

How the Stock Market Works

Why Do Companies Issue Stock?

Companies throughout the world issue new stock shares every day. But what is stock, and why does a company issue it? To help you to better understand these important concepts in this tutorial we will discuss:

- [What is Capital?](#)
- [Equity vs. Debt](#)
- [Why Do Corporations Issue Stock?](#)
- [Advantages for Stock Holders](#)

Let us begin by defining the word capital.

What Is Capital?

Let's imagine that you decide to start up your own ice cream shop business. You will need to invest in equipment, food supplies and property. All the money that you invest to start your business is called capital. Essentially, the capital of a business consists of all of its assets (or items to assist in the creation of wealth).

What if it dawns on you that you don't have enough cash to buy all the needed assets? Let's see how new businesses and companies deal with this problem.

[Top](#) →

Equity vs. Debt

To start a new business (or fund a new project) a company can raise money in two ways - by selling shares of equity or by incurring debt. If the owner of our ice cream parlor invested all their own savings to buy the materials necessary to start the business, they made an equity investment in the company. Equity is simply ownership of a corporation. Typically, ownership units in a corporation are referred to as stock.

However, if our owner did not have necessary funds to start their own business they could finance their operation in one of two ways:

1. Issue stock (or certificates of partial ownership in his company) to people who may be interested in helping their venture out in return for a proportional share of the profits that the company might generate.
2. Borrow money that will need to be paid back with interest.

So, what are the advantages of selling stock?

[Top](#) →

Why Do Corporations Issue Stock?

Businesses issue stock to raise capital.

Advantages of issuing stock:

1. A Company can raise more capital than it could borrow.
2. A Company does not have to make periodic interest payments to creditors.
3. A Company does not have to make principal payments.

Disadvantages of Issuing Stock:

1. The principal owners have to share their ownership with other shareholders.
2. Shareholders have a voice in policies that affect the company operations.

[Top](#) →

Advantages for Stockholders

As part owner of a corporation, you may be entitled to share in the profits of the company. There is also a chance that the company will grow and the price of the stock may rise.

If the company achieves economic success, the stock value will go up and stockholders will benefit. For example, if you invested \$1,000 to buy 100 shares of a company at \$10 each and the shares rose to \$13 each you would gain \$300. This is equivalent to a 30% return. In cases like this, both the stockholders and the business would be pleased.

Initial Public Offerings (IPOs)

The very first sale of stocks to the public is called an initial public offering (IPO), and occurs on the primary market. This tutorial will cover the following factors involved in initial public offerings:

- [The Process of Issuing Securities](#)
- [The Basics of Underwriting](#)
- [Types of Underwriting Arrangements](#)
- [The Prospectus](#)
- [Ways a Stock May Be Advertised Before it is Sold](#)
- [Newly Issued Stocks: Getting the Names Straight](#)

The Process of Issuing Securities

Corporations sell stock to the public as one way to raise capital. Before it can issue new stock, a corporation must first file registration statements with the Securities and Exchange Commission (SEC) www.sec.gov. A twenty-day wait is required before it can sell the stocks.

The issuing company may make their registration statement public with a preliminary prospectus called a red herring that summarizes the registration statement. Basic information about the new offering is also provided, including how many shares are being offered and which brokerage companies will distribute the stock to the public. At the time of issue, a final prospectus is presented. This includes the price of the stock (its offering price).

[Top](#) →

The Basics of Underwriting

A Corporation going public hires an investment banker to help it sell its stock. This process is called underwriting. The investment banker functions as an intermediary between the issuing corporation and the public. In most cases, the underwriter (investment banker) purchases the stocks from the company for resale to the public. To reduce its own risk, the investment banker may form an underwriting syndicate of other investment bankers to co-purchase the shares. The underwriting syndicate forms a selling group to sell specified allotments of the issue. The investment banker (underwriting syndicate) then marks up the price of the offering. This markup represents the fee for the syndicate's service. The difference between the price the underwriter pays and the price the public pays is called the underwriting spread.

The syndicate manager may bid on the stock in the offering to "stabilize" the price. This bid must be less than or equal to the offering price. By law, the prospectus must make this attempt to stabilize the stock price known to the public.

