

Notes from the PBS video



How Wall Street Works

Nightly Business Report



The **New York Stock Exchange** located on Wall Street in New York City, is where traders can buy and sell stocks and bonds.

Two major types of investors:

Bulls – think that stock prices will increase

Bears – think that stock prices will decrease

Investing in the security market is not for everyone. Trading stock and bonds carries significant risk and holds no guarantees.

Exchanges such as the NYSE make it possible for companies to raise a large amount of money, called **capital formation**.



Why Companies Issue Securities

Companies such as Carnival Cruise Lines are operating in a capital intensive business. They have the need for large amounts of money in order to keep providing their customers with the type of cruise ships that offer the desired amenities.

Carnival raised funds through an IPO (initial public offering) of common stock in 1987. Their IPO was for 27 million shares of common stock initially sold at \$15.50 per share. Through this sale they raised over \$400 million. Currently Carnival has over 800 million shares of stock held by investors.



What do investors get with stock ownership?

- They become part owners in the company.
- They may receive payments of shared profits (dividends).
- They may benefit from the appreciation of the stock value.



| | | | |
|-------|-------|-------|-----|
| 18.40 | 18.27 | +0.07 | 149 |
| 27.00 | 26.01 | -0.10 | 45 |
| 5.60 | 5.47 | -0.10 | 71 |
| 21.16 | 21.06 | -0.10 | 139 |
| 21.35 | 21.10 | -0.30 | 617 |
| 9.75 | 9.61 | +0.37 | 70 |
| 14.84 | 14.51 | -0.05 | 44 |
| 9.24 | 9.17 | +0.03 | 34 |
| 29.79 | 29.50 | +0.06 | 49 |
| 13.59 | 13.50 | +0.07 | 11 |
| 19.73 | 19.65 | +0.07 | 11 |
| 21.16 | 21.00 | -0.05 | 11 |

Bonds

In 1990 Carnival took a different tactic by issuing **bonds**. This permitted the company to borrow money from bondholder for a fixed period of time.

Carnival agreed to repay the bond owner the amount loaned plus 7.5% interest over a 15 year period.

After the IPO, the existing shares of Carnival stocks and bonds can be bought and sold on a stock market exchange.

Several billion shares of stocks are traded each day on the New York Stock Exchange and NASDAQ.

How a Stock is Traded

90% of stocks bought and sold on the NYSE are done via electronic networks versus by open outcry on the trading floor. NASDAQ has always been an electronic exchange.

Orders to buy or sell a stock are placed through stock brokers who have been granted the right to do business with a particular stock exchange.

Orders may be made over a telephone or by computer.

Trade terminology

Bid price - highest price someone is willing to pay for a stock

Ask price – lowest price someone else is willing to accept for a stock at that moment.

Market order – order placed to buy or sell the stock at the current price.

Limit order - order placed to buy or sell the stock at a specific price or within a specified price range.

Stock Quote – current price of stock – easily accessed online.

Close price – the last price at which a stock was traded the previous day.

