

Understanding the Stock Market

COURSE DESCRIPTION/INTRODUCTION

Welcome to the Understanding the Stock Market eLearning course, designed to give you a practical view of the stock market. In this course, you'll move beyond the media dramatization of trading floors and learn the real mechanics behind stock exchanges, order types, and how trades are executed and settled. You'll explore the natural rhythms of the market through bull and bear cycles, gain insight into historical market returns, and understand the key factors that influence stock prices—from internal company events to broader economic shifts. Finally, you'll demystify the concept of stock splits and their impact on investor psychology and long-term strategy. Whether you're just starting out or looking to deepen your investing knowledge, this course will help you navigate the markets with clarity and confidence.

LESSON ONE: HOW STOCK TRADING WORKS

INTRODUCTION

In this lesson, you'll learn the basics of stock exchanges and trading hours, the difference between market and limit orders, and follow the life of a trade from start to finish. We'll also cover what happens after you buy a stock—how it's held and recorded. By the end, you'll gain practical insights to help you navigate the markets with greater confidence and clarity.

BEYOND THE TRADING FLOOR DRAMA

When you think of the stock market, you might picture the chaotic trading floor, the ticker tape and the ringing bell. Hollywood and the news love to portray it that way, reinforcing the idea that it's a complex world only for financial wizards.

But here's the truth: the stock market is essentially a marketplace, a medium where buyers and sellers connect. It's a system designed to match those who want to buy stock with those who want to sell, all within a regulated framework.

The financial markets are regulated by the government and self-regulating agencies. Brokers are licensed, and companies must file financial reports with the Securities and Exchange Commission (SEC). There are mechanisms in place for investors who believe they've been defrauded, and authorities will prosecute those who break the law.

MARKET BASICS: EXCHANGES AND TRADING HOURS

There are numerous stock exchanges in the U.S. and globally. The New York Stock Exchange (NYSE) is the most famous, a physical location in New York City. Others, like the NASDAQ, are electronic, where trades happen via computer.

Trading typically occurs during standard market hours (9:30 a.m. to 4:00 p.m. in the U.S., Monday through Friday), with some pre- and post-market trading. For long-term investors, the regular trading hours are usually best, offering more liquidity and price stability.

To trade, you'll need a broker or a stock-buying service that uses a broker. There are different types: full-service, discount and online brokers. Each has its own fee structure.

TYPES OF STOCK ORDERS: MARKET VS. LIMIT

When you place an order, you'll need to decide whether to buy or sell at the current market price or at a specific price, called a limit price.

- **Market Price:** This is the current, widely available price.
- **Limit Price:** This is a price you set, higher or lower than the current price. While most brokers accept limit orders, they aren't guaranteed to be filled.

HOW A TRADE WORKS: A STEP-BY-STEP OVERVIEW

Once you place your order, your broker gets to work. They're legally obligated to get you the best possible price (best execution). This doesn't mean you'll get a better price than the market, but it means your broker must execute your trade efficiently.

Let's walk through an example:

Jane in Chicago wants to buy 100 shares of General Electric (GE). She places her order online. Her broker might execute the trade:

- Internally, by matching Jane's buy order with a sell order within the brokerage.
- Through a "market maker," a company that specializes in trading certain stocks.
- Through an electronic market or network, matching Jane's order with another sell order.

Once the trade is done, Jane's broker notifies her. Payment is typically settled within three days.

HOLDING YOUR STOCK: CUSTODY VS. CERTIFICATES

Most brokers hold your shares in custody, sending you regular statements. In the past, physical stock certificates were common, but now electronic custody is preferred. Getting a physical certificate often incurs a fee.

As for how long to hold a stock, that's up to you. Day traders buy and sell frequently, racking up fees. Long-term investors, like us, aim to hold onto quality growth companies, keeping costs down and maximizing potential gains.

KEY TAKEAWAYS

- The stock market is a marketplace for buyers and sellers.
- Trades happen through brokers, either on physical or electronic exchanges.
- You can place market or limit orders.
- Brokers are legally obligated to get you the best execution.
- Most stocks are held electronically.
- Long term investing is the best strategy for most people.

