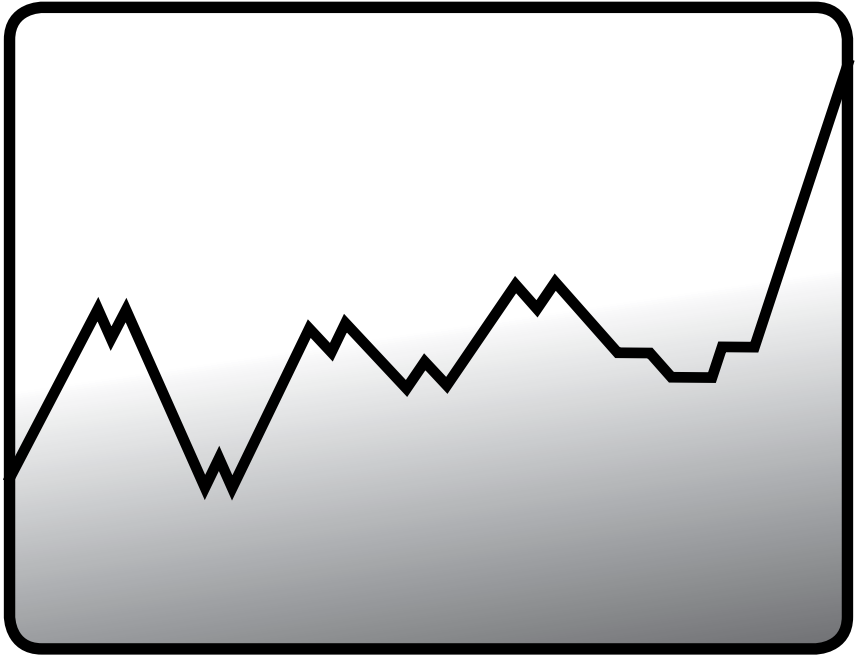




## **Part 2: Table Of Contents**

How It Works	3
Individual Investors	4
Short-Term Traders	4
Professional Traders	5
How Wall Street Keeps Score	6
The Dow Jones Industrial Average	6
Other Indexes	7
It's All About Points	8
How Much Is It Going to Cost?	9
How Much Did You Make?	9
What If No One Will Buy or Sell Your Stock?	10
Why Stocks Are a Good Idea	11
Risk!	
The Chance You Take When You Buy Stocks	12
The Dow 30 as of January 2011	13
Glossary of Market Terms	14



## **How It Works**

Now that you have some idea of what happens in the back rooms of the stock brokerage, We are going to take you upstairs. First, you'll be introduced to the three types of people who participate in the market: individual investors, traders, and professionals. By the time you finish this guide, you should have a better idea of where you fit in.

In the back of this guide you will find the current (2011) list of the Dow 30. For your convenience, we've included the handy Glossary of commonly used terms in the Stock Market and trading of stocks/shares from Part 1.

# Individual Investors

Investors buy stocks in corporations that they believe in and plan to hold those stocks for the long term (usually a year or longer). Investors generally choose to ignore the short-term day-to-day price fluctuations of the market. If all goes according to plan, they find that the value of their investment has increased over time.

One of the most profitable buy-and-hold investors of our time, Warren Buffett, likes to say that he is not buying a stock, he is buying a business. He buys stocks for the best price he can and holds them as long as he can... forever, if possible. (When asked when he sells, Buffett once said, “Never.”)

Keep in mind, however, that Buffett buys stocks in conservative (some would say boring) corporations like insurance companies and banks and rarely buys technology stocks. Buffett became a billionaire using his long-term buy-and-hold investment strategy (a strategy is a plan that helps you determine what stocks to buy or sell).

Investors who bought shares of stock in Caterpillar (CAT), Lockheed Martin (LMT), and Minnesota Mining and Manufacturing (MMM), for example, saw the value of their investments increase over time, especially during the latter half of the 1990s. Actually, there was never a better time to be an investor than during the 1990s. You bought shares of a corporation you knew and believed in, then sat back and watched the value of the shares increase by 25, 50, or 100 percent. (This is as good as it gets for investors!)