The SEC also requires the underwriter to investigate the issuing company-particularly any audits, how it uses proceeds, its financial statements and the management team. This process is called due diligence.

[Top](#) →

Types of Underwriting Arrangements

A stock issue can be underwritten by several methods.

The underwriter can act as an agent, in which it tries to sell as much of the issue as it can at market prices. This is a best effort arrangement.

The issuing company can also agree to issue new stock on the condition that all of it is sold. If all of the stock is not sold, then it will withdraw the issue. This is an all-or-none arrangement.

A negotiated underwriting is when the issuer and the corporation negotiate the terms of the issue, the price, the size and other details.

The issue may be subject to competitive bids from investment bankers. The top bidder underwrites the issue and resells it to the public.

When a public company issues more of its stock, it must first offer that stock to existing shareholders; that is their preemptive right. A standby is the public sale of whatever stock the existing shareholders have not yet purchased.

A firm commitment arrangement is when an investment banker buys all of the stock from the corporation and then resells it to the public at a higher price.

A private placement is an offering in which the company sells to private investors and not to the public. Private placements do not have registration fees.

[Top](#) →

The Prospectus

Prospectuses are legal documents that explain the financial facts important to an offering. They must precede or accompany the sale of a primary offering. The law requires companies selling

primary offerings to send prospectuses to anyone who wants to buy a primary offering. Prospectuses may also be used to solicit orders. Customers should read a prospectus carefully before purchasing any primary offering.

Prospectuses include but are not limited to the following:

- Offering price
- Legal opinions about the issue
- Underwriting method
- The history of the company
- Other costs related to investing in the stock
- The management team
- The handling of proceeds

The prospectus must be provided to customers before they complete any transactions. It must also include the SEC's disclaimers that it does not approve or disapprove of the stock being offered, and that it does not judge the prospectus' statements for accuracy.

[Top](#) →

Ways an Issue May Be Advertised Before it is Sold

A new issue of stock is allowed to be advertised before it is actually sold, although it may not be sold during the actual registration period.

Registered representatives are allowed to accept oral solicitations from clients. They are not allowed to sell any shares of the new stock. Neither are they allowed to affirm any offers of sale.

Registered representatives may send red herrings, or preliminary prospectuses, to clients. Information in these documents will discuss why the stock is being sold and the offering timetable. Red herrings are only issued for information purposes.

Tombstone advertisements are ads that announce the new stock. Their sole purpose is to function as communication. They are not prospectuses. They are called tombstones because they provide prospective buyers with the "bare bones" information: the name of the stock, the issuer and how to obtain a red herring.

[Top](#) →

Newly Issued Stocks: Getting the Names Straight

Two aspects of IPOs deserve special attention: hot issues and the so-called "when, as, and if-issued" stocks.

A hot issue is a security sold by broker-dealers on the secondary market just after it is first issued.

New stock may not be sold until after the registration period has expired. If the stock has not been issued by that time, it may be sold conditionally as a "When, as, and if-issued" stock. Should it fail to be issued, all buys, sells, earnings and losses will be canceled.

This concludes the introductory tutorial on initial public offerings. For more information on investing in IPOs check out the tutorial titled [Investing in Initial Public Offerings](#).

Stock Market Players

As an investor, you need to be familiar with the different players in the investment arena and how they buy and sell securities. Broker-dealers, registered representatives and the others have specific roles in clearing the way for commerce in securities.

This tutorial will cover the following topics:

- [Broker-Dealers](#)
- [What Broker-Dealers Are Not Allowed to Do](#)
- [Other Broker Services](#)
- [Registered Representatives, Market Makers and Specialists](#)

Broker-Dealers

A broker is a person or firm that facilitates trades between customers. A broker acts as a go-between and, in doing so, does not assume any risk for the trade. The broker does, however, charge a commission. A dealer is a person or firm that buys and sells for his or her own inventory of securities and for others. A dealer therefore assumes risk for the transactions. Dealers may mark securities up or down to make a profit on their transactions.

Many publications or websites use the term broker-dealer. A broker-dealer is allowed to operate in either role, but never as both at the same time.

To be involved in the buying, selling or trading of securities, a person or firm must be registered with the National Association of Securities Dealers (NASD). The NASD is a self-regulatory organization created by the Securities and Exchange Commission (SEC). Brokers and dealers must follow all rules of the NASD and SEC, including the NASD's Conduct Rules and its rules for arbitration, complaints and dealings with the public.