LESSON TWO: UNDERSTANDING MARKET CYCLES

INTRODUCTION

In this lesson, you'll learn how to recognize and respond to the natural ups and downs of the stock market. Also, we'll explore the difference between short-term market noise and long-term trends, helping you avoid emotional reactions to daily fluctuations. You'll gain insight into bear markets—those inevitable downturns—and bull markets, which reward patient investors. Most importantly, we'll emphasize the value of staying the course and maintaining perspective through every phase. By understanding market cycles, you'll be better equipped to make informed, resilient investment decisions over time.

THE DAILY NOISE VS. THE LONG-TERM SIGNAL

We're constantly bombarded with market news: "Dow up," "NASDAQ down." But if you're focused on long-term growth, these daily fluctuations shouldn't be your primary concern.

The market, by its very nature, goes up and down. Stock prices are driven by supply and demand. More buyers than sellers? Prices rise. More sellers than buyers? Prices fall.

In the short term, emotions like greed and fear can drive market sentiment. A stock might rise in price simply because the overall market is up, not because of the company's fundamentals. Or, a stock price might fall due to national events or economic conditions, which might not even impact the company's operations.

However, in the long run, it's the fundamentals that matter. Companies with growing sales and earnings tend to see their stock prices rise. That's why we focus on investing in quality growth companies for the long haul.

BEAR MARKETS – THE INEVITABLE DOWNTURNS

Bear markets, those periods of significant market decline, are a fact of life for investors. If you invest long enough, you'll experience them.

A bear market is generally defined as a decline of 20% or more from a recent market high. They can last for months or even years, triggered by events like wars, disasters, or the bursting of speculative bubbles, like the 1929 crash.

It's important to remember that different market segments can experience different cycles at the same time. For example, during the late 1990s tech boom, the NASDAQ soared while other sectors remained relatively flat. And then, the tech bubble burst.

Bear markets can be painful. During the 1973-1974 downturn, major indexes dropped by over 50%. A \$10,000 investment could have shrunk to \$5,000. So, why invest at all?

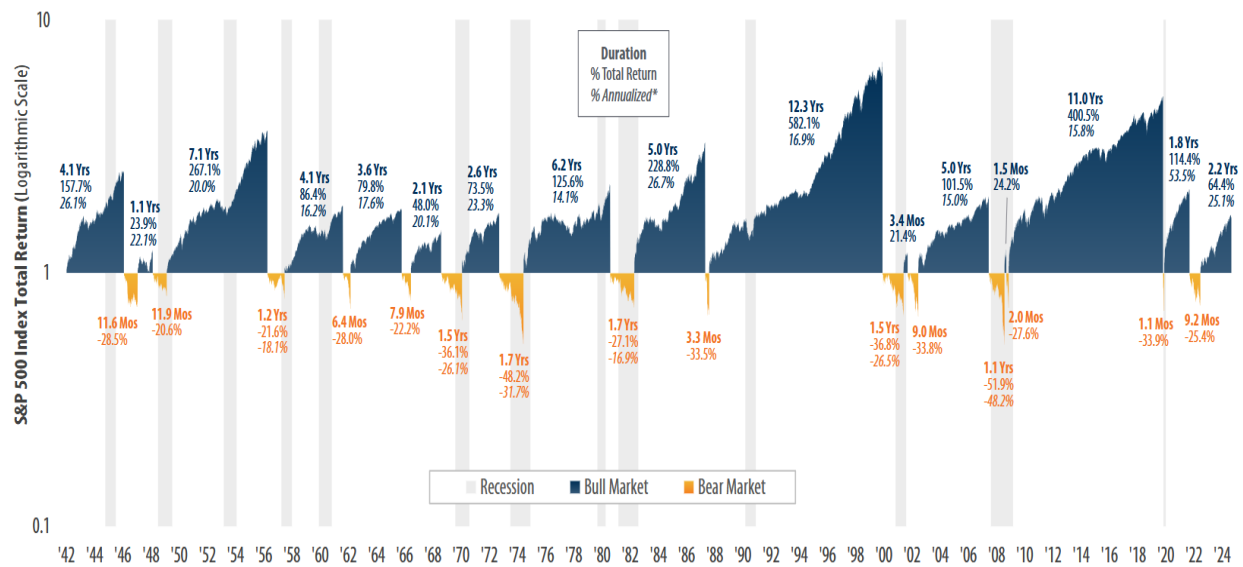
BULL MARKETS – THE REWARD OF PATIENCE

The answer lies in the potential rewards of bull markets. A bull market is defined as a 20% rise from a previous market bottom. Historically, the stock market has averaged about 11% annual growth over the past 75 years.

