PFL Academy

Teacher Guide: Chapter 66 — Understanding Financial Markets

OVERVIEW

TIME	MATERIALS	PREREQUISITES
45-50 Minutes	Student Activity Packet	L-47: Investment Types

LESSON FLOW

5 min — **THE CHALLENGE**

- Contrast Sofia's smart limit order vs. Marcus's costly market order mistake.
- Discussion: "What did Marcus do wrong? How could he have protected himself?"
- Preview: Small execution costs compound to significant wealth differences.

10 min — **CORE CONCEPTS**

- Draw bid-ask spread visually on board: buyers line up at bid, sellers at ask.
- Demonstrate: "You always BUY at ask (higher) and SELL at bid (lower)."
- Quick check: "If bid is $50 and ask is $50.10, what do you pay to buy? Receive to sell?"

25-30 min — **APPLY IT**

- **Part A (10 min):** Stock quote analysis. Ensure students understand liquidity indicators.
- **Part B (10 min):** Order type scenarios—when to use market vs. limit.
- **Part C (10 min):** Trading cost comparison—this is the "aha" moment.

10 min — **CHECK YOUR UNDERSTANDING**

- Q3 calculation shows long-term impact of trading costs.
- Q5 personal strategy development is important for practical application.

DIFFERENTIATION

Support

- Create visual diagram: "Bid = what buyers offer, Ask = what sellers want."
- Use simple rule: "Narrow spread = good, wide spread = expensive."
- Walk through Part C calculation step-by-step.

Extension

- Research actual bid-ask spreads for familiar companies (Apple vs. penny stock).
- Calculate market impact of larger orders on illiquid stocks.
- Compare brokerage platforms' order routing and execution quality.

ANSWER KEY

Part A: Reading Stock Quotes

1. Price paid: **$142.60** (the ask price). Spread: $142.60 - $142.55 = **$0.05**. Liquidity: **HIGH** (8.2M volume, narrow $0.05 spread).

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2. Buy at ask: 100 × $142.60 = $14,260
Sell at bid: 100 × $142.55 = $14,255
Spread cost: $14,260 - $14,255 = $5 loss
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Part B: Order Type Scenarios

Scenario 1: Market order. Spread is only $0.01 (minimal cost), and urgency requires guaranteed execution.

Scenario 2: Limit order. Wide $0.35 spread means market order would be expensive. Place limit order between bid and ask; wait for better execution.

Part C: Trading Cost Analysis

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3. Active Trader: 100 trades × $0.15 spread × 50 shares = $750/year
Buy-and-Hold: 4 trades × $0.02 spread × 200 shares = $16/year
Active trader pays 47x more in spread costs!
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Check Your Understanding

1. B (Execution only, not price)

2. Markets were closed Sunday. His market order queued for Monday open. Overnight bad news caused price to gap down. A limit order would have prevented execution at the unfavorable price.

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3. $750/year at 7% for 30 years:
FV = $750 × [(1.07^30 - 1) / 0.07] ≈ $75,000-$80,000 lost wealth
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4. "Commission-free" doesn't mean free. Wide bid-ask spreads on small-cap stocks, payment for order flow, and frequent trading still created substantial hidden costs. Commission was zero but spread costs were high.

COMMON MISCONCEPTIONS

Misconception	Clarification
"Commission-free means no trading costs."	Bid-ask spreads, payment for order flow, and market impact are hidden costs that exist even with $0 commissions.
"Market orders always execute at the price I see."	Prices can change between when you submit and when the order executes, especially during volatility or when markets are closed.
"Professional traders use market orders for speed."	Professionals almost exclusively use limit orders to control execution price. Speed matters less than avoiding slippage.