Course 3: Defining the Stock Market

What Is a Stock?

As discussed in Course #2, A **stock** represents ownership in a company. When you buy a stock, you become a **shareholder** — which means you own a piece of that company.

- **Common stocks:** Come with voting rights but dividends (profit payouts) can change.
- **Preferred stocks:** Pay fixed dividends but don't give voting rights.

👉 **Quick Example:** If you buy one share of Nike, you technically own a very tiny slice of the company. If Nike does well, your stock may increase in value, and you may even get dividend payments.

What Is a Bond?

A **bond** is basically an IOU. You loan money to a company or government, and they promise to pay you back with interest.

- **Benefits:** More stable than stocks, with predictable income.
- **Risks:** Lower returns and possible default (if the borrower can't pay you back).
- **Types:** Government bonds, corporate bonds, municipal (city) bonds.

👉 **Quick Example:** If you buy a $500 U.S. Treasury bond, the government pays you back later with interest — kind of like lending your friend money, but with less risk.

What Are Cash Investments?

Cash investments are low-risk, short-term investments that can be easily turned into cash.

- **Examples:** Savings accounts, Certificates of Deposit (CDs), money market accounts.
- **Benefits:** Safe, secure, and great for short-term goals.
- **Risks:** Very low returns and may not keep up with inflation.

What Are Mutual Funds?

A **mutual fund** is a pool of money from many investors, managed by professionals, and spread across different assets (stocks, bonds, etc.).

- **Benefits:** Instant diversification + professional management.
- **Risks:** Management fees can eat into returns (money you make); performance depends on managers and markets.
- **Types:** Stock funds, bond funds, index funds (like one that tracks the S&P 500).

What Are ETFs?

ETFs (Exchange-Traded Funds) are like mutual funds, but they trade on the stock market like individual stocks.

- **Benefits:** Lower fees, more flexibility.
- **Risks:** Can still fluctuate with the market.
- **Types:** Index ETFs, sector ETFs (like technology or energy).

👉 **Quick Example:** Buying an S&P 500 ETF means you own a little piece of 500 companies — all in one trade. Instant diversification!

The Stock Market in Action

Story 1: Emily Buys Her First Stock

Emily, a high school sophomore, saves up $200 from babysitting and decides to buy stock in Disney. She loves the company and figures it's a safe bet. At first, the stock goes up, and Emily is thrilled. But when Disney has a slow quarter, her stock value drops.

She learns that owning a single stock can be exciting but risky, and that it's better to spread money across more companies for more financial security.

Story 2: Raj and the Bond Investment

Raj, a junior, wants to save money for community college in two years. His uncle suggests buying a short-term government bond with part of his savings.

Raj buys a $1,000 U.S. Treasury bond at 3% interest. While his friends brag about stocks that went up and down, Raj's money grows quietly but safely — perfect for his short-term goal.

When the bond matures, Raj has $1,060 — enough to cover part of his tuition and books. Raj sees that bonds may not make you rich, but they're reliable when you need stability.

Story 3: Gabriela’s ETF Adventure

Gabriela, a sophomore, has been learning about investing through her older cousin. Instead of choosing one stock, she buys an ETF that mirrors the S&P 500. Now, with a single purchase, she owns a piece of companies like Apple, Amazon, and Coca-Cola.

Over time, the ETF grows steadily. Gabriela feels confident knowing she’s invested in hundreds of companies at once, not just one.

FAQs: Defining the Stock Market

Q: What’s the difference between a stock and a bond?
A stock means you own part of a company; a bond means you’ve loaned money to a company or government.

Q: Why would anyone choose a bond if stocks can make more money?
Because bonds are safer and give steady returns — good for short-term goals or lower risk tolerance.

Q: What’s the advantage of a mutual fund or ETF?
They spread your money across many companies (diversification), which lowers your risk compared to buying one stock.

Q: What’s a dividend?
It’s a payment some companies make to shareholders from their profits.

Q: Why are ETFs popular with younger investors?
They’re affordable, easy to trade, and usually have lower fees than mutual funds.

Think About It

1. If you had $500 to invest, would you choose a stock, bond, mutual fund, or ETF? Why?
2. Which would you prefer: higher risk for a chance at big rewards, or steady but smaller growth?
3. Why is diversification important in investing?
4. What’s one company you’d be excited to own stock in, and why?
5. If your savings goal was only 2 years away, what kind of investment would you choose?

Terms to Know

- **Stock** – Ownership in a company.
- **Common Stock** – Shares with voting rights; dividends can vary.
- **Preferred Stock** – Shares with fixed dividends but no voting rights.
- **Bond** – A loan to a company or government that pays interest.
- **Cash Investments** – Safe, short-term savings options like CDs or money markets.
- **Mutual Fund** – A professionally managed collection of stocks, bonds, or other assets.
- **ETF (Exchange-Traded Fund)** – A fund traded like a stock that holds many investments at once.
- **Dividend** – A portion of company profits paid to shareholders.
- **Portfolio** – The collection of all your investments.
- **Bull Market** – When stock prices are rising.
- **Bear Market** – When stock prices are falling.
- **Liquidity** – How quickly an investment can be turned into cash.