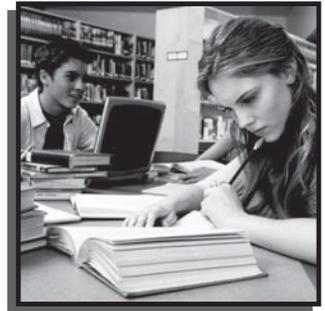


LESSON 7

WHAT ARE STOCK MARKETS?



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LESSON DESCRIPTION

The lesson introduces conditions necessary for market economies to operate. Against this background, students learn concepts and background knowledge—including primary and secondary markets, the role of investment banks, and initial public offerings (IPOs)—needed to understand the stock market. The students also learn about different characteristics of major stock markets in the United States and overseas. In a closure activity, students match stocks with the market in which each is most likely to be traded.

INTRODUCTION

For many people, the word *market* may be closely associated with an image of a place—perhaps a local farmer’s market. For economists, however, *market* need not refer to a physical place. Instead, a market may be any organization that allows buyers and sellers to communicate about and arrange for the exchange of goods, resources, or services. Stock markets provide a mechanism whereby people who want to own shares of stock can buy them from people who want to sell shares of stock.

The three largest stock markets in the world are the New York Stock Exchange (NYSE), the NASDAQ Stock Market, and the Tokyo Stock Exchange. Although these markets differ from one another, especially in the kinds of stock traded and the mechanisms used for trading, all three are known as secondary markets. They are different from a primary market in which a company sells shares and receives money in an initial public offering (IPO).

CONCEPTS

Initial public offering (IPO)

Market

Primary market

Secondary market

Stock market

OBJECTIVES

Students will:

- Identify conditions needed for a market economy to operate.
- Describe the stock market as a special case of markets more generally.
- Differentiate three major world stock markets and predict which market might list certain stocks.

CONTENT STANDARDS

Voluntary National Content Standards in Economics, 2nd Edition

- **Standard 5:** Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation, and among individuals or organizations in different nations.
- **Standard 7:** A market exists when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.
- **Standard 10:** Institutions evolve and are created to help individuals and groups accomplish their goals. Banks, labor unions, markets, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution, clearly defined and enforced property rights, is essential to a market economy.

National Standards in K-12 Personal Finance Education, 3rd Edition

- **Financial Responsibility and Decision Making Standard 2:** Find and evaluate financial information from a variety of sources.
- **Saving and Investing Standard 4:** Describe how to buy and sell investments.

TIME REQUIRED

60 minutes

MATERIALS

- Slide 7.1
- A copy of Activity 7.1 for each student

(Internet access required)

PROCEDURE

1. Tell the students that this lesson focuses on markets in general and on the stock market in particular. **Ask:** What is a market? What is a stock market?
2. To begin discussing markets, ask the students to list several markets they have participated in over the last few weeks. (*Examples might include a farmers' market, a supermarket, a retail store, a gasoline station.*)
3. Ask the students to think about what it would take to establish and maintain markets of the sort they have mentioned. What sort of legal and economic environment would be necessary? The question is somewhat abstract. To help the students get at it, you might use the following prompt: **We couldn't have markets unless we had _____.** Challenge the students to complete the statement. Provide help as necessary. Make a list of the necessary conditions on the board. The list should include the following:
 - **Private property.** Markets depend on an individual's ability to own and sell property. In market transactions, people can choose to sell property to others and transfer the right of ownership with the sale.
 - **Competition.** Markets foster competition because they allow the entry of many producers striving to meet the demands of consumers. Competition pressures these producers to satisfy consumer demand or be forced from the market by others who can.
 - **The profit motive.** Profits act as incentives for individuals and firms. In market transactions, individuals and firms that satisfy consumer desires and produce efficiently are rewarded with profits.
 - **Voluntary exchange.** Because consumers have choices in a market, market exchanges are voluntary. This allows consumers and producers to focus on what they do best and to trade with others who specialize in different areas. Markets encourage trade and thus create wealth.
4. Introduce the lesson's focus on stock markets by reference to the previous discussion. Just as there is a market for music downloads (iTunes), blue jeans (department store), or books (bookstore), there is a market for stocks. Somebody who wants to buy stocks can buy them at a stock market.
5. Explain that stock markets operate in the same sort of legal and economic environment needed by other markets. Stock markets are places where *private property* (shares of ownership) is bought and sold. Stock markets are *competitive* markets, with thousands of

buyers and sellers striving to make the best trades they can. The *profit motive* prompts traders to obtain and keep any gains they can make from stock trading. And stock markets depend on *voluntary exchange*. Stock trades are not coerced; rather, buyers and sellers choose to participate in their efforts to invest money wisely.