If you let fear drive you out of the market during downturns, you'll miss out on the subsequent upswings. Research shows that a significant portion of the market's overall returns occur in a relatively short period. Miss those periods, and you miss out on substantial profits.

The potential gains in a bull market are the flip side of the losses in a bear market. If you hold onto solid companies during downturns, you'll likely be rewarded when the market rebounds.

The following represents a history of Bull and Bear markets from 1942-2024



Source: First Trust Portfolios, L.P.

History shows us that bull markets are much more prevalent than bear markets. For long-term investors, bear markets can provide excellent buying opportunities.

THE BOTTOM LINE – STAYING THE COURSE

No one can predict market movements. In fact, when many investors give up and sell at the bottom of a bear market, it's often a sign that a bull market is near.

Before investing, consider your long-term goals. If you're years away from retirement, you can afford to ride out market downturns.

Diversification is key. Spreading your investments across different sectors, company sizes and asset classes (cash, bonds, real estate) can cushion the impact of a bear market.

The best strategy is to stick to a disciplined, diversified approach, regardless of market conditions. By doing so, you'll accumulate shares at lower prices during downturns, setting yourself up for substantial gains when the market recovers.

KEY TAKEAWAYS

- Market cycles are a natural part of investing.
- Short-term fluctuations are less important than long-term trends.

- Bear markets are inevitable, but bull markets offer significant potential.
- Diversification and a long-term perspective are crucial for success.
- No one can predict the market, so stay the course.

LESSON THREE: THE LONG-TERM PERSPECTIVE

INTRODUCTION

In this lesson, we'll take a deeper look at how markets have performed over time and what that means for your investment strategy. We will explore the concept of "markets within markets," highlighting how short-term fluctuations fit into broader historical trends. You'll examine the cycles of troughs and peaks, compare the long-term returns of stocks versus bonds and cash, and better understand the relationship between risk and reward. By gaining this perspective, you'll be better equipped to make informed decisions and stay focused on your long-term financial goals.

UNDERSTANDING HISTORIC MARKET RETURNS

Before committing your hard-earned money to the stock market, it's natural to wonder about potential returns. Historically, the overall stock market has demonstrated an average annual return of approximately 10 to 11 percent, significantly outpacing many other asset classes.

Since 1926, reliable stock market data has provided a long-term view of market performance. Analyses consistently show these average returns, but remember, these are averages. Individual years can vary dramatically, with periods of sharp declines often followed by strong recoveries.