Stock Information in a Newspaper Listing

- 52 week high selling price of a stock
- 52 week low selling price

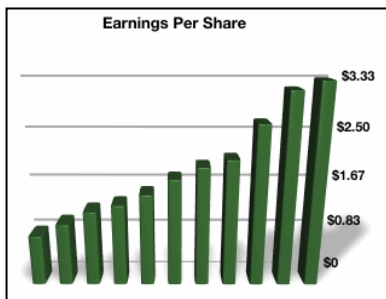
| | | | | | | | | | |
|--------|------|------|------|-----|-------|------|------|------|-----|
| JNS | 041 | 040 | 041 | 0 | TEAN | 585 | 585 | 585 | 005 |
| MEFC | 388 | 384 | 384 | 002 | AI | 865 | 860 | 870 | 010 |
| HLINK | 149 | 149 | 149 | 004 | BAFS | 1060 | 1070 | 1070 | 0 |
| SAMRT | 555 | 550 | 550 | 005 | BRMPU | 142 | 142 | 142 | 0 |
| SARTL | 860 | 858 | 855 | 005 | BCP | 875 | 880 | 880 | 005 |
| SATTEL | 640 | 635 | 640 | 0 | ERSTM | 375 | 340 | 375 | 010 |
| SKIN | 2315 | 2315 | 2650 | 0 | EMMP | 1000 | 80 | 78 | 0 |
| SIH | 1780 | 1740 | | | | 2750 | 2715 | 2750 | 050 |
| TRUE | 970 | 975 | 975 | | | 1080 | 11 | 1050 | 010 |
| TT&T | 654 | 653 | 653 | | | 038 | 001 | 038 | 001 |
| UCON | 1475 | 1475 | | | | 268 | 270 | | 0 |
| VEI | 888 | 890 | 888 | | | 104 | 105 | | 0 |
| WSTAR | 068 | 068 | 068 | | | 34 | 3425 | 34 | 0 |
| FANCY | 248 | 252 | 252 | | | 422 | 422 | 420 | 002 |
| TT | 810 | 810 | | | | 384 | 388 | | 386 |
| CVF | 5950 | 60 | | | | 635 | 7 | 635 | 015 |
| WTCO | 491 | 495 | | | | 48 | 493 | 495 | 007 |
| WDA | 471 | 448 | | | | 50 | 6050 | 61 | 0 |
| RSC | 320 | 338 | | | | 1730 | 1740 | | 010 |
| SINGER | 290 | 298 | | | | 1350 | 1330 | | 010 |
| EVOR | 67 | 68 | | | | 850 | | | 815 |
| KS | 261 | 264 | | | | 700 | 700 | | 010 |

- Company’s abbreviated name
- Ticker Symbol
- Volume of shares sold that week (quoted in 10,000s)
- Stock’s Yield – annual percentage return via dividends
- P/E ratio – measure of stock price to company earnings
- Previous day’s closing price
- Change in stock’s value versus one week previous

Company Earnings are an Important Factor in Stock Valuation

All public companies listed on stock exchanges must report their earnings on a quarterly basis. Every three months a report must be sent to the Securities Exchange Commission as well as released to the public.

Market analysts interpret the earnings reports and then give their opinion about the future potential of the company’s stock.



Earnings per Share (an important number that is watched closely) is the company’s earnings divided by the number of shares of stock.

Investors should compare the current EPS to that of the previous quarter and the previous year. Did it grow? If so, at what pace?

For investors, projections by a Wall Street analyst regarding what a particular company’s earnings will be the following quarter is of great importance.

Another critical factor is company’s actual performance versus the projected performance. The actual performance is compared with the expected performance and if there’s a significant difference, the price of their stock will usually change. Lower earnings than projected result in a drop in the stock price. Higher earnings than projected result in an increased stock price.

Information from Karen Blumenthal, author of *Grande Expectations: A Year in the Life of Starbucks’ Stock*

A company like Starbucks is wise if it can set earnings expectations at a level that they can meet or beat and then keep Wall Street informed about what it is doing and planning to do.

Investors love growth stock – stocks that appreciate in value, more than stocks that pay out good and reliable dividends. Starbucks achieved high growth in their stock



values because they had a rapid expansion strategy that achieved remarkable sales growth by opening 100s of new outlets.



Wall Street players that can influence the price of a stock:

The market analysts – because so many people use their opinions as guidance

The mutual fund and hedge fund managers – because they trade in such large volumes.

Company Tactics to Increase the Value of a Stock

Stock buy-backs – a company buys back some of its own stock. The remaining stockholders then own a larger percentage of the company. Companies use this as a marketing tactic to push up its stock price.

Stock splits – in a 2:1 stock split, the share holder receives two shares for every one held. It reduces the selling price of the stock by half, thus making the stock more attractive to potential investors.

The best stock to buy is one from a company that shows real earnings growth and not get duped from feel good marketing efforts such as buy-backs and splits.



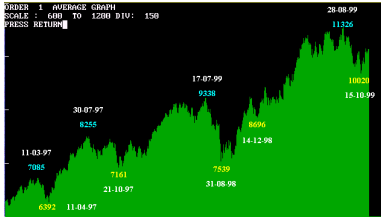
How News Affects the Markets

Besides earnings, news reports about the following items can affect the stock price, turning the entire market hot or cold:

- The state of the overall market
- News or rumors about politics, the economy or interest rates
- Stock markets and economies in foreign countries
- The performance of a company that is considered to be a market leader (Amazon.com; Microsoft)

However if the news has been well-circulated (pro or con) then the outcome can have very little impact on the price of the stock. Company performance issues that are widely anticipated do not have major impact if they come true.