Broker-dealer status can be revoked for freely breaking securities rules; for having been expelled or suspended from any self-regulatory organization; for making misleading statements to the SEC or the NASD; or for having committed felonies or misdemeanors in the securities industry.

[Top](#) ↗

What Broker-Dealers Are Not Allowed to Do

The following are practices that broker-dealers are forbidden to do:

- Churning: Excessive trading of a client's discretionary account to increase the broker's commissions.
- Use deception or manipulation to trade securities, or failing to state material facts
- Recommending low-priced, speculative securities without determining whether they are suitable for the customer
- Make unauthorized transactions
- Guarantee that loss will not occur
- Try to talk clients into buying mutual funds inappropriate for their means and goals
- Use fictitious accounts to disguise trades
- State that the SEC has approved or judged positively either the security or the broker
- Not promptly transmitting the client's money or securities

Broker-dealers convicted of any of these actions may be expelled or suspended by the NASD.

Because brokers have so much control over other people's money, their activities are highly regulated.

[Top](#) →

Other Broker Services

Brokers, when authorized by the client, may set up discretionary accounts. These accounts allow brokers to buy and sell securities for a client's account without contacting the client for each transaction. The authorized broker may determine the security traded, how much of it may be traded, the price and the time of transaction.

Brokers may lend funds to customers who have margin accounts. With margin accounts, customers can buy additional securities with money borrowed from a broker.

[Top](#) →

Registered Representatives, Market Makers and Specialists

Registered Representatives

A registered representative is an individual who has passed the NASD's registration process and is therefore licensed to work in the securities industry. The process includes an examination that tests the candidate's knowledge of securities and markets. Further, the registration agreement requires that the candidate agree to follow the rules of the NASD.

Registered representatives sell to the public; they do not work on exchange floors.

Market Makers

Market makers are firms that maintain a firm bid and offer price in a given security by standing ready to buy or sell at publicly-quoted prices. The Nasdaq is a decentralized network of competitive market makers. Market makers process orders for their own customers, and for other NASD broker/dealers; all NASD securities are traded through market maker firms. Market makers also will buy securities from issuers for resale to customers or other broker/dealers. About 10 percent of NASD firms are Market Makers; a broker/dealer may become a Market Maker if the firm meets capitalization standards set down by the NASD.

Specialists

Specialists keep markets for securities orderly and continuous. This means they must buy when there are others selling without buyers, and they must sell when others are buying without sellers. They must maintain their own inventories of securities that are large enough for sizable trades. Specialists both buy and sell out of these inventories and mediate between other customers.

Specialists work on the exchanges where they hold seats. Among their duties is buying and selling odd-lots (trades of less than 100 shares) for exchange members. To trade a security, a specialist must be able to keep a position on it with at least 5,000 shares. Specialists, like others, who buy and sell for the public, are subject to rules and regulations. Specialists often choose to keep inventories in multiple securities, often in more than one market sector.

This concludes our tutorial on brokers, specialists and market makers.

The Life of a Trade

The life of a trade can vary a great deal depending on whether the trade involves a listed, Nasdaq or over-the-counter bulletin board security. The following description is intended to give you a general idea of how the process of trading stocks works.

Trading is based on supply and demand. When you buy or sell a stock, you are literally trading with another investor — someone in your city, across the country or on the other side of the world. An order from you to buy a stock must be matched with a seller's order to sell. If you place an order on the Nasdaq, or one of the many other exchanges, this match may be done electronically.

If your order is sent to the trading room floor of one of the exchanges, the auction process begins. A member of the stock exchange walks to the appropriate trading area where your stock is traded and presents your order. Sometimes there will be a broker in the crowd with a sell order at the same price. In this case your order will be completed or filled. Brokers must often act quickly or risk missing the market. If a broker hesitates, a competitive bid could be placed, driving up the market price for the next trade.

The broker may also hand your order to a specialist. The specialist is a person in each trading area, whose job is to guarantee a fair and orderly market by matching buys and sells or by buying or selling themselves if needed. When an order is away from the market, it can be placed under a specialist's care. From this point on the specialist is in charge of representing your order.