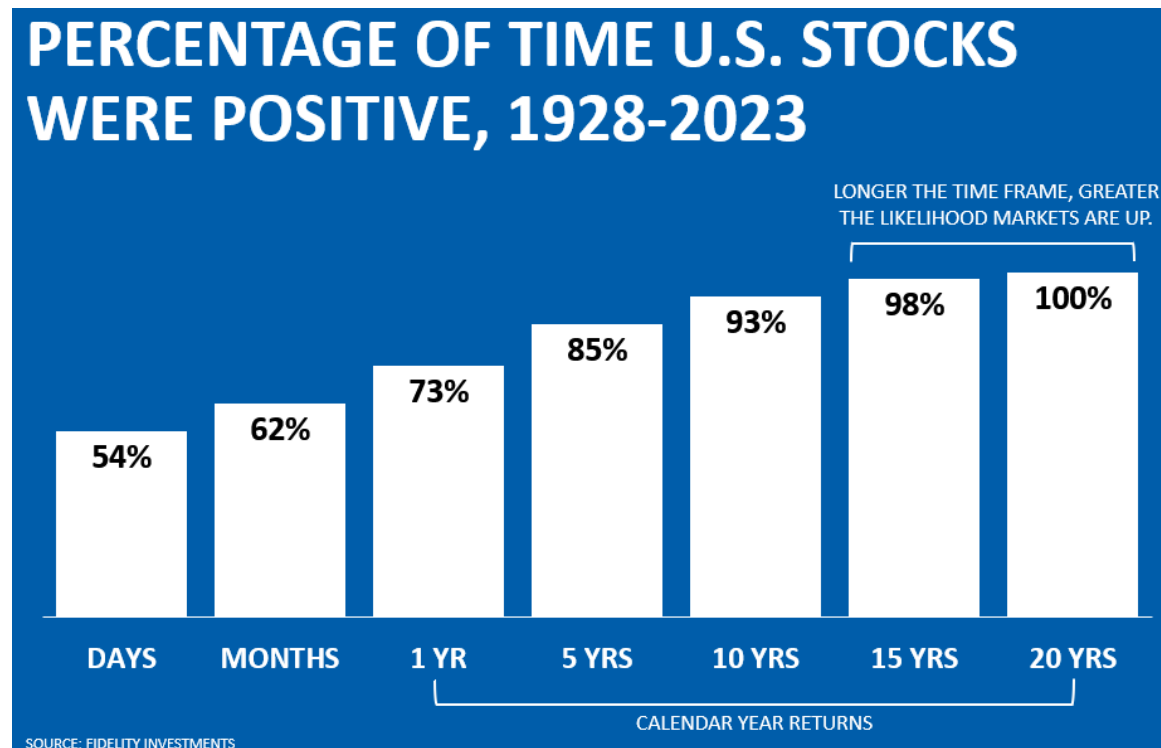
These fluctuations can be unsettling, even for seasoned investors. Additionally, different segments of the market perform differently at various times. Small-cap stocks might surge while large-cap stocks stagnate, or international markets may outperform domestic ones.

Despite these short-term gyrations, the long-term trend of the stock market is undeniably upward. A historical chart spanning decades (shown below) reveals a consistent upward trajectory, albeit with inevitable peaks and troughs.



SOURCE: FIDELITY INVESTMENTS

While past performance is not indicative of future results, long-term investors who have remained disciplined over decades have generally been rewarded.



MARKETS WITHIN MARKETS

The term "stock market" can be misleading, as it encompasses a diverse range of exchanges and companies. Within the U.S. markets alone, you'll find large, mid and small companies, along with penny stocks and American Depositary Receipts (ADRs) representing foreign companies.

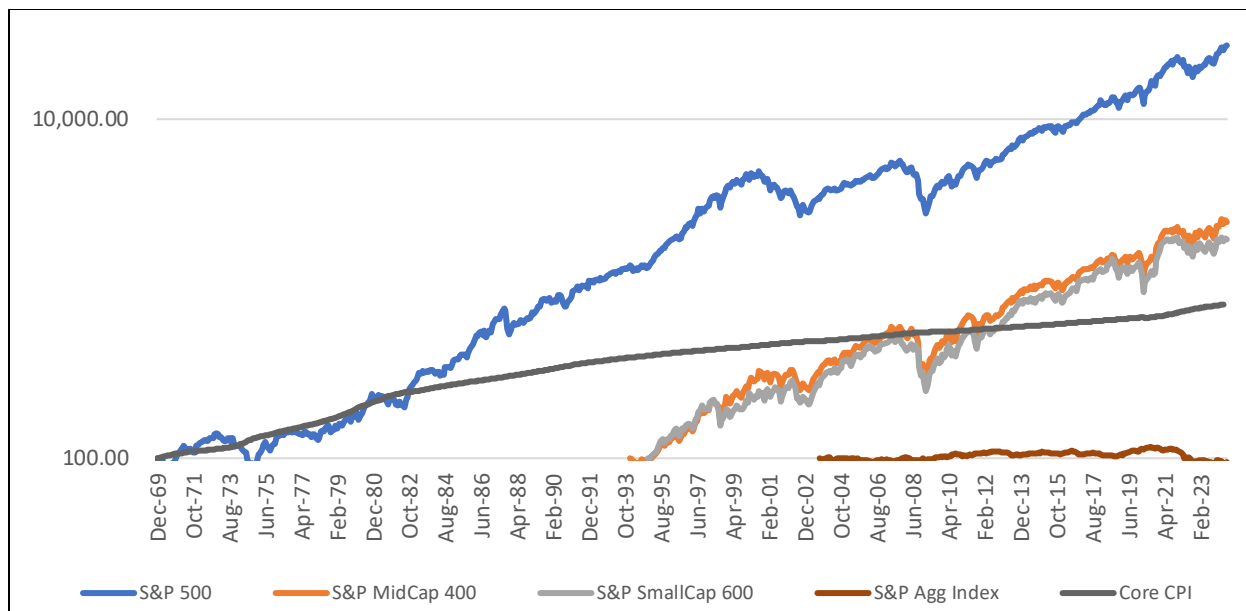
During the late 1990s, large-company technology stocks experienced extraordinary growth. However, a study in the Journal of Financial Economics highlighted that small-company stocks outperformed large-company stocks between 1931 and 1974.