# Short-Term Traders

Unlike investors, short-term traders don't care about the long-term prospects of a corporation. Their goal is to take advantage of the short-term movements in a stock or the market. This means that they may buy and then sell a stock within 5 minutes, a few hours, a few days, or even a week or month on occasion. When you are a trader, you are primarily focused on the

price of a stock, not on the business of the corporation.

There are many kinds of short-term traders. Some of you may have heard the term “day trader”, which refers to a very aggressive short-term trader. For example, a day trader might buy a stock at \$10 a share with a plan to sell it at \$10.50 or \$11, usually within the same day. If the stock goes down in price, he or she will probably sell it quickly for a small loss. In other words, day traders buy stocks in the morning and sell them for a higher price a few minutes or hours later. Generally, they move all their money back to cash by the end of the day. Keep in mind that it’s extremely hard to consistently make money as a day trader. Only a small percentage of people make a living at it.

## **Professional Traders**

Professional traders use other people’s money (and sometimes their own) to make investments or trades on behalf of clients. Professionals include individuals who work for Wall Street brokerages and stock exchanges, but they also include institutional traders like pension funds, banks, and mutual fund companies.

There is no doubt that institutional investors that have access to millions of dollars influence not only individual stocks but the entire market. Some of these institutions have set up computer programs that automatically buy or sell stocks when certain prices have been reached. (On days when the market is up or down hundreds of points, the stock exchanges limit how much institutional investors can buy or sell.)

If you want to be a professional Wall Street trader, you can also apply to become a member of one of the exchanges. At current prices, it will cost you several million dollars to buy a seat on the NYSE, and all you get for this is the freedom to trade stocks directly on the exchange floor. Some people with seats rent them out to professional traders and thus bring in extra income.

# How Wall Street Keeps Score

Wall Street has several ways to keep track of the market. One of the easiest ways to find out how the market is performing each day is to look at a newspaper, television, or the Internet. Typically, people look at the Dow Jones Industrial Average (DJIA), the most popular method of determining whether the market is up or down for the day.

## The Dow Jones Industrial Average

In 1884, a reporter named Charles Dow calculated an average of the closing prices of 12 railroad stocks; this became known as the Dow Jones Transportation Average. His goal was to find a way to measure how the stock market did each day. He then wrote comments about the stock market in a four-page daily newspaper called a “flimsie,” which later became the Wall Street Journal.

A few years later, the company Charles Dow helped start, Dow Jones, launched the Dow Jones Industrial Average, consisting of 12 industrial stocks. If you know about averages, you know that you basically add up the prices of the stocks in the index and divide by the number of stocks to create a daily average. By watching the Dow, you can get a general idea of how the market is doing. It also gives us clues to the trend of the market, whether it is going up, down, or sideways. (The trend is simply the direction in which a stock or market is going.)

The original 12 stocks in the Dow were the biggest and most popular companies at the end of the nineteenth century—for example, American Tobacco, Distilling and Cattle Feeding, U.S. Leather, and General Electric, to name a few.

By 1928, the Dow Jones Industrial Average was increased to 30 stocks, which is the number of stocks in the index today. (By the way, this index is sometimes called the Dow 30.) These 30 stocks are a cross section of

the most important sectors in the stock market. (A sector is a group of companies in the same industry, such as technology, utilities, or energy.) Over time, the Dow changed from an equal-weighted index to one in which different stocks have different weights. This means that stocks with a higher weighting affect the Dow index more than stocks with a lower weighting. For example, since American Express is weighted high in today's market, if this stock is having a bad day and falls by several points, the Dow could end up down for the day.

It's easy to find out how the Dow did each day—it's reported in the media. Since more than half of the public is invested in the stock market, there is a lot of interest in what the Dow does each day.