6. As necessary, pause here to establish clearly what a stock is (or review Lesson 4). Explain that a stock is a share of ownership in a company. If you buy 100 shares of Acme Electronics, you become a part-owner (100 shares' worth) of Acme Electronics. And why would people want to buy stock in a given company? Identify two main reasons: (a.) they expect to share in a company's profits (called dividends) paid out to shareholders; (b.) they believe the price of the company's stock will rise above the price they paid for it—in other words, that their asset will grow in value.
7. Ask the students if they have ever seen a stock store at the mall. If not at the mall, where can you go to buy stocks? Explain that almost all stock sales and purchases—often called stock trades—are handled by a specialized salesperson called a broker. In addition, almost all stocks are sold by these brokers in secondary markets.
8. To distinguish between primary and secondary markets, **Display Slide 7.1**. Explain that companies such as Company X often seek additional resources to expand or run their business. One way to generate these resources is to offer all, or a portion, of the company for sale to the public-at-large (“take a company public”). This is done in the primary market through an initial public offering (IPO) in which stocks are sold to large investment banks. Investment banks then sell the shares

to brokerage houses, and brokers offer the shares for sale to individuals and institutional buyers on the secondary market through one of the major stock exchanges like the New York Stock Exchange (NYSE), the NASDAQ Stock Market in the United States, or a stock market in another country, such as the London Stock Exchange or the Tokyo Stock Exchange.

9. **Distribute a copy of Activity 7.1** to each student. Have the students read the introduction. Briefly review the overview of market mechanics, using **Slide 7.1** as needed.
10. Have the students read the descriptions of the three major stock markets. Call on students to identify the distinctive characteristics of each of the three markets. Record their responses on the board. Sample responses:

New York Stock Exchange (NYSE)	NASDAQ Stock Market	Tokyo Stock Exchange
<i>Founded in 1792.</i>	<i>Founded in 1971.</i>	<i>Founded in 1878.</i>
<i>About 3,500 companies listed.</i>	<i>About 2,800 companies listed.</i>	<i>About 2,300 companies listed.</i>
<i>Home of large and well-established companies.</i>	<i>Considered the home of tech stocks.</i>	<i>Home of the Nikkei 226 index.</i>
<i>Listed companies must have at least \$100,000,000 in outstanding stock and trade an average of at least 100,000 shares per day.</i>	<i>No physical location; trades done via computer network.</i>	<i>Companies separated into three categories: large, mid-sized, and growth / startup.</i>
<i>1,336 member seats.</i>	<i>Largest market in terms of stocks traded.</i>	<i>104 members.</i>
	<i>No fixed number of members.</i>	

11. Have the students complete the **Place the Stock** activity. Answers:

Market	Stocks		
New York Stock Exchange (NYSE)	<i>Con Ed</i>	<i>DuPont</i>	<i>McDonald's</i>
NASDAQ Stock Market	<i>Atari</i>	<i>Intel</i>	<i>Telecom Austria</i>
Tokyo Stock Exchange	<i>Toyota</i>	<i>POSCO</i>	<i>YTL Corporation</i>

CLOSURE

12. Briefly review major points of the lesson. The students have studied concepts and background information about stock markets, including the general legal and economic conditions that support markets generally. They have learned that the stock market is a specialized market in which shares of stock are bought and sold. Also review the three stock markets discussed in this lesson.
13. Organize the class into groups of four students each. Working in their groups, the students should look at the clothing and shoes they are wearing, their backpacks or book bags, and any other items they may have brought with them to class. Can they identify the companies that made these items? If so, have them list several of the companies on a piece of paper. Then ask the students to make some well-informed guesses about which stock markets the companies that made their products might be listed on. For example, if a student has an AT&T cell phone, she might guess that AT&T is a high-tech firm listed on the NASDAQ (although this guess would be wrong). If a student is wearing Nike shoes, he might guess that the stock of this company, given the company's size, would be traded on the NYSE (and he would be

correct). If a student has a calculator, it might be made by Casio or Sony. Both of these firms are traded on the Tokyo Stock Exchange. Once the students have made their guesses, ask them to use the internet in class to determine which ones are correct and which are incorrect (or you might assign this as homework or a library project).