International markets offer further diversification, including both developed and emerging economies. Understanding these various "markets within markets" is crucial for informed investing.

STOCK RETURNS VS BONDS & CASH

Historically, the stock market's 10 to 11 percent average annual return significantly outperforms bonds (5 to 6 percent) and cash (around 3 percent). Over decades, this difference compounds into substantial wealth accumulation. See the chart below.

Furthermore, inflation and taxes erode returns from all asset classes. Cash, in particular, can offer near-zero real returns after accounting for these factors. While stocks and bonds are also affected, their higher nominal returns provide a greater buffer.



“Source: CFRA, S&P Global, NAREIT. Past performance is no guarantee of future results.”

RISK AND REWARD

Higher returns come with increased risk. The stock market, with its potential for both significant gains and losses, exemplifies this principle. However, a long-term approach, coupled with investments in quality companies, can mitigate risk and capitalize on the market's upward bias.

By maintaining a long-term perspective and focusing on fundamentally sound companies, investors can harness the power of the stock market to achieve their financial goals.

KEY TAKEAWAYS

- The stock market has historically delivered average annual returns of 10 to 11 percent.
- Short-term market fluctuations are normal and should not deter long-term investors.
- Understanding different market segments is beneficial when diversifying your portfolio.
- Long-term investing in quality companies can mitigate risk and maximize returns.
- Stocks have historically outperformed bonds and cash over the long term.

LESSON FOUR: UNDERSTANDING INFLUENCES ON STOCK PRICES

INTRODUCTION

In this lesson, we'll explore how internal company events, like earnings reports or leadership changes, and external factors, such as economic news, geopolitical developments or natural disasters, can impact stock prices. You'll also gain strategies for navigating these influences without overreacting to every headline. By the end, you'll have a clearer understanding of the forces that move the market and how to stay focused on your investment strategy amid the noise.

DECODING MARKET MOVEMENTS

For those new to investing, stock price fluctuations can seem random and unpredictable. However, while short-term movements may appear erratic, long-term stock prices tend to follow somewhat logical patterns.

As we've discussed, the fundamental driver of stock prices is supply and demand. When more investors want to buy a company's shares than sell them, the price rises. Conversely, when selling pressure outweighs buying interest, the price falls.

But what factors influence investor behavior? What causes shifts in buying and selling psychology? The forces affecting stock prices can be broadly categorized as internal company events and external events.

INTERNAL COMPANY EVENTS

Internal events are specific to a particular company and generally do not impact the broader market. These events, such as management changes, mergers and acquisitions, and new product launches, can influence a company's earnings and sales, driving its stock price up or down.

Distinguishing between significant and trivial news is crucial. Events that can materially affect a company's stock price and future prospects include:

- Introduction of a major new product or service
- Change in key leadership positions (CEO, CFO)
- Significant acquisition or divestiture
- Expansion or contraction of a major business segment

Investors should analyze company news to assess management's competence. While a single negative event may not reflect poorly on management, a pattern of unfavorable news might indicate underlying problems that current management is unable to address.

