



Understanding Stocks and the Stock Market

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Stock Classification

Stock is ownership in a company, with each share of stock representing a tiny piece of ownership. The more shares you own, the more of the company you own, and the more dividends you earn when the company makes a profit. In the financial world, ownership is called equity.

Stocks are in two primary classes. The one you choose depends on what you want from a stock. **Preferred stock** typically pays regular dividends, and investors who want income foremost from their stocks favor it. **Common stock** represents ownership of a company and may offer more rights and privileges than preferred stock.

Issuing Stock

Businesses issue stock to raise money. They use this money to finance expansions, pay for equipment and fund projects, etc. Corporations issue stock when they may need additional capital to operate successfully.

The fancy term for issuing stock to raise money is **equity financing**. The money received from investors who buy stocks is called **equity capital**. In the world of securities, the word “equity” usually refers to stocks. The other method of raising money is **debt financing**, which involves selling bonds. When companies make profits, they may reward their stockholders with pieces of their profits, known as **dividends**. Dividends are an incentive for investors to hold stocks.

Now that you know the why of buying stocks, you will need to know the where.

The Stock Market and Stock Exchanges

Investors may purchase stock on the primary or secondary market. A company sells its stock to the public on the primary market through its initial public offering. The **primary market** is the market in which investors have the first opportunity to buy a newly issued security. Investors may sell their shares through brokers to other investors on the secondary market. The **secondary market** can be structured as an auction market, such as the New York Stock

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Exchange (NYSE), or a dealer market, such as the National Association of Securities Dealers Automatic Quotation System, called NASDAQ. Stock prices (quotes) can be found in newspapers, on television and the Internet.

Stock exchanges are the physical locations where stocks are bought and sold. The **over-the-counter** (OTC) market refers to a market in which securities transactions are conducted through a telephone and computer network connecting dealers in stocks and bonds, rather than on the floor of an exchange. Together, these two markets (stock exchange and

OTC) form the secondary market. The primary and secondary markets together make up the stock market.

Exchanges are located all over the world, with the most famous one being the New York Stock Exchange. The NYSE annually trades almost \$12 trillion dollars worth of capital. Thousands of stocks are listed on this exchange. When you buy a stock, you will need to learn which exchanges list it. Other than locating a quote in the newspaper, with online trading and the automation of order systems, customers have very little reason to determine where the stock trades from.

Determining Your Return

Determining the return on stock for any particular period involves determining both the **capital gains or losses** and the **dividends**. Capital gain or loss is the difference between the amount you paid for the stock and the current sale price. Dividends are the periodic payments that stockholders receive and the board of directors determines. These payments can range from zero to any amount the company can afford to pay, and you have no guarantee you will receive dividends.

The **holding period yield (HPY)** measures the percent return on stocks during a period of time. The formula is as follows:

$$\text{HPY} = \frac{\text{Dividends} + \text{Price Change}}{\text{Purchase Price}}$$

For example, assume you bought 100 shares of XYZ stock at \$20 a share one year ago. You received a total of 50 cents per share in quarterly dividends, and the price of the stock has risen to \$22 per share.

Your holding period yield would be:

Dividends	= 50 cents x 4 = \$2 per share per year
Price Change	= \$2
HPY	= \$2 + \$2/purchase price
	= \$4/\$20
	= 20 cents
HPY	= 20 percent per share



Understanding the Stock Table

Generic Stock Table								
Monday, August 23, 1999								
1	2	3	4	5	6	7	8	9
52 Weeks								
HI - LO	SYM	DIV	VOL	YLD	PE	HI - LO	CLOSE	NET CHG
47 - 37	Z	2.30	335	5	10	43 - 40	42 3/8	+1

A stock table provides you with valuable information about stock values. Here is an example of a table that could be found in the financial section of a major newspaper, such as The Wall Street Journal. The Wall Street Journal is not the only newspaper that provides information on the stock market; many other local and national newspapers also provide this service. However, the information usually is presented in a similar manner. The chart gives information about the last 52 weeks' high and low price, the company name's symbol on the exchange, dividends, volume of shares sold, dividend yield, price/earnings ration, the high and low price for the previous day's trading, the closing price per share and the net change in price.

The world's best known stock indicator, the **Dow Jones Industrial Average**, is an index based on the 30 industrial stocks representing every important sector in the stock market (except transportation and utilities), and responding to every important factor in the economy.

Regulation

The **Securities and Exchange Commission (SEC)** regulates stock trading and exchanges and makes laws and rules governing the securities industry. The **National Association of Securities Dealers (NASD)** administers additional regulations. The NASD makes and enforces rules for its members and enforces federal securities acts. As you learn more about investing, you will become more familiar with these organizations and their protective regulations.

Regulation in North Dakota

The North Dakota Securities Department regulates the offer and sale of securities and franchises in North Dakota, and enforces compliance with our state's laws, protecting the investing public. The department promotes public awareness of securities laws to prevent violations and investment fraud. The department provides investor education programs for all ages to improve the level of financial literacy in our state.

Major responsibilities of this department include:

- Enforcing the North Dakota Securities Act and North Dakota Franchise Investment Law
- Registering securities offerings, broker-dealer and investment adviser firms and representatives, and franchises
- Facilitating businesses' capital formation
- Investigating consumer complaints and initiating appropriate disciplinary action
- Promoting sound financial planning through investor education programs

Goals of this department are to:

- Maintain the integrity of the marketplace for securities, franchises and commodities in North Dakota
- Exact high standards of those who seek to use the money of others
- Assist industry firms and salespeople in employing sound sales practices
- Promote investor confidence in our capitalistic economy
- Foster the formation of capital for business and economic development
- Provide public information and education about financial planning and investing to help citizens make wise personal financial choices

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References

Investing for Your Future

www.investing.rutgers.edu

Learning the Stock Market: Self Directed Study Guide

<http://pages.prodigy.com/wealth/learn.htm>

North Dakota Stock Market Game, North Dakota Securities Department

www.ndsecurities.com/investor-education/stock-market-game.asp

The Stock Market Game, Foundation for Investor Education

www.stockmarketgame.com

Stock Market–Understanding the Stock Market: Investing it Right

www.investingitright.com/stock-market.html

Other Resources

www.younginvestor.com/parents/investIt/

www.ameritrade.com/education/html/encyclopedia/tutorial1/

<http://moneycentral.msn.com/content/investing/startinvesting/p33734.asp>

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For more information on this and other topics, see: www.ag.ndsu.nodak.edu



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