

# What Causes Stock Prices to Change?

## Suggested Grade

Grades 4-5

## Suggested Time

45 – 50 minutes

## Teacher Background

This lesson discusses influences that effect stock prices. A stock's price may change from minute to minute *even second to second!* A number of factors may determine this change. Market forces such as supply and demand impact share prices. If more people want to buy a stock (demand) than sell it (supply), then the price goes up. Conversely, if more people wanted to sell a stock than buy it, supply exceeds demand and the price falls.

Many factors determine why people favor one stock and dislike another. Fundamental data such as P/E ratios and projected earnings help investors place a value on a stock. News reports, positive or negative, can also influence the price of a stock. There are always varying opinions on what is good or bad for a company, so news reports are seldom the sole factor determining price. News that moves a stock's price may be the reporting of internal corporate activity, industry trends or information based on national or international political, social or even scientific events.

A stock's price change indicates what investors believe a company is worth. The price of a stock not only reflects a company's current value, it also reflects the future growth and earnings that investors expect. The most important factor that affects the value of a company is its earnings. Public companies must report their earnings four times a year (once each quarter). Wall Street carefully watches earnings results. Analysts base their future value of a company on its earnings projections. If a company's results are better than expected, the stock price rises. If a company's results are worse than expected, the stock price falls.

Earnings are one way to change investors' opinion of a stock and ultimately, its price. Investors have developed literally hundreds of variables, ratios and indicators that help predict or determine stock price changes. Even with all these measurements, forecasting prices consistently and accurately is almost impossible. However, despite that fact, industry professional conduct analyses using many of the measurements described above and try to predict price movements.



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## Vocabulary

**Earnings:** Profits, or net income, after the company has paid income taxes and bond interest.

**Inflation:** An increase in the general level of prices of goods and services.

**P/E Ratio:** A company's closing price divided by its latest annual earnings per share.

## Performance Objectives

Students will be able to:

- Discuss the various ways stock prices are influenced.
- Evaluate the ways investors can be affected by the change in market prices when choosing to buy, sell or hold.
- Interpret charts and graphs to better understand the growth and change in stock prices.

## Materials

Activity Sheet 1: A Tale of Two Marts

Activity Sheet 2: The Ripple Effect

## Springboard Activity

Ask your students:

1. Why is the price of an air conditioner highest at the beginning of the summer?
2. When would the cost of a snow shovel be the highest? Why?
3. Why did people wait on line all night to buy the last Harry Potter book?

Discuss how the products' supply and demand affects the value of the companies that make both products.

## Procedure

Present the following scenario to the class:

Mark wants to raise \$40 dollars to buy a new video game. He has decided to sell umbrellas to raise the money. His father is willing to lend him money for 20 umbrellas at \$2 each. They sell in stores for \$3, so Mark can make a \$1 profit on each umbrella. But even if he sells all 20 umbrellas he will have only \$20 profit after he pays his father back, not enough to buy the new video game.

His friend Peter suggests Mark wait and sell the umbrellas for \$4 each or \$2 profit per umbrella a strategy that, if successful, will earn the \$40 he needs. Peter's plan is to sell the umbrellas on the street on the next rainy day. Mark



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and Peter believe people will be willing to pay more for the umbrellas than the cost in the store if Mark follows the plan. Why?

Explain that the need or popularity of a company's product can force the price of that company's stock up.

Ask your students:

1. Why do you think that might be?
2. Elicit various reasons and list these reasons.
3. Have students complete *Activity Sheet 1: Tale of Two Marts*. Discuss their answers as a class

### **Novice & Apprentice Levels:**

Have each SMG team list one product or service provided by each company in their SMG portfolio. Have team members circle the product or service they believe will be most popular and result in an increase in stock price for the company that makes it.

Ask your students:

1. Why do you believe the product will result in higher stock prices? Be sure to include all the factors that support your choice.
2. Have the teams share their picks with the class.

### **Master & Grand Master Levels:**

Have students use the Internet to locate the company that manufactures the following: iPhone, Kindle, Xbox 360.

The iPhone is a product by Apple, the Kindle by Amazon, and the Xbox by Microsoft.

Have the students rank these products from most popular to least popular and predict the impact the product will have on the company's profit and the price of its stock.

Ask your students: In which company would your team invest? Why?