It's also essential to consider company news within the context of broader economic conditions, as we'll discuss in the next section. For instance, declining earnings might be attributable to company-specific issues or a broader economic downturn.

EXTERNAL EVENTS

External events influence the overall market and affect many companies simultaneously. Global events, economic conditions and policy changes can all have a significant impact on stock prices. In our interconnected world, developments in one region can have repercussions for markets worldwide.

Geopolitical events, economic data releases and shifts in government policies can create both short-term volatility and long-term trends.

Economic factors, such as inflation, interest rates and currency exchange rates play a crucial role.

- The central bank's decisions on interest rates can influence investor sentiment and the flow of capital between stocks and bonds.
- Inflation can affect consumer spending and corporate profitability.

- Currency fluctuations can impact the competitiveness of companies engaged in international trade.

NAVIGATING MARKET INFLUENCES

It's natural to feel concerned when the price of a stock you own declines. However, it's crucial to manage your emotions and avoid impulsive selling.

The market can sometimes overreact to news, with short-term trading dominating investor behavior. Institutional investors and fund managers may prioritize short-term results, leading to selling pressure even if the news doesn't fundamentally alter a company's long-term prospects.

As a long-term investor, your role is to carefully evaluate news and its potential long-term implications. If the news is temporary or outside of the company's control, try to disregard short-term price volatility.

Remember that stock prices don't always reflect a company's intrinsic value. Intrinsic value is the inherent worth of an asset, investment or entity based on its fundamental qualities, independent of its market price. Intrinsic value also represents the fundamental value of a company's stock based on the company's underlying business. Market overreactions can create price swings, and in turn, opportunities to buy shares of high-quality companies at attractive prices.

Conversely, stock prices can also become inflated due to excessive optimism. If a company's stock price rises significantly beyond its fundamental value, consider whether to take profits or re-evaluate the company's long-term prospects.

KEY TAKEAWAYS

- Stock prices are influenced by both internal company events and external events.
- Internal events, such as product launches and management changes, affect individual companies.
- External events, such as economic conditions and geopolitical developments, affect the broader market.
- Investors should analyze news carefully and avoid emotional trading decisions.
- Market fluctuations can create opportunities for long-term investors.

LESSON FIVE: DEMYSTIFYING STOCK SPLITS

INTRODUCTION

In this lesson, you'll learn the difference between regular and reverse stock splits, why companies choose to split their shares, and how these actions affect stock prices and investor perception. We'll also explore the psychology behind stock splits and how market reactions can differ from actual changes in value. Most importantly, you'll gain insight into what stock splits mean—or don't mean—for long-term investors, helping you make more informed decisions with clarity and confidence.

THE INFLUENCE OF STOCK SPLITS ON INVESTORS

Stock splits can seem confusing at first, but they are essentially a straightforward adjustment to a company's share price and outstanding shares. The core concept is that the overall value of an investor's holdings remains the same immediately following the split.

A company's board of directors authorizes stock splits, and the split takes effect on a specified date, typically a few weeks after the announcement.

The primary motivation behind stock splits is to influence the stock's price and perceived attractiveness to investors.

REGULAR STOCK SPLITS

A regular stock split involves decreasing the price of each share while increasing the total number of outstanding shares. The idea is that a lower share price may make the stock more accessible to a broader range of investors, potentially increasing demand.

For example, in a 2-for-1 stock split, a stock trading at \$50 per share will begin trading at \$25 per share, and the number of outstanding shares will double.

It's crucial to understand that a regular stock split does not directly create or destroy value for shareholders. If you owned 100 shares of a company at \$50 per share (total value: \$5,000) and the company executes a 2-for-1 split, you will then own 200 shares at \$25 per share (total value: \$5,000). Your ownership stake in the company remains the same.

Common regular stock split ratios include:

- **3-for-2 split:** For every two shares owned, the investor receives one additional share.
- **3-for-1 split:** For every one share owned, the investor receives two additional shares.
- **5-for-4 split:** For every four shares owned, the investor receives one additional share.

