8 Stock markets

Countdown

1 What is the difference between a private company and a public company? Which of them is listed on a stock market?

2 What information does a stock index, like the *FTSE 100* or *S&P 500*, contain?

3 Where can you find the stock market indices below? Match the indices with the cities where they are based, one of the cities matches with two indices.

1 Dow Jones	6 Hang Seng
2 FTSE 100	7 NASDAQ
3 Nikkei	8 Bovespa
4 CAC 40	9 MICEX
5 DAX	10 Straits Times Index

4 Look at the news items below. Which sectors of the market would they affect the most? Would they have a positive or negative effect on these sectors?

Central bank cuts interest rates

Oil prices hit a 2-year high

Consumer debt levels continue to rise

London wins Olympic bid

5 Who do you think are the biggest investors in the stock markets?

6 What is the main index in your country? What are the biggest companies in it?

Reading

Stock markets

When a university in Moscow invited an equity broke to the university to introduce students to the stock market, they asked students for questions to find out what they wanted to know about markets.

1 Look at the list of questions students submitted onlin below. First, work in pairs and see how many of the questions you can answer together before you read the text.

1 What is the difference between a *share* and a *stock*
2 What rights do you get if you buy a company's shares?
3 What is a dividend?
4 Who decides how much dividend to pay?
5 Why do some companies not pay dividends?
6 What are the two main ways shareholders make money from shares?
7 How does a company become a listed company?
8 What is an IPO?
9 What does it mean when an investment bank 'underwrites' a company's shares?
10 What is the difference between a primary listing and the secondary market?
11 What is the role of the market regulators?
12 What is a rights issue?
13 When a company makes a rights issue, the share price usually goes down. Why is that?

2 You are going to work together by sharing information to check your answers to the questions in **1**.

Issuing stocks and shares

Successful companies can **issue stocks or shares** (certificates representing part ownership of the company) to raise capital to expand their operations.

Offering these stocks for sale to financial institutions and the general public changes the business from a private to a public company, and is called **going public**. Selling stocks for the first time is called **IPO or initial public offering** in the US and a **floatation** or **IPO** in Britain.

Companies use an investment bank to find buyers, and to **underwrite** the stock issue, i.e. to guarantee to buy the stocks if there are not enough other buyers.

The company going public commissions a **due diligence** report from an auditing firm, and then issues a **prospectus** explaining the company's position, and giving details about the senior managers and **financial results** from previous years.

New shares are sold on the **primary market** and may be repeatedly traded on the **secondary market** at the **stock exchange** on which the company is **listed** (the US) or **quoted** (Britain).

Stock prices fall and rise depending on **supply and demand**, i.e. how many sellers and buyers there are. Consequently the **nominal value** of a share – the price which is written on it – is rarely the same as its **market price** – the price it is currently being traded at on the stock exchange.

Some stock exchanges match up buyers and sellers with automatic, computerized trading systems, while other exchanges use **market-makers.** Some customers place their buying and selling orders with **stockbrokers** who trade with the market-makers; others trade directly online.

Companies either distribute part of their profits to **shareholders** as an annual **dividend**, or keep the profits in the company, which also causes the value of the stocks to rise.

Companies that do not meet requirements of major stock exchanges, such as New York or London use **over-the-counter (OTC)** markets, such as Nasdaq in New York or the Alternative Investment Market (AIM) in London, which have fewer regulations.

Find words or expressions that mean the following:

1. A detailed examination of a company and its financial situation.
2. A document inviting the public to buy stocks, giving information about the company and stating the terms of sale.
3. Certificates representing part-ownership of a company.
4. Details about sales, costs, debts, profits, losses, etc.
5. The market on which new stocks are sold.
6. The price at which a stock is currently being traded on the stock exchange.
7. The price written on a stock (which never changes).
8. To guarantee to buy newly issued stocks if no other buyers can be found.
9. Traders in stocks who quote bid (buying) and offer (selling) prices.
10. Intermediaries who trade stocks for investors.

Discussion

1. Many economists argue that it is (theoretically) impossible to regularly outperform the stock market, as all available information is already factored into a company's share price. So analysing a company's finances, or trying to discover or predict patterns in price movements, is a waste of time. What implications does this have for investors?
2. Imagine that you have just come from a secret meeting of a company's board of directors, which has made a decision that you know will financially ruin some close friends of yours unless they can sell some shares before the board's decision becomes known. You are having dinner at their home the same evening. Should they expect you to warn them? Should you do so?
3. How can you make money from a falling stock market (when the prices are going down)?

Stocks and stockholders

Read the text and decide where the part-sentences below it should be inserted.