Therefore, when we talk about the Dow Jones being up or down each day, we're really talking about a representative group of 30 stocks, the Dow 30. Even if the market is down for the day, the stock you own could be up, or the other way around.

## **Other Indexes**

Although the Dow (operated by the Wall Street Journal) was the first index to keep track of stocks, hundreds of other indexes have been created to track almost everything from transportation to utilities to technology stocks. Some sophisticated investors keep an eye on many of these indexes, but most people watch just three.

The next most popular index (after the Dow) is the NASDAQ Composite Index, which tracks the more than 2,800 stocks listed on the NASDAQ (down from over 5000 during the Dot Com boom). On television or on the Internet, when you see the Dow listed, you will almost always see the NASDAQ below it.

The third index that many people watch closely is the S&P 500. If you guessed that this contains 500 stocks, you are right. These are 500 stocks

that Standard & Poor's Corporation (S&P) has selected to represent the overall stock market. They are usually the largest stocks and include a lot of technology stocks. Other popular indexes are the Wilshire Global Index, BBC Global 30, MSCI World, S&P Global 100, S&P Global 1200, Russell Global 10000 Launched, FTSE Global 100, and The Global Dow (Global version of the Dow Jones Industrial Average). You'll learn later that you can invest directly in them, since they trade just like stocks.

If you were a professional money manager, your goal each year would be to beat the major indexes. What does this mean? It means that if the Dow is up 15 percent this year, you would try to get 15 percent or more. The bad news is that it's very hard for people, even professional investors, to beat the indexes. In 2001, it was reported that 50 percent of the professional money managers don't beat the indexes each year. In 2002, it was reported that only 37 percent of the professional managers beat the indexes.

## **It's All About Points**

To measure how much you make or lose in the stock market, Wall Street uses a system of points that represent dollars. For example, if your stock went from \$5 a share to \$10 a share, we would say that your stock went up 5 points. That's how we keep score on Wall Street, but accountants and market analysts make it seem a lot more complicated than it is.

The same type of scoring is done with the major indexes like the Dow, the NASDAQ, and the S&P 500. If the Dow went from 10,000 to 10,100, you would say the market went up by 100 points. If your stock went from \$10 a share to \$11 a share, you made a point, not a dollar.

*Note: Although it's okay to tell people how many points you made or your percentage gain, it's not polite to tell people the exact amount of money you made on a stock deal. Even if you made \$5000 in 5 minutes, it's best to keep it to yourself. To be polite, stick to the point system and avoid talking about money.*

## How Much Is It Going to Cost?

If you can figure out the following calculation, then you will understand how to buy or sell stock. Just as in an auction, every stock has a price. This price changes frequently—every few seconds for some stocks. Let's say that a stock you're interested in, Bright Light, is currently trading at \$20 a share. You decide you want to buy 100 shares. The math goes like this: 100 shares multiplied by \$20 a share will cost you \$2000. That means you must pay \$2000 if you want to buy 100 shares of Bright Light (plus commission, of course).

This is so important that I'll give you another example. Let's say you want to buy 1000 shares of a stock that is selling for \$15 a share. How much will it cost you? The answer is \$15,000. One more example: Let's say you want to buy 100 shares of a stock that costs \$5 a share. The answer is \$500.

## How Much Did You Make?

Let's say you decide to buy 1000 shares of a stock that costs \$15 a share. It will cost you \$15,000. If the stock goes to \$16, you have made 1 point. If the stock goes to \$17, you have made 2 points. Here's the important part: If you have 1000 shares of a stock and you made 1 point, you made \$1000 in profit. If the stock goes up 2 points, you made \$2000 in profit. So the more shares you own, the more money you'll make (or lose).

(More examples? If you own 100 shares of a stock and it goes up 1 point, you made \$100. If you own 100 shares of a stock and it goes up by 5 points, you made \$500.)