REVERSE STOCK SPLITS

A reverse stock split is the opposite of a regular split. The company's board of directors increases the price of each share while decreasing the total number of outstanding shares.

Companies often use reverse stock splits to increase their stock price, particularly if it has fallen below a certain threshold.

For example, in a 1-for-5 reverse stock split, a stock trading at \$1 per share will begin trading at \$5 per share, and the number of outstanding shares will be reduced to one-fifth of the original amount.

Similar to regular splits, reverse splits do not inherently change the overall value of an investor's holdings. If you owned 1,000 shares of a company at \$1 per share (total value: \$1,000) and the company performs a 1-for-5 reverse split, you will then own 200 shares at \$5 per share (total value: \$1,000).

Companies with very low stock prices (often referred to as "penny stocks") face several disadvantages:

- They may be delisted from major stock exchanges, which can reduce investor confidence, reduce trading activity and produce an overall lack of liquidity.
- Many institutional investors and mutual fund managers have restrictions on investing in stocks below a certain price.

Reverse stock splits can be a strategy to avoid these issues. However, they are often viewed with skepticism, as they may indicate underlying financial difficulties. Investors generally prefer companies that increase their stock price through organic growth in sales and earnings.

THE PSYCHOLOGY OF STOCK SPLITS

There's a psychological aspect to how some investors perceive stock splits. Some traders believe regular stock splits can create positive sentiment and increase trading activity.

While there might be short-term market reactions to stock split announcements, research suggests that any positive effect on stock prices is usually short-lived and not guaranteed.

Some analysts suggest that companies initiate stock splits when they are optimistic about their future prospects. In some cases, split announcements coincide with positive news, which can create positive momentum.

THE LONG-TERM INVESTOR'S PERSPECTIVE

For long-term investors, stock splits are generally considered neutral events. There is no proven correlation between stock splits and long-term stock price appreciation.

Long-term investors prioritize investing in high-quality companies with strong fundamentals, regardless of the stock's past split history.

Ultimately, focusing on a company's quality and value is more important than the mechanics of stock splits.

KEY TAKEAWAYS

- A stock split adjusts a company's share price and the number of outstanding shares.
- Regular stock splits lower the share price, while reverse stock splits increase it.
- Stock splits do not directly create or destroy shareholder value.
- Reverse stock splits are sometimes used to avoid delisting from exchanges.
- Long-term investors should prioritize company fundamentals over stock split activity.

COURSE CONCLUSION

BUILDING CONFIDENCE THROUGH CLARITY

Congratulations on completing the course! You've taken an important step toward becoming a more informed and empowered investor.

Throughout this course, we've moved beyond the myths and media noise to uncover the real workings of the stock market:

- In Lesson One, you learned that the stock market isn't a chaotic casino—it's a regulated marketplace with clear mechanisms, from how trades are placed to how stocks are held.

- Lesson Two showed you that market ups and downs are not just normal; they're expected. By understanding cycles, you're better prepared to keep your emotions in check and stay focused on your long-term goals.
- Lesson Three gave you the historical perspective to see how time is one of the most powerful tools in your investment strategy. Markets rise and fall, but disciplined long-term investment in quality companies has historically delivered strong returns.
- Lesson Four explained the many forces that move stock prices—from internal business decisions to global events—and taught you how to separate signal from noise.
- In Lesson Five, you demystified stock splits, learning that these structural changes don't alter the value of your investment but can influence how others perceive a stock.

YOUR PATH FORWARD

You now have a foundational understanding of how markets work, what drives stock prices and how to manage your mindset through all phases of the investing journey. More importantly, you've seen how long-term thinking, emotional discipline and a clear strategy are your greatest assets as an investor.

The most successful investors aren't those who react to every headline—they're the ones who stay the course, stay informed and stay focused.

NEXT STEPS

- Keep learning. The markets are always evolving, and continuous education is key.
- Review your investment goals and risk tolerance regularly.
- Don't chase quick wins—invest in quality, stay diversified and give your investments time to grow.

Thanks for joining us on this journey. Here's to making smart, confident, and long-term investment decisions.