Repeat the exercise with the following products: Kool-aid, Pepsi, Tropicana orange juice

## **Assessment**

Stocks are often influenced by the demand for products. Have students select a stock in their portfolio they feel is most likely to be influenced by the demand for the product. Have students explain how the product produced by that company may increase or decrease the value of that stock.



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## Application

### Novice and Apprentice Levels:

Have students review their portfolios in their SMG groups. Have each student choose a company to research and track possible influences on the price changes that have occurred within the last two weeks.

### Master and Grand Master Levels:

Have students download a quarterly report for one of the companies in their portfolio and create a presentation reviewing the reasons the company's shares were up or down. Most publicly traded companies have separate "investor relations" sites where they provide quarterly reports and financials.

Ask your students to search the investor relations site of the company they have selected from their portfolio and write their predictions about the future of the company. Have students can make these presentations in class and discussed their conclusions.

## Enrichment Activities

There are many news websites that can be used with this activity. It's recommended that you pre-select one to use with your class. Distribute *Activity Sheet 2: The Ripple Effect* and ask the students to visit the news website you've selected.

Each SMG team will select one current event story they believe will influence the stock prices of a company. They will present their headlines and determination of the events' impact on the stock price of that company.

## Answer Key

### Activity Sheet 1

1. Between 1991 and 2002, the price of Walmart's stock went up while the price of Kmart's stock went down. Explain why.

Wal-Mart's stock went up because the company was earning more profit for its stockholders. Eager to own some of this growing profit, investors bid up the company's stock price. Meanwhile, Kmart's stock went down because the company's earnings dropped and turned into losses. The stock became less attractive to investors, so its price fell.

2. Explain how profits and losses enable shoppers to reward or penalize companies.

Shoppers like companies that offer them the products and services they want at prices they're willing to pay. They reward these companies by buying their products and boosting their profits (earnings). In contrast, shoppers avoid companies that



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don't give them the products and services they want at prices they're willing to pay. By choosing not to shop at these companies, shoppers penalize them with losses.

3. How did stock prices act like "financial faucets" for Wal-Mart and Kmart?

As Walmart's stock price went up, the company was able to raise more money for its growth. Its higher stock price opened the financial faucets to the company. Meanwhile, Kmart's stock fell, so it was less able to raise more money for its operations. The financial faucets to Kmart were shutting off.

4. How do investors open and close the "financial faucets" to companies like Walmart and Kmart?

Investors opened the financial faucets to Walmart by bidding up its stock price and helping the company raise more money. Investors closed the financial faucets to Kmart by pushing down its stock price and preventing the company from raising more money.

5. Do you think shoppers would have approved of investors' actions as they opened or closed the financial faucets to Walmart and Kmart? Explain.

Yes. Shoppers approved of Wal-Mart and wanted the company to grow. By opening the financial faucets to Wal-Mart, investors were helping shoppers get what they wanted. Kmart was just the opposite, however. Shoppers generally disapproved of the company and preferred to shop elsewhere. By closing the financial faucets to Kmart, investors were helping to direct money away from Kmart to other companies like Walmart that shoppers preferred.

## Activity Sheet 2:

Answers will vary depending on the articles your students chose. The objective of this exercise is for students to gain an understanding of the relationship between current events and stock prices. Students evaluate the impact of internal and external events on a company.

For example, if when a drug company announces the availability of an effective new treatment for a disease, its stock price may go up. If the news is reporting that the CEO of the same company is involved in a social scandal, the price of the stock may go down.



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# Activity 1: A Tale of Two Marts

It was the best of stores. It was the worst of stores. It was a place of profits. It was a location of losses. So begins a tale of two marts: Kmart and Walmart.

## The Okay Mart

Kmart was first to appear when Sebastian S. Kresge started the S.S. Kresge Company in 1899. Customers liked the new store because it sold everything for five and 10 cents. New stores sprouted and by 1912 they numbered more than 80. To raise money for its continued growth, the company sold shares of stock to the public for the first time in 1918. The stock then began its long listing on the New York Stock Exchange.

The company grew like Jack's beanstalk. In 1962, Kresge led the way in discount retailing by opening its first Kmart store. The number of Kmart stores quickly multiplied, reaching more than 160 by 1966. In that year, Kresge's total sales, including those of its Kmart stores, climbed above \$1 billion.

The popularity of the Kmart stores mushroomed, and by 1977 they accounted for nearly all of Kresge's sales. So it was no surprise when the company changed its name to Kmart Corporation in that year.

