

What Causes Stock Prices to Change?

Suggested Grade

Grades 6-8

Suggested Time

50 minutes

Teacher Background

The following lesson discusses influences that effect stock prices. We can consider the stock market a living entity because of its volatility—and stock's ability to change price minute to minute. A number of factors may determine this change. Market forces such as supply and demand at times determine 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 what makes people favor a particular stock and dislike another. Fundamental data such as P/E ratios and projected earnings help investors place a value on a stock. News events, 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 alone is seldom the sole determining factor of price, but it can influence its change. News that moves a stock's price may be a result of internal corporate activity, industry trends or information based upon national or international occurrences including 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 opinions about future value of a company on its earnings projections. If a company's results are better than analysts expected, the stock price rises. If a company's results are worse than expected the stock price falls.

Earnings are just 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. Forecasting prices consistently is almost impossible.

The main forms of stock analysis are fundamental, technical and quantitative. Each approach involves following various market indicators to decide whether to buy, sell, or hold. This lesson, however, will touch on the analysis of outside influences (i.e., current events). It is a broader and more basic approach to understanding the influences of the market.



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Vocabulary

Earnings: Whatever profits or net income remains after subtracting the company's expenses from its revenue (also called a company's profit).

Fundamental Analysis: A primary method for analyzing a stock's potential return. It involves assessing a corporation's financial history and current standing, including earnings, sales, and management, as well as the strength of the corporation's products or services in the marketplace.

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

Market Capitalization: A measure of the value of a company, calculated by multiplying the number of outstanding shares by the current price per share. For example, a company with 100 million shares of stock outstanding and a current market value of \$25 a share has a market capitalization of \$2.5 billion.

P/E Ratio: A company's closing price divided by its latest annual earnings per share. The Price / Earnings is the relationship between a company's earnings and its share price. It is calculated by dividing the current price per share by the earnings per share.

Quantitative Analysis: Analysis focused on a corporation's financial data including looking at profit-and-loss statements, sales and earnings histories and the statistical state of the economy.

Technical Analysis: Tracking price movements and trading volumes in various securities to identify patterns in the price behavior of particular stocks, mutual funds, commodities, or options in specific market sectors or in the overall financial markets.

Performance Objectives

Students will be able to:

- Discuss the various ways stock prices are influenced.
- Interpret charts and graphs to better understand the growth and change in stock prices.
- Analyze and interpret market indices, which influence change in the price of stock.

Activity Sheet 1 The Ripple Effect (3 copies per team)

Activity Sheet 2 Influences on the Market

Springboard Activity

List the following pairs:

- iPod vs. iPhone
- Video tapes vs. Digital recordings
- Digital cameras vs. Film Cameras
- Slide projector vs. SmartBoard



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Ask your students:

- In your SMG team, discuss which product in each pair you believe is the better investment.

Discuss the answers, noting that new products reduce the demand for old products, which affects the value of the companies that make both products.

Procedure

Explain: Share prices fluctuate for many different reasons. In addition to new products replacing old ones, what are some other reasons that you can think of for a company's stock to rise or fall?

Elicit various reasons and list these reasons.

Explain that today we will focus on the impact of current events on stock prices.

Distribute and have students discuss *Activity Sheet 2: Influences on the Market*, which contains four different scenarios.

Ask your students: Which of the four companies' stock would you purchase? Why?

Novice and Apprentice Levels:

Have each student choose one company for follow-up research. Track possible influences on the price changes that have occurred within the last two weeks.

Master and Grand Master Levels:

Have students download the quarterly financial report of one of the companies in their portfolio. Students may locate financial information through the "Investor Relations" link on their company's website. Students should use this information to create a PowerPoint presentation reviewing the reasons the company's shares were up or down. Have students write their predictions about the future of the company. Have students make these presentations in class and discussed their conclusions.

Assessment

Distribute *Activity Sheet 1: The Ripple Effect*. Use this sheet in conjunction with the instruction below.

Novice and Apprentice Levels:

Ask the class to go to a general news website. Have each SMG group select one current event story they believe will influence the stock prices of a company.

Have each group present its headline and its determination of the event's impact on the stock price of that company.



