

# Activity Sheet 1: A Simple Guide to Making Money in the Stock Market

You are almost ready to select your team's initial investments. To manage your portfolio wisely, it is important for you to know the ways to earn money through investing. The first thing you must understand is that supply and demand has a lot to do with how well your team's portfolio will fare. Simply stated, shareholders of stock in high demand can sell their shares for a profit and may earning dividends.

Most smart investors are in the market over the "long haul;" they expect to ride out the ups and downs of daily market changes and see their investments grow over an extended period. In SMG, your team, in most cases, invests for a three-month period. You will not be able to see the impact of long-range trends on your investments. However, as you invest, keep in mind that social, economic and political issues and events impact the market. You need to keep these factors in mind as you invest and decide to sell. Changes in the economy related to taxes, monetary policy, war, unemployment, holiday-seasonal buying, a national crisis such as Hurricane Katrina, the avian flu, and even the weather—like an extended heat wave across the country—can impact stock prices.

In addition to your portfolio growing when you buy low and sell at a higher price, you can make money from the company whose stock you own. When a company is doing well, there are several ways they use their profits or earnings. These include:

1. Reinvesting profits for expansion, new product development, modernization and other improvements.
2. Giving a percentage of profits to the shareholder in the form of dividends.
3. The company's board of directors decides whether to reinvest the profits or pay dividends to their shareholders or both. A dividend is a cash amount distributed to everyone who owned company shares on a certain date. A dividend is allocated per share; therefore the more shares you own, the greater the dividend you receive. The annual dividend is distributed to shareholders quarterly. For example, if you own 100 shares of XYZ Company and the company declares a \$2 annual dividend, you will receive \$50 each quarter that you own the stock during that year. Dividends can and do change over time.

Declaring a dividend does not guarantee that the company is healthy. Sometimes a company will continue to declare a dividend during a slow period because they do not want to scare off investors by having them think that the company is not doing well. Or they may not want to break a long corporate history of declaring dividends. Companies like Coca Cola, Procter & Gamble, General Electric, Pfizer, Inc, Eli Lilly and Bank of America have paid yearly dividends over 100 years. Each of them has weathered downturns in business during the past century. Over fifty percent of the Standard & Poor's list of 500 leading companies declares a dividend.

Your SMG team portfolios are automatically credited with the cash value of dividends your stock has earned. You should know that if you sell shares right before the record date, you will not earn dividends even if you owned the shares for most of the previous quarter. Purchasers who buy the stock during the period just before the record date and up until the distribution date—called ex-dividend—do not receive dividends for that quarter. Your team's dividends will appear in the cash balance of your portfolio. Your team can use these funds to purchase additional shares of stock in any company (not just in the shares of the company that has declared the dividend).

Some companies pay their dividends in the form of additional shares of stock; thus increasing the shareholder's equity in the company. This is not a stock split. A stock split increases the number of shares of the corporation without changing the value of the shareholder's equity in the company.

Most of the money your team will make or lose in the SMG comes not from dividends, but from price appreciation. Remember "*buying low, selling high.*" The wise investor also knows the rule of the marketplace: *caveat emptor*; let the buyer beware. Despite excellent research and careful monitoring your investments, there is nothing in the market is guaranteed to make a profit.

Answer the following questions based upon the reading above.

1. How does an investor make money from an investment?
2. What do companies usually do with profits that are left after all expenses are paid?
3. What factors can influence the price of a stock?
4. Why do some companies continue to pay dividends even when they are not having a good year?

5. Can Stock Market Game portfolios earn dividends? Explain.
  
6. How will the information you learned from this reading influence your plans for investing as a member of your Stock Market Game team?
  
7. How might the information you learned influence the investment decisions you will make in real life? How do these decisions differ from the decisions you make as a SMG team member?