If you placed a GTC order with us, it would stay open until it is filled, canceled by you, or until the last day of the next calendar month. If the order is filled, the broker or specialist will report the fill to us. You can choose to be contacted by phone, fax or e-mail. Of course, if you monitor the Order Status section of the website, you can also see when the order is filled. You will also receive a U.S. Mail copy of your order confirmation and fill. You should check your order confirmation carefully no matter how it is received.

Once the order is filled another process kicks into place; one which is generally invisible to you. First the fill is reported to the Market Data System of the exchange. This system transmits the trade details such as the stock name, the number of shares traded and the price of the trade to all interested parties through the ticker tape. The trade can be seen online, TV or through other media by the investor and other interested parties. The ticker tape will also update the information (sometimes with a time lag) on your Quote Monitor.

The tickets sent to your brokerage firm and the brokerage firm of the person who bought or sold the stock from you is entered into a computer. Over the next few hours, the two trades are matched to make sure they agree. If they do not agree, the brokers meet again to settle any differences. This will not affect your fill. Once agreement is ensured, the settlement process begins. Settlement of the trade generally occurs three business days from the actual trade date. Upon settlement the brokerage firms exchange (usually electronically) the stock certificates and the money for the stock.

Understanding Bull & Bear Markets

Simply put, bull markets are movements in the stock market in which prices are rising and the consensus is that prices will continue moving upward. During this time, economic production is

high, jobs are plentiful and inflation is low. Bear markets are the opposite--stock prices are falling, and the view is that they will continue falling. The economy will slow down, coupled with a rise in unemployment and inflation. In either scenario, people invest as though the trend will continue. Investors who think and act as though the market will continue to rise are bullish, while those who think it will keep falling are bearish.

The basics of bull and bear markets will be reviewed in this tutorial. Specifically we will cover the following:

- [What Drives Bull and Bear Markets?](#)
- [Predicting Bull and Bear Markets](#)
- [Investing During Bull Markets](#)
- [Investing During Bear Markets](#)

What Drives Bull and Bear Markets?

What causes bull and bear markets? They are partly a result of the supply and demand for securities. Investor psychology, government involvement in the economy and changes in economic activity also drive the market up or down. These forces combine to make investors bid higher or lower prices for stocks.

To qualify as a bull or bear market, a market must have been moving in its current direction (by about 20% of its value) for a sustained period. Small, short-term movements lasting days do not qualify; they may only indicate corrections or short-lived movements. Bull and bear markets signify long movements of significant proportion.

There are several well-known bulls and bears in American history. The longest-lived bull market in U.S. history is the one that began about 1991 and is still climbing. Other major bulls occurred in the 1920s, the late 1960s and the mid-1980s. However, they all ended in recessions or market crashes.

The best-known bear market in the U.S. was, of course, the Great Depression. The Dow Jones Industrial Average lost roughly 90 percent of its value during the first three years of this period. There were also numerous others throughout the twentieth century, including those of 1973-74 and 1981-82.

[Top](#) →

Predicting Bull and Bear Markets

Investors turn to theories and complex calculations to try to figure out in advance when the market will scream upward or tumble downward. In reality, however, no perfect indicator has been found.

In their attempts to predict the market, economists use technical analysis. Technical analysis is the use of market data to analyze individual stocks and the market as a whole. It is based on the ideas that supply and demand determine stock prices and that prices, in turn, also reflect the moods of investors. One tool commonly used in technical analysis is the advance-decline line, which measures the difference between the number of stocks advancing in price and the number declining in price. Each day a net advance is determined by subtracting total declines from total advances. This total, when taken over time, comprises the advance-decline line, which analysts use to forecast market trends.

Generally, the A/D line moves up or down with the Dow. However, economists have noted that when the line declines while the Dow is moving upward, it indicates that the market is probably going to change direction and decline as well.

[Top](#) →

Investing During Bull Markets

A key to successful investing during a bull market is to take advantage of the rising prices. For most, this means buying securities early, watching them rise in value and then selling them when they reach a high. However, as simple as it sounds, this practice involves timing the market. Since no one knows exactly when the market will begin its climb or reach its peak, virtually no one can time the market perfectly. Investors often attempt to buy securities as they demonstrate a strong and steady rise and sell them as the market begins a strong move downward.