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Master and Grand Master Levels:

Ask the class to go to a general news website. Have each SMG group select one current event story they believe will influence stock prices.

Have each group present its headlines and determination of the event's impact on stock prices by:

- Identifying the industry effected
- Listing three to five stocks from that industry
- Explaining how the current event will influence stock prices for those companies and in that industry

Application

Novice and Apprentice Levels

Stocks are easily influenced by world events. Have students select a stock in their portfolio that is most likely to be influenced by the news. Have students explain how current events may increase or decrease the value of that stock.

Master and Grand Master Levels:

Have students download a recent quarterly financial report for the most successful stock in their portfolio. Have them use the report together with current events to create a presentation that convinces their team members to either sell or purchase more of the stock.

Enrichment Activities

Have students create a quarterly report on a stock that the SMG group has chosen and present it to the class. Ask them to present their reports as PowerPoint presentations or with charts and graphs. Students should make the document come alive and be graded on their creativity in dispersing the information. Presentation rubrics are available in the Assessment section of the SMG Teacher Support Center.

Answer Keys

Activity Sheet 1

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 Sheet 2

Scenario 1:

The largest toy company in the United States, Toys for Everyone, produces the most famous toys in America. The company has grown quickly and consistently since it was founded fifty years ago. This fall, the CEO of Toys for Everyone was accused of embezzling twenty-five million dollars from the company. The company is now under investigation:

How could this event affect the manufacturing of the product?

The event would cause the manufacturing of the product to slow down. The product may not sell because the public may not trust the company.

How might this event affect the consumer's interest in buying the product/company?

The consumer's interest in buying the product and/or the company would dramatically decline.

How might the event affect the future of the company?

The company wouldn't be as trustworthy to consumers and/or stockholders.

How do you think this event will affect the price of the company's stock?

It would decline if the public knew about the rumor. The stock price of the company may never be as high as it used to be.

How might this event impact other companies in the same industry?

Answers may vary.

How might the event impact the overall economy?

Answers may vary:

Currently, while the company is under investigation, how will this affect the company's stock?

Answers may vary: The company's stock will decrease.

If the CEO is convicted of these charges, how do you think this will influence the stock?

Answers may vary: Decrease in demand.

If the CEO is cleared of the charges, how do you think this could influence the stock?

Answers may vary: Increase in demand.

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Would you invest in this company? Explain.

Answers may vary.

Scenario 2:

The Good Health Pharmaceuticals Company has been in business for 20 years. The company developed a drug that can cure lung cancer and is ready to distribute it to the public. Good Health Pharmaceuticals requested the Food and Drug Administration (FDA) to endorse and release the drug. The FDA asked for more tests to verify the safety of the drug and denied the release. These required tests could take up to ten years to complete!

In what way could this event affect the manufacturing of the product?

The event would cause the manufacturing of the product to slow down. The product may not sell because the public does not have enough information/statistics about the product.

How will it affect the future of the company?

The interest in the company would decline.

How will the FDA's denial of the release of the drug affect the company's stock?

The company's stock value would decrease.

If the drug was released, how will that event most likely affect the price of the company's stock?

After the release of the drug, the price of the company's stock would increase.

Would you invest in this company? Explain.

Answers may vary.

Scenario 3:

The Good House Builders Company, located in Mississippi, has been in existence for 14 years. It has had steady work for the past few years. Last summer a horrible hurricane hit Mississippi, wiping out major towns and cities in the southern part of the state. Every home and business was destroyed; people were left homeless and jobless. People are now returning after the disaster to rebuild. The only construction company in the area is the Good House Builders.

How will the event affect the manufacturing of homes?

There will only be one construction company to profit, since consumers would need it to build their houses again.



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What affect will the event of last summer have on the cost of materials that go into producing new homes? Explain why.

Everything will be more expensive because the major towns and cities were destroyed, hence, less supply of materials in the area.

How will this event most likely affect the earnings of the company?

The earnings of the company will still be high since it still is the only construction company in the area, even though it will have to pay more for their materials.

How will the event most likely affect the future of the company?

The future of the company will be great because it would have many clients.

