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Professors Explain Basics of Stock Market

by Dustin Pridgen / STAFF WRITER
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It has been more than 13 months since the start of what has been termed by some the Great Recession of 2008.

In that time, the Dow hit a low of 6739.29 points in March, which is a 52 percent drop from the record of 14,164.53 Oct. 9, 2007.

Oct. 14 the Dow climbed back over the 10,000 point mark, a feat first accomplished in March 1999.

Auburn professors explain the basics of the stock market for those who want to learn the ins and outs of Wall Street's world.

"Simply put, the stock market is people buying and selling shares," said Kevin Yost, associate professor of finance.

There are two types of stock markets — physical stock exchanges such as the New York Stock Exchange and the NASDAQ, which is a computer network of stock dealers.

There are several different stock markets located all over the world, but the most prominent markets are the ones in New York.

"A stock or share is ownership in a corporation," said Steve Swindler, professor of finance. "When you buy a share of Apple, then the stockholder owns a piece of Apple."

The Dow Jones Industrial Average is a stock index measuring the overall stock market by looking at the performance of the larger stocks.

There are several of these with different factors and numbers corporations.

The Dow looks at 30 stocks in its index, the Standard and Poors 500 has 500 stocks in its index, and the Russell 2000 has 2000 stocks in its index.

Different factors can cause one index to change relative to another.

In order to raise capital (money) without going into the debt occurring from issuing bonds, companies will sell off pieces of themselves known as stocks.

"A bond is an obligation the firm issues to pay back money borrowed plus interest," Swindler said. "When an investor buys a stock, the investor then has claims to the profits of that company usually paid in dividends."

David Gropper, professor of economics, said dividends are flexible and managers are hesitant to change them.

Overall, they tend to be stable, Gropper said.

Stocks can also pay investors in an indirect way of capital appreciation.

“If you buy Southern Company at $50 and sell it for $75 then you have appreciated $25,” Gropper said.

For the beginning investor, advice from a stock broker or financial advisers was recommended since the market can be so vast and sometimes difficult to understand.

Different factors affect stock in different ways.

Beginners can also invest in mutual funds. Mutual funds buy stocks of many different companies and then issue a stock of their own.

Some mutual funds invest solely in one area, such as energy, while some buy both stocks and bonds.

“A mutual fund is an efficient method of purchasing a portfolio of securities,” Swindler said.

A place for beginning investors to look when looking for a good investment is at the stock price ratio.

The stock price ratio is stock price to percentage of their earnings. Or stock price divided by earning for the year.

“An example is a stock price of $50 and the stock earned $2 for the year then the price earnings (P.E.) ratio is $25,” Swindler said.

Comparing the P.E. ratio of an individual’s firm to the P.E. ratio of the industry overall is then recommended.

“P.E. of McDonald’s is 21, and the P.E. of fast food industry overall is 17,” Swindler said.

Experts generally agree that most of the time guarantees are too good to be true.

“Avoid anything that promises guaranteed returns,” Yost said. “There are no guarantees in the stock market. It is hard to beat the market. Invest in Index Funds that try to match the market performance is usually good for beginning investors.”