Portfolios with larger percentages of stocks can work well when the market is moving upward. Investors who believe in watching the market will buy and sell accordingly to change their portfolios.

Speculators and risk-takers can fare relatively well in bull markets. They believe they can make profits from rising prices, so they buy stocks, options, futures and currencies they believe will gain value. Growth is what most bull investors seek.

The opposite of all this is true when the market moves downward.

[Top](#) →

Investing During Bear Markets

Successful investing in bear markets can involve many different strategies. Some investors try to secure their assets in less volatile securities such as fixed-income bonds or money market securities. Others wait for the downward trend of prices to subside. When it does, they begin buying. Still others seek to take advantage of the falling prices.

When the market goes down, portfolios with a greater percentage of bonds and cash fare well because their returns are fixed. Many financial advisors emphasize the value of fixed income and cash equivalent investments during market downturns.

Another strategy is to simply wait for the downward prices to reverse themselves. Investors who wish to remain invested in stocks may seek out companies in industries that perform well in both bull and bear markets -- shares in these companies are called defensive stocks. The food industry, utilities, debt collection and telecommunications are popular defensive stocks. However, there is no guarantee that a defensive stock will perform well during any market period.

Finally, some investors attempt to exploit profits from the downward price movements. One method is to sell at the beginning of a downward turn, when prices are still high. Proponents of this strategy wait for prices to bottom out before reinvesting in the market. However, as simple as it sounds, this process involves the nearly impossible task of timing the market. Another, more complicated way to attempt to profit from falling prices is called selling short.

Concluding Remarks

There are many investment methods that seasoned investment professionals use to take advantage of opportunities during bull or bear markets. Methods such as dollar-cost averaging, selling short, and diversification exist. Understanding well-founded strategies will help you to improve your chances for superior performance in either market environment. However, there is no surefire way to always succeed. The best weapon you can employ is education. Do your homework!

Fast Markets

You've probably heard about "fast markets" in the news. But what does it really mean? What are the dangers of a fast market? How can you protect yourself as an investor?

We will discuss the following topics related to fast markets:

- [A Fast Market in Action](#)
- [How It Starts](#)
- [Protecting Yourself in a Fast Market](#)
- [Market Order, Stop Order, Limit Order...What's the Difference?](#)
- [Be Aware of How the Trading Process Works](#)
- [Timing is Everything](#)

A Fast Market in Action

A fast market is an event that's becoming increasingly common: A hot new technology company goes public. Within minutes of opening the Initial Public Offering (IPO) on secondary markets, investors from around the country are online trying to get a piece of the action. With only a limited number of shares of the small company available, the stock price skyrockets.

Or there's the opposite scenario: A popular stock disappoints investment analysts or fails to meet projected earnings. By the close of market, its stock price has been sent tumbling by investors eager to unload it from their portfolios.

Up and down, volatile stocks have been spiking in both directions — sometimes as much as 10% to 50% — in the course of a day or even a few hours. While this kind of fast market activity has spelled success for some investors, it has meant disastrous results for others.

In a fast, high-volume trading environment, the price of a stock can change so quickly that by the time a real-time quote on the computer screen is updated, it's already history. The result can be market order execution prices drastically different from what an investor expected.

[Top](#) →

How It Starts

News about a company hits the wires, like:

- An Initial Public Offering (IPO).
- Change in a company's earnings, positive or negative.
- Recommendation by an analyst or publication.

Trading Gets Heavy

- Internet, phone and broker orders pour in.
- The balance of trade orders is upset with more "buys" than "sells" or vice versa.

Order Executions Are Delayed

- Orders are placed so fast, a backlog may develop.
- Trades are lined up in a queue and executed in the order received.

Systems Can Overload

- Market Makers turn off auto-execution systems and revert to manual order handling procedures in which execution of trades is on a "best efforts" basis. The trading process slows down and the "reasonable time" it takes to execute an order can greatly increase.
- Orders are often subject to partial fills at various prices.
- Trade reports are delayed so investors checking their accounts don't know if their trade was executed. Trying to change or cancel orders may result in duplicate orders or orders that arrive too late to halt the trade.
- Sometimes volume is so heavy that access to brokerage web sites can slow down or be unavailable.