# What If No One Will Buy or Sell Your Stock?

This is actually a very good question. It's like having a house sale that no one goes to. To solve this problem, the stock exchanges have set up a system in which there is always someone on the other side of a transaction. In other words, there will always be a buyer or seller for you. You may not get the best price, but at least you know that there is someone who is willing to sell you the stock or buy it from you if you own it.

On the NYSE, there is one person, a specialist, who acts as the intermediary for each stock. The specialists "make a market" for every stock listed on the exchange. This means that the specialist keeps track of and fills all of the orders for a particular stock that comes in, sometimes using his or her own money if no one else wants to buy or sell the stock. Does this sound like a fun job? Laptop computers make the job a lot easier. Before computers, the specialists used to fill the orders by hand. Once orders increased from hundreds to billions of shares, computers were installed to handle the orders.

You might wonder how the specialists get paid, since they are using their own money to fill the orders. First of all, because specialists know the stock so well, they are able to buy it at the lowest possible price and sell it to you at the highest possible price. It doesn't sound really fair, but that's how they make their money. They also get a cut on every trade they make. They claim this is to compensate them for the risk they take when they use their own money to buy or sell.

If you are investing in only a few hundred shares, or even a few thousand, it's not worth your time to worry too much about the few cents the intermediaries make on each trade. It's the million-share traders who try to save money on each trade. By the way, those few cents add up to *thousands of dollars every day* for the specialists. They make money whether the market goes up or down.

At the NASDAQ market, the computerised stock exchange, buyers and sellers are matched with the help of an intermediary called a “market maker”. Unlike the arrangement at the NYSE, where only one specialist is assigned to a stock, at the NASDAQ you can have multiple market makers for a stock. The more popular the stock, the more market makers will be assigned to the stock.

For instance, a stock like Microsoft could have as many as 30 market makers, while a \$1 stock might have only one market maker. There is, however, at least one market maker assigned to each NASDAQ stock. Keep in mind that all of this happens behind the scenes within seconds. Because billions of shares are traded each day, your orders end up being routed by computers. It is nice to know, however, that there will always be someone who is willing to buy or sell shares of your stock.

## **Why Stocks Are a Good Idea**

There are a number of reasons why you should buy stocks. According to many experts, stocks have returned an average of 11 percent annually for the last 75 years, handily beating inflation as well as bonds, money market accounts, and savings accounts. In addition, it’s cheaper to buy stocks over the long term, especially if you buy and hold. And according to the experts, the odds are quite good that the market will continue to go up in the long-term just as it’s done in the past (although there are no guarantees).

# **Risk!**

## **The Chance You Take When You Buy Stocks**

A lot of people enter the stock market without a clear idea of the risks. (Too many people look up at the stars without looking out for the rocks below.) Let's be clear: when you invest or trade in the market, there is a chance that you could lose some or all of your money. It's even possible to lose more money than you put in. The goal for many investors and traders, therefore, is learning how to recognise and minimise risk. Keep in mind, however, that you can't completely eliminate risk, but you can learn to manage it.

There are all kinds of risk. First, the entire stock market could go down in price because of outside events like war, recession, or terrorism. Second, even if the stock market as a whole goes up, there are a number of reasons why your stock could go down. Third, even if you avoid the stock market and put your money in a savings account (or under your mattress), there is the risk that your money will be worth less because of inflation. And finally, if you do not invest in the market, there is the risk that you will miss out on some very profitable buying opportunities. Therefore, whether you invest in the market or not, there will be risks.