But Kmart was not unchallenged. Another competitor in the discount retailing market was also becoming popular with shoppers. Two brothers, Sam and James Lawrence "Bud" Walton, founded the new company in 1962. Their single store in Rogers, Arkansas soon multiplied to more than 20 stores by 1967. In 1970, the company, known as Walmart Stores, became a public company.

Walmart continued to grow, and in 1972 the New York Stock Exchange began listing its stock. By 1979, the company had nearly 300 stores with annual sales of more than \$1 billion. During the 1980s, Walmart opened its first Sam's club, started its first Supercenter and introduced one-hour photo labs. By 1990, the company had become the nation's biggest retailer. After the company became the biggest employer in the U.S. economy in 1997, the Dow Jones Company made a spot for it in its popular Dow Jones Industrial Average. In 2002, Walmart became the biggest business listed on the Fortune 500.

## Profits and Losses

During the 1990s, Walmart's sales and earnings soared as customers rewarded the store for its lower prices, customer service, and product selection. Its rising earnings and stock price clearly show a major role of profits in our economy. Profits enable customers to reward successful companies that sell the products and



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services they want at prices they're willing to pay. These rewards (profits or earnings) give a company the incentive and ability to grow.

How do profits do this? First, companies may keep some of their profit instead of paying it all out to its stockholders as dividends. The profit a company keeps helps finance the companies' continued growth. Second, when growing earnings push stock prices ever higher, companies like Walmart can more easily sell new shares of stock. The money raised from the stock sale can also help the company grow.

But consumers don't just reward successful companies with profits. They also penalize with losses companies that fail to offer the products and services they want at prices they're willing to pay. Kmart learned this lesson all too well. After pioneering discount retailing and growing to one of the biggest companies in our economy, Kmart began to stumble. Often unhappy with Kmart's product line, service, and prices, many customers began shopping instead at stores like Walmart and Target. In January 2002, the company went bankrupt, which means it couldn't pay all its bills.

Later in November, Kmart announced an agreement with Sears, Roebuck & Co. to merge with that company in May 2005. The new company, Sears Holding Corporation, would be the third largest retailer behind Walmart and Home Depot. On the day of the announcement, Kmart's stock price jumped — a sign that some investors believed the new company might compete successfully with the likes of Walmart and Target.

## Financial Faucets

This tale of two marts holds an important lesson about the stock market. The story shows how stock prices act like financial faucets in our economy.

Here's why. An increasing stock price opens the flow of money to a prosperous or promising company like Walmart.

With a higher stock price, the company is better able to sell new shares of stock to obtain some of investors' savings. The business can then raise the money it needs for its growth and expansion. In contrast, a falling stock price turns off the flow of money to a business like Kmart that is failing or unlikely to prosper.

A new Kmart emerged from bankruptcy in May of 2003. After shutting more than one of every four stores, its stock began trading on The NASDAQ Stock Market. In January 2004, the company reported its first profit following its bankruptcy. As the company continued to earn money during the year, investors pushed its stock price up. By early November 2004, it had soared to more than \$90 a share — a far cry from its \$15 level the year before.



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In this way, the stock market reinforces the judgment of consumers, who are rewarding one company with profits and penalizing another with losses. As the stock market opens the financial faucet to successful companies and closes it to others, it directs the nation's savings to companies most likely to use the money effectively. This process helps our economy grow.

## Sources

Kmart Corporate History, Kmart Timeline:  
<https://searsholdings.com/about/kmart/kmart-history>

Walmart Timeline:  
<https://corporate.walmart.com/our-story/our-history>



**Directions:** Answer each of the following questions:

1. Between 1991 and 2002, the price of Walmart's stock went up while the price of Kmart's stock went down. Explain why.
2. Explain how profits and losses enable shoppers to reward or penalize companies.
3. How did stock prices act like "financial faucets" for Walmart and Kmart?
4. How do investors open and close the "financial faucets" to companies like Walmart and Kmart?
5. Do you think shoppers would have approved of investors' actions as they opened or closed the financial faucets to Walmart and Kmart? Explain.

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# Activity Sheet 2: The Ripple Effect

After reading each of the three news articles selected, answer the following questions and attach the answers to the article.

1. How will this event affect the earnings of the company?
2. How might the event affect the future of the company?
3. How do you think this event will affect the price of the company's stock?
4. How might this event impact other companies in the same industry?
5. How might the event impact the overall economy?



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