How do you think the event will affect the price of the company's stock?

The price of the company's stock will increase since the company itself will be doing good.

What other things do you think might have affected the stock?

Answers may vary.

Would you invest in this company? Explain.

Answers may vary.

Scenario 4:

Inflation is at an all time high. In response, the Federal Reserve decides to raise interest rates. Most people buy cars on credit, so the car manufacturers worry that the interest rates may have an effect on their business. As a response to this event, Ford Motor Company decides to have a major sale on their cars and trucks.

How might the event affect the manufacturing of the product?

There would be a decline in manufacturing cars if the interest rates are raised.

How will the event affect the consumers' interest in buying cars and trucks?

It would have a slight effect on the consumers because the cars may be more expensive. Even though vehicle companies like the Ford Motor Company would have a major sale to balance the interest rates.

How will this affect the earnings of the company?

The company would have fewer earnings because Federal Reserve decided to raise the interest rates. But we cannot underestimate the number of



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customers they will have when the major sales begin. Maybe Ford will sell more cars so they can balance their earnings. Answers may vary.

How do you think it will affect the price of the company's stock?

Answers may vary.

How will the interest rate affect the company?

Vehicle companies may reduce the prices of the vehicles because of the interest rates. There is a large negative affect, but it may be a positive affect as well.

Does the company have reason to worry about their business?

Answers may vary

If you were the CEO of Ford Motor Company what would you try to avoid any trouble with your business?

Answers may vary.

Would you invest in Ford? Explain.

Answers may vary.



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Activity Sheet 1: The Ripple Effect

Directions: 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?

Activity Sheet 2: Influences on the Market

Scenario 1:

The largest toy company in the United States, Toys for Everyone, produces the most famous toys in America. The company has grown quickly and consistently since it was founded fifty years ago. This fall, the CEO of Toys for Everyone was accused of embezzling twenty-five million dollars from the company. The company is now under investigation:

How could this event affect the manufacturing of the product?

How might this event affect the consumer's interest in buying the product/company?

How might the event affect the future of the company?

How do you think this event will affect the price of the company's stock?

How might this event impact other companies in the same industry?

How might the event impact the overall economy?

Currently, while the company is under investigation, how will this affect the company's stock?

If the CEO is convicted of these charges, how do you think this will influence the stock?

If the CEO is cleared of the charges, how do you think this could influence the stock?

Would you invest in this company? Explain.

Scenario 2:

The Good Health Pharmaceuticals Company has been in business for 20 years. The company developed a drug that can cure lung cancer and is ready to distribute it to the public. Good Health Pharmaceuticals requested the Food and Drug Administration (FDA) to endorse and release the drug. The FDA asked for more tests to verify the safety of the drug and denied the release. These required tests could take up to ten years to complete!

1. In what way could this event affect the manufacturing of the product?
2. How will it affect the future of the company?
3. How will the FDA's denial of the release of the drug affect the company's stock?
4. If the drug was released, how will that event most likely affect the price of the company's stock?
5. Would you invest in this company? Explain.

Scenario 3:

The Good House Builders Company, located in Mississippi, has been in existence for 14 years. It has had steady work for the past few years. Last summer a horrible hurricane hit Mississippi, wiping out major towns and cities in the southern part of the state. Every home and business was destroyed; people were left homeless and jobless. People are now returning after the disaster to rebuild. The only construction company in the area is the Good House Builders.

How will the event affect the manufacturing of homes?

What affect will the event of last summer have on the cost of materials that go into producing new homes? Explain why.

How will this event most likely affect the earnings of the company?

How will the event most likely affect the future of the company?

How do you think the event will affect the price of the company's stock?

What other things do you think might have affected the stock?

Would you invest in this company? Explain.

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1. How might the event affect the manufacturing of the product?
2. How will the event affect the consumers' interest in buying cars and trucks?
3. How will this affect the earnings of the company?
4. How do you think it will affect the price of the company's stock?
5. How will the interest rate affect the company?
6. Does the company have reasons to worry about their business?
7. If you were the CEO of Ford Motor Company what would you try to avoid any trouble with your business?
8. Would you invest in Ford? Explain.