The Dow Jones Industrial Average

The DJIA is the most widely reported indicator of the stock market's minute-to-minute performance. It is an average of the prices of stocks from 30 companies (which change over time.)

It is not an accurate indicator of how the market is really doing – but it has a 113 year track record for comparison – no other indicator has that.



Standard & Poor's 500

The S&P 500 is considered to be a better measure of market activity than the DJIA. It contains 500 large companies (rather than just 30). Unlike with the DJIA, the calculations of the S&P stock price averages are weighted to the size of the companies.

If you wish to see how the market is performing for companies based on their size:

- **S&P 100** Large Cap companies – over \$5 billion
- **S&P 400** Mid Cap - Medium sized companies \$1-\$5 billion

Other Indexes of Importance to an Investor

The **NYSE Composite** and **NASDAQ Composite** Indexes reflect the stock price averages for all companies listed on those respective exchanges.

Indexes can also be tied to various sectors of the market such as the **Dow Jones Transportation** and **Dow Jones Utility Indexes**.

These are excellent indexes that provide a broad total market overview:

- **Russell 2000**
- **Russell 3000**
- **Dow Jones Wilshire 5000**

To which index should the average investor pay the closest attention? To get a good idea about where the market is headed.

1. Start with S&P 500 – shows a measure of the most popular companies
2. Dow Jones Wilshire 5000
3. Russell 3000





Other ways of Building a Stock Portfolio

Futures Contract Trading (Chicago Board of Trade)

Lets investors bet on the direction of the market. This is one of the riskiest types of trade.

Index based fund – a type of mutual fund with an objective to achieve approximately the same return as a particular market index such as the S&P 500 Price Index, the Russell 2000 Index or the Wilshire 5000. An index fund will invest in the securities (stocks or bonds) of companies that are included in a selected index.

Exchange Traded Fund (ETF) – often tied to a stock index. These are similar to mutual funds but can be traded at the stock exchange at any time of the day. These can be very volatile.

Buying stocks based on an Index can be less risky than buying individual stocks.

Mutual Fund - A company that brings together a group of people and invests their money in stocks, bonds, and other securities. Each investor owns shares, which represent a portion of the holdings of the fund.



Securities Regulation: U.S. Securities and Exchange Commission

The SEC is the federal watchdog organization that sets the rules for stock exchange activities and monitors the stock exchanges for fraud or manipulation of stock prices. Their goal is to protect investors. They require financial disclosure of all companies listed on the exchange so that everyone has access to the same information (versus insider information that leads to insider trading).

Financial disclosure is of primary importance to the SEC – they believe it is what separates the stock market from a casino.

Brokers are also policed by a sister organization, FINRA. It maintains a broker check system that allows investors to look into the backgrounds on brokers and contains a listing of disciplinary actions and complaints. (www.finra.org)

SEC regulators recommend that investors check out a broker's record before accepting their advice and deal only with registered stock or bond offerings.



Advice for a New Investors

- Based on Kiplinger's Personal Finance Magazine

1. Have a plan or an investment philosophy. Before investing, have a clear strategy in mind. Where are you going and how will you get there? What can you afford?
2. Become informed – take the time to educate yourself about a particular company and about your broker.
3. Check on the quality of the information you're receiving. Anyone can post advice on Internet blogs and web pages.
4. Don't invest money that should be set aside for another use. If you need the money for something within two or three years, don't put it into the stock market.
5. Don't be overly optimistic at the top of the market and overly pessimistic at the bottom.
6. Don't buy stock based on tips and rumors. We're all potential suckers for suggestions from the Internet, television, and radio shows.
7. Don't be sentimental about a stock – companies come and go. Sell those stocks that haven't shown growth for several years.
8. Stay away from penny stocks. There's a good reason why stocks are valued at very low prices.

People with a long-term goal are considered **investors**. These people buy a stock and leave it unsold for at least three years.

People with a short-term goal are considered **speculators**. These people get in and out of a stock quickly.

How to Know when to Sell a Stock

- When the stock value has achieved a certain price objective.
- When some fundamentals have changed regarding the company (e.g. new management) or in the industry.

Best advice for a new investor

Develop an investment approach that has you investing a certain amount of money on a regular basis – and stick with it even when the market is down as well as up.