Prices Fluctuate

- Price of the limited number of shares available can change quickly as demand grows.
- Trades executed first in the queue can influence the price of subsequent orders waiting behind them.
- Quotes — including real-time quotes — can't keep up with the huge trading volume and lag far behind actual market prices.

By the time a market order is executed, the stock price may have skyrocketed or plummeted far beyond what the investor expected — as much as 50% or more.

[Top](#) →

Protecting Yourself in a Fast Market

The only surefire way to protect yourself in a fast market is to stay out of it. If you feel you must trade during a fast market there are a few things you can do to protect yourself.

Place a Limit Order

When trading a volatile or new stock, you can reduce your risk by placing a limit order specifying the maximum you're willing to pay to buy a stock or the minimum you'll accept to sell a stock.

Unlike a market order, which is an order to buy or sell at the best available price when the order is received in the marketplace, a limit order gives you price protection by ensuring you get your limit price or better. There's no guarantee your trade will be executed, but it's the most effective strategy for limiting your risk.

[Top](#) →

Market Order, Stop Order, Limit Order . . . What's the Difference?

A **market order** is an order to buy or sell a stock as soon as possible at the best price available. In a fast market situation, a market order can be very risky.

A **stop order** is an order to buy or sell a stock when the price reaches or passes a specified point (the stop price). When that happens, a stop order automatically becomes a market order and is executed at the best price available. In fast markets, however, after a stop order hits the stop price and becomes a market order, it can keep climbing or drop sharply - and ultimately be executed much higher or lower than originally specified.

A **limit order** is the safest way to trade in a fast market because it's an order to buy or sell a stock only at the specified price (the limit price) or better.

Know What You're Buying

What do you know about the company you're buying? Have you researched it? Buying a stock on impulse or hearsay isn't smart investing. Be sure the company you're buying a piece of is one you really want.

[Top](#) →

Be Aware of How the Trading Process Works

Educating yourself about investing is an ongoing process. If you're a new investor or need a review of trading procedures, pick up a book like *The Wall Street Journal Guide to Understanding Money and Investing*, take a virtual trip to the New York Stock Exchange on the Web at www.nyse.com (click on Education), or locate an investing club in your area through the American Association of Individual Investors at www.aaii.com.

Stay on Track with Your Investment Strategy

When you're considering a stock, first see if the company meets your investment objectives. If you haven't formulated an investment strategy yet, now is a good time to start. Begin by determining your goals and your time horizon, then choose the investments that will best meet them.

Weigh the Risk . . . Before You Click

Before you place a market order for a volatile stock, ask yourself how much you could afford to lose in the event of sweeping price fluctuations. Don't risk spending more than you can afford.

[Top](#) →

Timing Is Everything

If you're planning to place an opening market order, make sure your order is entered before 9:20 a.m. Eastern Time. Otherwise, your order may not queue until after the pre-open is completed. At the end of the day, enter market orders at least 10 minutes before closing or your order may not be executed.

Why Watch Market Indicators?

A common and effective way to gain perspective on stock price fluctuations is to compare the movement of your stocks to that of indices or market indicators. About 100 years ago, as the number of individual stocks grew, the need to measure how the stock market performed became obvious. In 1896 The Dow Jones Company took groups of stocks and averaged their prices to create the first indices, the Dow Jones Averages. They created four different indices: one for industrial companies, one for utilities, one for transportation companies and a composite that included the three other indices.

In the 1920s, Standard & Poor's Corporation (S&P) created separate indices. These indices also measured the market as a whole in addition to some sectors of the market. In 1957, when technology enabled the companies to start calculating their indices on an hourly basis, S&P created the S&P 500 Index, which measured the performance of a larger proportion of the market compared to the more popular Dow Jones Industrial Index.

Over the years, the S&P and Dow Jones indices have remained popular, leading both companies to create other indices. In addition, other companies and even the exchanges themselves have created more indices.

Different indices are calculated in different ways. Few remain as simple averages. An index moves when the stocks in it move. When a stock in an index goes up or down, so does the index. Hence, when you hear that the Dow Jones closed at 10,500, down 20 points for the day, it means that the average of the prices of the 30 stocks that comprise the Dow is 10,500 and the combined value of these 30 stocks (as calculated by the index) dropped 20 points during that day's trading.