# The Dow 30 as of January 2011

*(including ticker symbol)*

- 3M Co. (MMM)
- Alcoa Inc. (AA)
- American Express Co. (AXP)
- AT&T Inc. (T)
- Bank of America Corp. (BAC)
- Boeing Co. (BA)
- Caterpillar Inc. (CAT)
- Chevron Corp. (CVX)
- Cisco Systems Inc. (CSCO)
- Coca-Cola Co. (KO)
- E.I. DuPont de Nemours & Co. (DD)
- Exxon Mobil Corp. (XOM)
- General Electric Co. (GE)
- Hewlett-Packard Co. (HPQ)
- Home Depot Inc. (HD)
- Intel Corp. (INTC)
- International Business Machines Corp. (IBM)
- Johnson & Johnson (JNJ)
- JPMorgan Chase & Co. (JPM)
- Kraft Foods Inc. Cl A (KFT)
- McDonald's Corp. (MCD)
- Merck & Co. Inc. (MRK)
- Microsoft Corp. (MSFT)
- Pfizer Inc. (PFE)
- Procter & Gamble Co. (PG)
- Travelers Cos. Inc. (TRV)
- United Technologies Corp. (UTX)
- Verizon Communications Inc. (VZ)
- Wal-Mart Stores Inc. (WMT)
- Walt Disney Co. (DIS)

# Glossary of Market Terms

## **Advanced Computerized Execution System (ACES)**

This is the service offered by NASDAQ to broker-dealers to automatically perform internal transactions and process the records appropriately.

## **After Hours Trading**

Trading on normal currencies after normal trading hours.

## **Arbitrage**

This is transacting to profit between two or more markets by taking advantage of the difference in prices in the similar markets.

## **Ask**

This is the price which a trader can buy a currency offered for sale.

## **Attain ECN (ATTN)**

This is a broker-dealer that specializes on direct access electronic trading.

## **Auction Market**

This is the market where buyers and sellers compete to buy and sell currencies respectively.

## **Back testing**

This means analyzing the history of the investment opportunity provided and comparing with the present trends to see how successful (if successful) the investment would be.

## **Bear Market**

This is the period when the declines in prices of individual securities or assets have fallen for a long time.

## **Best Ask**

This is the lowest price of a security or asset which a seller can accept at a particular time.

## **Best Bid**

This is the highest price of a security or asset which a buyer can give at a particular time.

## **Beta**

This term is used to note how volatile or how risky an investment on a security might be when compared to the overall market.

## **Bid**

This is the price one is offering on stocks or commodities.

## **Big Board**

This is the major indigenous stock exchange company in the US, responsible for overseeing the activities in the stock exchange operations.

## **Block Trade**

This is the transaction of a very large amount of shares (typically 10,000 or more) worth at least \$200,000.

## **Blue Chip**

These are stocks that are seen as less volatile. Their investments are considered to be more profitable.

## **Book Value**

This is the value of a company if assets and common stock equity are added together and all liabilities are subtracted. There is little correlation between the book value and the market value. Book value is used in such fundamental analysis measurements as Price to Book ratio.

## **Broker / Dealer**

This is an individual or a company that trades on securities. The individual or company can also perform the actions of a broker or a dealer.

## **BRUT ECN**

An Electronic Communications Network owned by Brut.

## **Bull market**

This is a market where prices of securities have risen for a long time without returning to the normal prices.

## **Circuit Breakers**

This refers to the procedures/measures that are employed to halt trading on all US stock markets for a particular period of time.

## **Close Position**

This means buying back a stock to prevent a reversal of price trend which may have been observed in the stock market.

## **Consolidated Quote System (CQS)**

This is the service delivered by NASDAQ informing its subscribers on quotations of stocks traded on the regional stock exchanges in the US.

## **Common Stock**

This is the security owned by investors to seal their participation in owning a company.

## **Crossed Market**

This is the case when the bid price of an asset or stock is greater than the ask price.

## **CUSIP**

Committee on Uniform Security Identification Procedures.

## **Day Order**

An order, if not transacted on the day it was placed would get expired.

## **Day Trading**

This refers to the transactions that are made and within the same trading day before close of trade for the day.

## **Depth of Market**

This is the amount of assets or commodities that can be transacted without a large difference in price change at the end of trading.

## **Derivative**

This is an asset/commodity that gets its value from another asset/commodity.

## **Diversification**

This is the method of spreading investments within a portfolio to reduce the risk of losing within a portfolio.