ASSESSMENT

Multiple-Choice Questions

- All of the following conditions are essential to a market economy except
 - the private property of individuals is well defined and protected.
 - the government controls decisions about production and consumption.*
 - competition puts pressure on businesses to satisfy consumer desires.
 - profits are an incentive for producers to respond to consumer choices.
- In the case of stock trades, the secondary market consists of
 - the trading of a company's stock in a stock market.*
 - the purchase of a company's stock by an investment bank.
 - the first offering of a company's stock to the public.
 - all trading that occurs in the initial public offering of the stock.
- All of the following are true of the New York Stock Exchange except that
 - it has a fixed number of memberships called "seats."
 - it operates a physical trading floor rather than being all electronic.
 - it contains a smaller proportion of young technology companies than the NASDAQ Stock Market.
 - it is the largest stock market in terms of trade volume.*

4. Which of these is an accurate statement about the NASDAQ and NYSE?
 - a. The NASDAQ Stock Market is a secondary market; the NYSE is a primary market.
 - b. *Membership on the NYSE is limited; the NASDAQ has an open membership.*
 - c. Trading on both the NASDAQ Stock Market and the NYSE is limited to one physical location.
 - d. The NASDAQ Stock Market was founded before the NYSE.

often referred to as an initial public offering [IPO] or “going public.” In the secondary market, shares of stock are bought and sold by individuals and brokers in a stock market.)

Constructed-Response Items

1. Identify and briefly explain four conditions that enable market economies to operate.

*(**Private property.** Markets depend on an individual’s ability to own and sell property. In market transactions, people can choose to sell property to others and transfer the right of ownership with the sale. **Competition.** Markets foster competition because they allow the entry of many producers striving to meet the demands of consumers. Competition pressures these producers to satisfy consumer demand or be forced from the market by other producers who can. **The profit motive.** Profits act as incentives for individuals and firms. Individuals and firms that satisfy consumer desires and produce efficiently are rewarded with profits. **Voluntary exchange.** Because consumers have choices in a market, all exchanges are voluntary. This allows consumers and producers to focus on what they do best and to trade surplus production or wealth. Markets encourage trade and thus create wealth.)*

2. Describe the difference between primary and secondary stock markets.

(In the primary market, the firm sells stock to an investment bank. This is



Gen i Connection

Among the print lessons in this book, Lesson 7 (“What Are Stock Markets?”) and Lesson 14 (“How Are Stock Prices Determined?”) have close ties to Mission 12 of the Gen i Revolution game, “Show Jasmine what determines stock prices.” In this mission, Jasmine needs help in understanding the stock market so that she can help her clients make trades. The 4-1-1 tutorial guides students to equilibrium at the intersection of demand and supply curves, and it shows them how events could change equilibrium stock prices. As students complete this mission, they find themselves on the floor of a fictional stock exchange as they are asked to react to the news of the day and help Jasmine predict changes in stock prices.

Gen i Reflection



Jasmine learned in Gen i Revolution Mission 12 that she would have to react quickly to incoming news in order to be a successful stock trader. Some jobs are like that, requiring constant attention and fast action. Other jobs, such as accounting, call for patience and discipline but not as much fast action. Thinking about your own skills and abilities, which type of job would you find more satisfying? Explain your answer.

ACTIVITY 7.1

MEET THE STOCK MARKETS

The stock market is an institution enabling people who want to buy shares of stock to buy them from others who want to sell shares of stock. This market matches buyers and sellers and provides a means for reaching mutual agreement on price. That is, the price of a share of stock is set at the moment when a buyer and seller agree to make a trade, and not before. The stock market is more than a physical location (and need not be a physical location at all); it is a set of arrangements, advertisements, online transactions, computer listings and personal relationships that make it possible for stocks to be traded.

Although often referred to as if it were a single entity, “the stock market” is actually a number of different markets. The three largest stock markets in the world are the New York Stock Exchange (NYSE), NASDAQ Stock Market, and the Tokyo Stock Exchange in Japan.

The New York Stock Exchange (NYSE)

The oldest stock exchange in the United States, the NYSE was founded in 1792 when 24 brokers agreed to form the exchange. Today about 3,500 public companies are traded on the NYSE, and these companies have a combined value of about \$13.5 trillion. Generally, small corporations’ stocks are not listed on the NYSE. In order to be listed on the NYSE, the company must have outstanding share value (the value of all the shares of stock not owned by the company itself) of at least \$100 million and must trade at a volume of at least 100,000 shares per day.

The NYSE operates a trading floor in New York City. Members of the NYSE—1,336 brokers and specialists—carry out all trades. Members are said to have a “seat” on the NYSE, although they never actually sit down, and such seats have sold for as much \$4 million in recent years. Investors purchase stocks by placing orders with brokers from around the United States and the world. These brokers then place floor orders at the NYSE, and those orders are filled by the members. In recent years, nearly 80 percent of the order volume has been delivered electronically.

NASDAQ Stock Market

The NASDAQ Stock Market began trading in 1971, and in 1999 it surpassed the NYSE as the largest stock market (as measured by volume of stock trades) in the United States. The NASDAQ Stock Market is unique because it does not reside any single location. Rather, trades are executed using the NASDAQ’s sophisticated computer and telecommunication network. As the world’s first electronic stock market, it is made up of the NASDAQ National Market and the NASDAQ Small Cap Market. The NASDAQ allows multiple market participants to trade through its electronic communications network structure, thus increasing competition.