Stocks and shares are also known as **equity** or **equities**. **Equity financing** is one of the two main ways companies can raise capital, the other being **debt financing** – issuing bonds. The people who buy equities (1) ________ . Investors buy stocks and shares in order to receive an income in the form of annual **dividend**, (2) ________, or hoping to **make capital gain** by selling the stocks at a profit. Companies that make a profit do not have to pay a dividend to their shareholders: they can also retain the earnings by keeping the profits in the company, (3) ________ . Some stockholders prefer not to receive dividends, because (4) ________ .

Companies can also choose to **capitalise** part of their **retained earnings**, which means turning their profits into capital by issuing new stocks to their stockholders instead of paying a dividend. This process is variously known as a **scrip issue**, **capitalization issue** or **bonus issue**. Companies that require further capital can issue new shares. If these are offered to existing shareholders first this is known as a **rights issue** – because the current shareholders have the first right to buy them. Companies with surplus cash can also buy back some of their stocks; these are then called **treasury stock** in the US and **treasury** or **own shares** in Britain.

The most common form of equities is called **common stock** in the US and **ordinary shares** in Britain. (In Britain, **stock** also means fixed-income securities such as **government bonds**, and is a synonym for **inventory**). Some companies also have **preferred stock** or **preference shares** whose holders receive a fixed dividend that must be paid before holders of common stock receive a dividend.

Investors and financial journalists classify stocks and shares in different categories. **Blue chips** are stocks in large, stable companies with a good reputation (5) ________ **Growth stock** are expected to regularly rise in value, (6) ________ . On the contrary, **income stocks** have a history of paying consistently high dividends. **Defensive stocks** are stocks of companies whose sales and earnings remain relatively stable throughout the business cycle, (7) ________. **Value stock** are those that investors think are trading for less than they should be worth, compared with a company's **book value** (common stock equity, recorded on the balance sheet, equal to total assets minus liabilities).

A common term to describe investors who expect prices to rise is **bulls**, while people who expect prices to fall are **bears**. Consequently a period when the value of most stocks is rising is a bull market, and one in which most of them are falling is a **bear market**. This can be measured by stock **indexes** (or **indices**), (8) ________ , which show changes in the average price of a selected group of important stocks.

Another animal term is **stags**, used to describe investors who buy new stock issues hoping that they will be **over-subscribed**, meaning that they hope there will be more demand that stocks available, (9) _____.

A) a share of the company's profits
B) and consistent or growing earnings over a long period of time
C) are called stockholders or shareholders
D) possibly because they do not pay dividends
E) so successful buyers can immediately re-sell their stocks at a profit
F) so their value is not expected to change very much
G) such as the Dow Jones Industrial Average (DJIA) in New York, and the FTSE 100 (the 'Footsie')
H) tax on capital gains is lower than income tax on dividends
I) which causes the value of the stocks to rise

Complete the sentences with the following:

scrip issue	*blue chips*	*value stock*	*income stock*	*rights issue*
own shares	*defensive stocks*	*growth stock*		

1. A stock whose price has suddenly fallen a lot after a company has had bad news could be a _________________, as it will probably rise again.
2. The stocks of food, tobacco and oil companies are usually ___________________, as demand doesn't rise or fall very much in periods of economic expansion or contraction.
3. Pension funds and insurance companies, which can't take risks, usually only invest in __________________ .
4. The best way to make profit in the long term is to invest in ____________________ .
5. This stock used to be considered an ___________________________, but two years ago the company started to cut its dividend and reinvest its cash in the business.
6. The financial director announced a forthcoming ____________________ of new shares to existing shareholders.
7. The company is planning a ___________________ of one additional share for every three existing shares.
8. We have bought back 200,000 ordinary shares, which increased the value of our _____________________ to €723,000.

The terms below are indicators of a company's performance and are listed in financial publications. Match each one to its definition.

earnings growth *p/e ratio* *dividend yield* *market capitalization* *return on equity*

1. share price multiplied by total number of issued shares ____________________________
2. earnings per share, compounded over several years _________________________________
3. how much profit is generated in relation to the money shareholders have invested __________________
4. current share price compared to its earnings per share ____________________________
5. the annual dividends per share divided by the share price ___________________________

Match the names of the different stock indices to their descriptions.

CAC *DAX* *DJIA* *FTSE* *NASDAQ* *S&P* *WIG30*

1. index of 500 large US companies ___________
2. index of 4,000 US companies, many of them in the technology area, and some quite small _______
3. index of 30 largest Polish companies ___________
4. index of 30 large, well-established US companies, chosen by the editors of the Wall Street Journal ___________
5. index of 30 large German Companies ___________
6. index of 40 large French companies ___________
7. index of 100 large UK companies ___________