## **Dividend**

This refers to the profits issued by companies to their share holders.

## **Dollar Cost Averaging**

This means buying stocks bit by bit over a long period of time.

## **Downtick**

This is normally experienced when a current transaction price falls below the initial transaction price.

## **Dow Jones Industrial Average**

This is a compilation of the 30 most traded blue chip stocks. This list is the most widely used for analyzing stock market indexes.

## **Dow Theory**

This theory states that the market appreciates if one of its averages goes above a previous important high.

## **ECN**

It is designed to facilitate trading of stocks and currencies.

## **Fill or Kill (FOK)**

This is an order made on a large amount of stocks. It is either that the transaction to be made will be made completely or it will not be made at all.

## **Firm Quote**

This is a non negotiable price of a security made by a market maker on not more than 100 shares.

## **Floor**

This is the medium whereby bids and offers are made by traders.

## **Floor Trader**

This is a registered competitive trader who understands the rules of a stock/commodities exchange for his own account.

## **Front Running**

This happens when a broker trades based on the information obtained from the analyst department before the clients (of the broker) receives the information.

## **Fundamental Analysis**

This means understanding the overall state of a business company. Factors that may be looked into are earnings and productions made by the company.

## **Gap**

This simply refers to the break between prices.

## **Good-'Til-Cancelled Order (GTC)**

This is an order to invest in a security which does not close until the conditions/ requirements for executing the order are met.

## **Hedging**

This is the method of buying or selling the same amount of securities, almost at the same time, in two different markets.

## **Imbalance of Orders**

This is used to describe the event when buy orders exceed sell orders.

## **Initial Public Offering (IPO)**

This is the first sales of stock by a private company that want to become publicly owned, so that they can expand.

## **Inside Market**

This is the market maker spread. It shows the highest bid quoted and the lowest price offered.

## **Instinet ECN (INCA)**

This is the first medium brokerages had to display bid and ask prices for most stocks in North America.

## **Joint Account**

This is any an account that is operated by more than one person.

## **Level I**

This is beginner trader who does not trade with real money.

## **Level II**

This is an advanced beginner. He trades with real money but at a minimum risk.

## **Level III**

This is a competent trader. He can trade on a more professional level.

## **Limit Order**

A price set by an individual to buy or sell a stock. Above or below this price, the trader is neither willing to buy nor sell securities or stocks.

## **Liquidity**

This is the ability of a trader to convert his assets to cash in a fast way.

## **Margin**

This is a collateral willing to be issued by a trader to a broker when he wants to borrow funds.

## **Margin Account**

This is the account a trader must own in order to qualify for borrowing funds.

## **Margin Call**

This is the call made by a broker to his clients when he observes that the securities bought from the borrowed funds have decreased in value. This call is normally made to tell the trader to add more money to his account.

## **Market Capitalization**

A company's market capitalization, also known as its market cap, is calculated by taking the number of outstanding shares of stock multiplied by the current price per share.

## **Market Maker**

This is a broker-dealer firm that facilitates the trade of a particular security by dealing on a large amount of them.

## **Market Order**

This is also called unrestricted order. It is the order that guarantees the execution of a trade.

## **Market Timing**

This is the process of predicting future price movements of stocks or securities.

## **Momentum Investing**

This means buying stocks that have been profitable around 3-12 months ago and selling off stocks that have not been profitable around the same time period (3-12 months ago).

## **NASDAQ**

This is the largest electronic screen based securities trading market in the US which originally stood for "National Association of Securities Dealers Automated Quotations".

## **New York Stock Exchange (NYSE)**

This is the largest equities-based exchange in the world.

## **Odd Lot**

This refers to stock that is less than 100.

## **Odd Lot Theory**

This states that if odd lot investors are selling, it is likely that buying such stocks at that time will be a profitable venture.

## **OptiMark**

This is a company that owns patents and intellectual properties and also has its own securities exchanges.