Calculation method aside, all indices measure the performance of the stock market or some subsection of it on a continuing basis throughout each trading day. By tracking an index, or a variety of indices, investors can quickly gauge market trends that may impact investment decisions.

What is the point of following the indices when what you care about is your own stock portfolio performance?

Indices often reflect trends in the market and in the economy. Watching overall market performance can be the key to making smart decisions about your individual investments. For example:

- Indices can function as benchmarks to compare the performance of the stocks you own against the market in general.
- Comparing today's market movement with similar market movements from the past may help you become aware of trends, and the best times to buy or sell.

You may want to create an index of your own stocks so you can measure your own investments against the performance of the more established indices. As an illustration of how to do this we have created the following hypothetical index.

Stock	12/17 Close	12/18 Close	12/19 Close
ABC	52	51	52

DEF	25-1/2	23 ¾	25
GHI	49	46	47-1/2
JKL	15	15 ¼	15-1/2
Total	141.50	136	140
Average	35.375	34	35
Percent Move		-4%	+3%

Now, you can compare the movement of your index to some of the big market indicators, like the S&P 500, the Dow Jones Industrial Average (DJIA) or the Nasdaq.

There are a couple of ideas to keep in mind when analyzing indices. First, the percentage move is often more meaningful than the move in points. It means a lot more when the DJIA moves 50 points if it is at 1,000 than if it is at 10,000. Second, while individual stock prices, at least for the time being, are generally expressed as fractions, indices are displayed in decimals.

Dow Jones Industrial Average

One of the best-known market indicators, the Dow Jones Industrial Average, is comprised of 30 leading companies. Calculated by adding the prices of these 30 stocks, the Dow is now considered a figure that indicates the general state of the market. Originally, the Dow divided the sum of the prices of the 30 stocks by 30, giving a true average. However, to be consistent every time a stock split or paid a dividend, the number 30 had to be adjusted. Now, over 100 years later, the sum of the prices of the 30 stocks is divided by a number less than one! Since a \$1 movement in the price of a \$100 stock counts equally with a \$1 movement in the price of a \$20 stock, the Dow Jones is considered a price weighted index.

Dow Jones Chart	9/13/99 1:37 PM
Last:	11,033.49
Change:	+5.06
Open:	11,027.40
High:	11,042.36
Low:	10,982.20

Volume:	35,816,500
Percent Change:	+0.05%
Yield:	1.58%
P/E Ratio:	27.99
52 Week Range:	7,399.38 to 11,428.94

Charles Dow designed the average to represent the current business market, which in 1896 included industries such as sugar, leather, tobacco, gas, rubber and coal. Today the DJIA is led by retailers, oil, technology, pharmaceutical and entertainment companies. The only company on the original list that is still included today is General Electric.

S & P 500 Index

Created in the 1920s by the Standard and Poor's Corporation (S & P), this index tracks 500 companies in leading industries: transportation, utilities, financial services, technology, health care, energy, communications, services, capital goods, basic materials, consumer products, cyclicals and more. Many consider it the most accurate reflection of the U.S. stock market today. This high regard has led many money managers and pension plan administrators to use it as a benchmark for judging the overall performance of their fund against the stock market.

Since the calculation for this index equals the price of each stock multiplied by the number of shares held by the public, the companies with the most shares make the greatest impact. This is known as a market weighted index.

Nasdaq Index

This index tracks the stocks on the National Association of Securities Dealers Automated Quotation System (Nasdaq) stock market. Since many new companies elect to join the Nasdaq, the number of stocks on the Nasdaq has grown from 100 to more than 5,500 today. Because this index includes many companies in the technology sector where market trends change quickly, this index can be volatile

Ameritrade Online Investor Index

The Ameritrade Online Investor Index tracks the daily buying and selling activity of individual online investors at Ameritrade, Inc.

While most major market indices include the activity of institutions and mutual fund companies, the Online Investor Index is unique in that it helps you understand what individual investors are doing in relation to the stock market.

The Online Investor Index does not measure price changes or volume-other indices do that. Instead, the Index measures buyer participation as a behavioral indicator related to investor confidence.

To learn more about the Ameritrade Online Investor Index, visit our website at www.ameritradeindex.com.