikipedia.org/wiki/Stock) and bonds and other elements of the market. There have been a number of famous stock market crashes like the [Wall Street Crash of 1929](https://en.wikipedia.org/wiki/Wall_Street_Crash_of_1929), the [stock market crash of 1973–4](https://en.wikipedia.org/wiki/Stock_market_crash_of_1973%E2%80%934), the [Black Monday of 1987](https://en.wikipedia.org/wiki/Black_Monday_(1987)), the [Dot-com bubble](https://en.wikipedia.org/wiki/Dot-com_bubble) of 2000, and the Stock Market Crash of 2008.

One of the most famous stock market crashes started October 24, 1929 on Black Thursday. The [Dow Jones Industrial Average](https://en.wikipedia.org/wiki/Dow_Jones_Industrial_Average) lost 50% during this stock market crash. It was the beginning of the [Great Depression](https://en.wikipedia.org/wiki/Great_Depression). Another famous crash took place on October 19, 1987 – Black Monday. The crash began in Hong Kong and quickly spread around the world.

By the end of October, stock markets in Hong Kong had fallen 45.5%, Australia 41.8%, Spain 31%, the United Kingdom 26.4%, the United States 22.68%, and Canada 22.5%. Black Monday itself was the largest one-day percentage decline in stock market history – the Dow Jones fell by 22.6% in a day. The names "Black Monday" and "Black Tuesday" are also used for October 28–29, 1929, which followed Terrible Thursday—the starting day of the stock market crash in 1929.

The crash in 1987 raised some puzzles – main news and events did not predict the catastrophe and visible reasons for the collapse were not identified. This event raised questions about many important assumptions of modern economics, namely, the [theory of rational human conduct](https://en.wikipedia.org/wiki/Theory_of_rational_conduct_of_human_being), the [theory of market equilibrium](https://en.wikipedia.org/wiki/Theory_of_market_equilibrium) and the [efficient-market hypothesis](https://en.wikipedia.org/wiki/Efficient-market_hypothesis). For some time after the crash, trading in stock exchanges worldwide was halted, since the exchange computers did not perform well owing to enormous quantity of trades being received at one time. This halt in trading allowed the [Federal Reserve System](https://en.wikipedia.org/wiki/Federal_Reserve_System) and central banks of other countries to take measures to control the spreading of worldwide financial crisis. In the United States the SEC introduced several new measures of control into the stock market in an attempt to prevent a re-occurrence of the events of Black Monday.

Since the early 1990s, many of the largest exchanges have adopted electronic 'matching engines' to bring together buyers and sellers, replacing the open outcry system. Electronic trading now accounts for the majority of trading in many developed countries. Computer systems were upgraded in the stock exchanges to handle larger trading volumes in a more accurate and controlled manner. The SEC modified the margin requirements in an attempt to lower the volatility of common stocks, stock options and the futures market. The [New York Stock Exchange](https://en.wikipedia.org/wiki/New_York_Stock_Exchange) and the [Chicago Mercantile Exchange](https://en.wikipedia.org/wiki/Chicago_Mercantile_Exchange) introduced the concept of a circuit breaker. The circuit breaker halts trading if the Dow declines a prescribed number of points for a prescribed amount of time. In February 2012, the Investment Industry Regulatory Organization of Canada (IIROC) introduced single-stock circuit breakers.