## **Overbought**

This means that the price of an asset has risen to a very high value within a short period of time.

## **Oversold**

This means that the price of an asset has fallen to a very high value within a short period of time

## **P/E Ratio**

This widely used analysis tool of Price to Earnings ratio measures how you pay for each dollar of corporate earnings. For example, if you have \$30 stocks that report a profit of \$2 per share, your P/E ratio is 15; \$30 per share divided by \$2 earnings per share equals 15. In this ratio the lower the P/E ratio, the better.

## **Paper Trading**

This is the practice made by potential investors when they start learning how to trade stocks.

## **Pink Sheets**

This is another way of referring to over the counter trading.

## **Preferred Stock**

These are stocks owned by those higher than the ordinary share holders of a company.

## **Program Trading**

This is the method used to take advantage of arbitrage possibilities. It occurs automatically when created.

## **Qualitative Analysis**

This means understanding the qualities of a company.

## **Quantitative Analysis**

This means measuring the strength of financial instruments and institutions.

## **Random Walk Theory**

This states that the prices of stocks in the market cannot be predicted.

## **Regulation T**

This is the regulation done by a Federal Reserve Board to control customer cash accounts and the issuance of credit to customers by brokers to purchase securities.

## **Round Lot**

This is 100 shares of stock.

## **SEC Fee**

This is an additional fee implemented by the Securities Exchange Act of 1934 for stock traders. They are paid into the brokers' account from where the sum is collected and remitted to the US treasury.

## **SEC Order Handling Rules**

This consists of the limit order display rule and the quote rule.

## **Sell-side**

This refers to a firm that sells securities and offers investment services.

## **Settlement Date**

This is an agreed date between the buyer and the seller when transactions must be made complete by effecting payments for securities bought.

## **Sharpe Ratio**

This is the value of the excess return per unit of risk in any trade or investment.

## **Short Sale**

This means selling borrowed stocks from a broker to take advantage of the falling prices of the stocks in the market.

## **Short Squeeze**

This is an upward price of stocks caused by lack of supply and over demand of stocks in the market.

## **Specialist**

This is a person who tries to narrow the gap that may be experienced when the market maker is not available.

## **Spiders (SPDR)**

SPDR means Standard and Poor's Depository and Receipt. They are traded under the symbol SPY just like other American stock exchanges.

## **Spread**

This is the difference in value between the bid and the ask price of a commodity/stock.

## **Stock**

This is the smallest measurable unit of ownership in a company. Shares fall into either the common or preferred categories; companies issue shares of stock in order to raise capital without borrowing money. Investing terms – These words and phrases reflect stock market terms for various stock market strategies. These stock market terms are used to describe specific conditions or analysis.

## **Stock Symbol**

This refers to letters used to represent stocks for trading purposes. The numbers of the letters vary among different stock exchanges. These letters are used for security purposes.

## **SuperDot**

This is an electronic system used on the New York Stock Exchange to place orders of listed stocks.

## **Systematic Risk**

This is the risk possessed on an individual which cannot be reduced by diversification.

## **Technical Analysis**

This means understanding the price movement of securities in the market.

## **Trading Halt**

This refers to the period when trading is stopped. Its normal duration is around 30 minutes.

## **Trin**

This is a tool used to indicate the presence of volume in the market.

## **Triple Witching Hour**

This is the final trading hours on the third Fridays of March, June, September and December.

## **Uptick**

This is the case when the current transaction price is above the initial transaction price.

## **Volatility**

This is the measure of the daily changes in the price of securities.

## **Volume**

This is the number of shares that are available to be traded in the market at a particular period and time.

## **Wash Sale Rule**

It states that an investor should not claim a capital loss for tax purposes as long as the capital was repurchased within 30 days.

## **Yield**

This is the percentage of a dividend paid against the stock price. For example, if you receive a \$3 dividend on a \$30 per share stock, your yield is 10%.

## **Zero-Sum Game**

This is the case when someone only gains when another investor losses.