The NASDAQ Stock Market currently lists the stocks of more than 2,800 companies, with a combined value of \$3.2 trillion. The NASDAQ is widely known as the home of many of the world’s largest technology-based companies, particularly those involved with computers, software, and the internet. More shares are traded on the NASDAQ than any other stock market in the world, largely because membership is not limited to a fixed number of seats. Any firm or individual that meets certain requirements may join the NASDAQ. This policy allows more than 300 “market makers” (also known as dealers, to their customers) to operate like retail store owners, buying inventory of stock shares to sell to their customers.

Stock Indexes

Several important stock indexes are tracked on U.S. markets. A stock index is a composite of the value of a number of stocks used to measure the ups and downs of the overall market. The most famous stock index is the Dow Jones Industrial Average (DJIA), or “the Dow,” which consists of 30 of the biggest companies in the United States including firms such as Walt Disney, Coca Cola, and Walmart. Today, the Dow is the most widely followed measurement of the stock market. A second important index of stocks is the Standard and Poor’s (S&P) 500. This index uses the stock prices of 500 companies including Boeing, Microsoft, and 3M.

Tokyo Stock Exchange

The Tokyo Stock Exchange (TSE) was established in 1878 in Tokyo, Japan. It has almost 2,300 listed companies with a combined value of \$3.8 trillion, making it the third-largest stock exchange in the world. Stocks listed on the TSE are separated into the First Section for large companies, the Second Section for mid-sized companies, and the Mothers Section for high-growth startup companies.

The best known TSE stock index is the Nikkei 225. Formerly called the Nikkei Dow Jones Stock Average, it consists of 225 of the biggest companies in Japan including firms such as Mitsubishi, Sony, and Sharp. Many major Japanese companies are also listed on the NYSE via American Depositary Receipts (ADR), which represent shares of foreign-based corporations so American investors can buy shares in the United States.

Place the Stock

Listed below are brief descriptions of nine stocks that are listed on one of the three major world stock markets described above. After reading these descriptions, and using what you know about each market, place each stock in the appropriate place on the grid that follows. Pay close attention to the information provided. For example, newer high-tech companies are more likely to be listed on the NASDAQ Stock Market (which opened in 1971).

1. POSCO

A multinational steel-making company headquartered in Pohang, South Korea. It had an output of 35.4 million metric tons of crude steel in 2010, making it the world’s third-largest steelmaker. POSCO currently operates two integrated steel mills in South Korea, in Pohang and Gwangyang. In addition, POSCO operates a joint venture with U.S. Steel, USS-POSCO, which is located in Pittsburg, California.

2. ATARI

Atari’s principal activities are to develop, publish, and distribute interactive entertainment software for leisure entertainment, gaming enthusiasts, and children’s markets for a variety of platforms. This stock was first listed in 1998, and shares traded often average more than 100,000 per day.

3. DUPONT

Founded in 1802, this firm offers a wide range of innovative products and services for markets including agriculture, nutrition, electronics, communications, safety and protection, home and construction, transportation, and apparel. Operating in approximately 90 countries, this company’s stock is part of both the Dow Jones and the S&P 500 stock indexes.

4. **INTEL**
Intel's principal activities are to design, develop, manufacture, and market computers, networking, and communication products. Listed since 1998, this stock regularly averages over 10 million shares traded per day.
5. **MCDONALD'S**
McDonald's Corporation operates in the food-service industry, franchising quick-service restaurant businesses under the McDonald's brand. This stock was first listed in 1966; it is part of the Dow Jones Industrial Average. Shares traded often average near 10 million per day.
6. **TOYOTA**
Toyota Motor Corporation is one of the world's largest automobile manufacturers. Founded in 1937, Toyota manufactures, sells, leases, and repairs passenger cars, trucks, buses, and their related parts worldwide. Shares traded often average near 10 million per day.
7. **TELEKOM AUSTRIA**
This group's principal activities are to provide fixed-line and wireless communication services in Austria and throughout Europe. Listed since 1998, this stock averages 1,000 shares traded per day.
8. **CONSOLIDATED EDISON (CONED)**
Con Edison of New York provides electric power in all of New York City (except Queens) and most of Westchester County. This stock was first listed in 1824. Shares traded per day often exceed one million.
9. **YTL CORPORATION**
YTL Corporation is Malaysia's leading integrated infrastructure conglomerate. The company is involved with utilities, high-speed rail projects, and construction. The stock was first listed in 1985; shares traded per day average about 10,000.

Match the Stocks to the Markets

Market	Stocks		
New York Stock Exchange (NYSE)			
NASDAQ Stock Market			
Tokyo Stock Exchange			

SLIDE 7.1

