Stocks and Mutual Funds

Introduction

One characteristic of a market economy is private ownership of property. Property is not just land and real estate; it is anything of economic value that belongs to you. Your stereo is your property, a baseball card collection is your property, and shares of stock in a corporation are property, too. If you own shares of stock, you have equity in the corporation. Equity means ownership.

By owning stock in a corporation, you become part-owner of that company. You can earn dividends, which are distributed from profits of the company. You can also earn a capital gain when you sell shares of stock at a higher price than you paid for them. Your shares of stock are called equities.

Stocks are bought and sold in the stock market. There are actual physical stock markets such as the New York Stock Exchange, and there are stock markets that operate on the Internet such as NASDAQ. When stockholders want to sell stock they own, they often contact a broker who acts as an agent for the seller by selling the stock for the stockholder. When someone wants to buy stock in a company, he or she often contacts a broker who acts as an agent for the buyer in purchasing the stock. The stock buyer pays for the stock, and the stock seller gets the money. The brokers get a small percentage of the money for the service they perform.

For the stock buyer, there is no guarantee that the investment will be successful. As an owner of stocks, you have some say about how the corporation should be run. You also get to share in the profits that are made. But there is no guarantee that the corporation in which you are an owner will be successful. If the corporation does not make a profit, there is no built-in safety net or insurance to reimburse you for your losses.

Then why do so many people—more than 50 percent of Americans—invest in the stock market? Many people choose to invest more of their money in the stock market rather than putting it into CDs, money market deposit accounts, statement savings accounts or U.S. Savings Bonds. People invest in the stock market because of the possibility of earning a better return.

Vocabulary

Capital gain: Gain from selling stocks or other investments for more than what was paid for them.

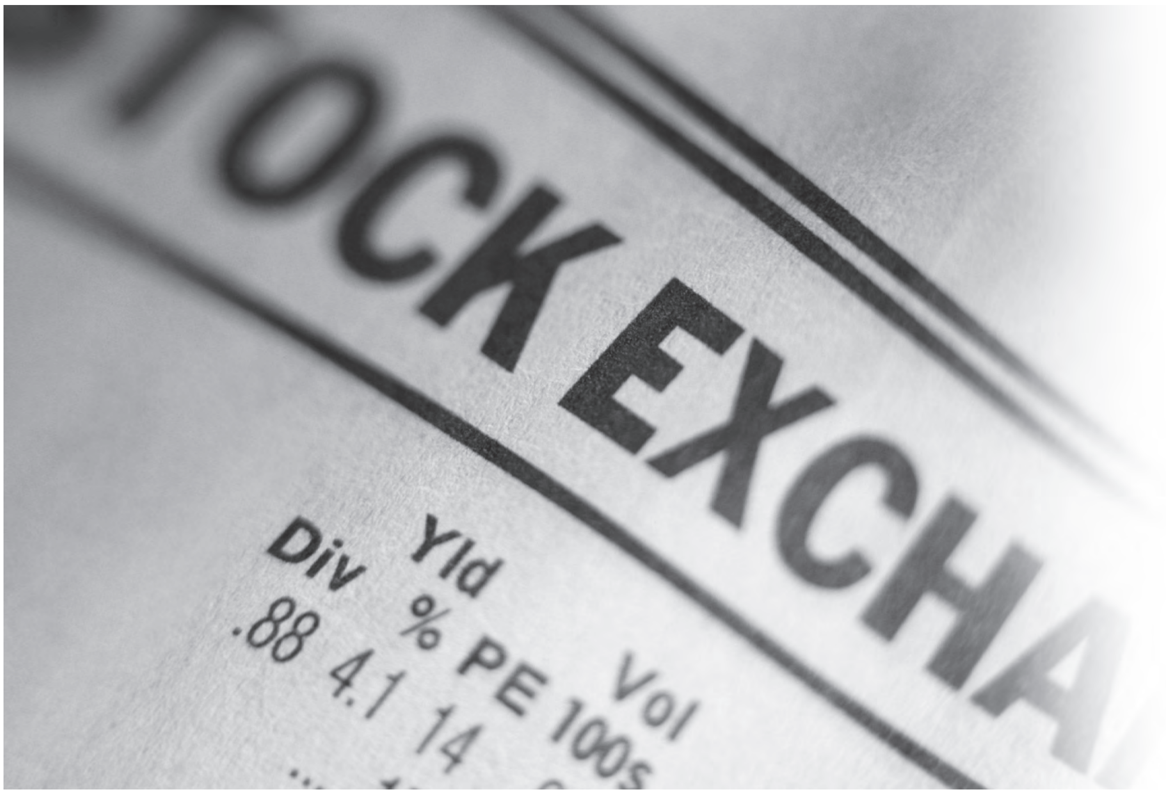
Capital loss: Loss from selling stocks or other investments for less than what was paid for them.

Dividend: Periodic payment distributed from profits of a corporation to its stockholders.

Equity: The value of property that is owned, including shares of stocks in a corporation.

Stock: A share of ownership in a company.

Stock market: Where shares of stocks are bought and sold (can be a specific, physical place or sales can take place online).



The Pie War

CAST OF CHARACTERS	
Pretty Pies, store owner	**Lydia,** customer
Perfect Pies, store owner	**Kendall,** person at the party
Meredith, customer	**Narrator**

Students will play the parts of pie-store owners, the customers (Meredith and Lydia), and Kendall. The teacher should serve as narrator.

Choose the two pie-store owners and have them stand next to each other at the front of the room.

Choose the two customers and have them stand at opposite ends of the front of the room.

Choose Kendall and have him or her stand toward the back of the room.

Begin the play.

Narrator: This is a story about two businesses: Pretty Pies and Perfect Pies. The owner of Pretty Pies has a little store where she makes pies in the back and sells them in the front. She makes the best pies. She uses fresh fruit for the filling. The crust is brown and flakey, and the pies never fall apart when sliced.

The owner of Perfect Pies also has a little store where he makes pies in the back and sells them in the front. He makes perfect pies. He uses fresh fruit for the filling. The crust is brown and flakey, and the pies never fall apart when sliced.

It just so happens that Pretty Pies and Perfect Pies are located right next door to each other, in identical buildings. They produce the same number of pies at the exact same cost. They sell the same number of pies at the exact same price, so their profits are exactly the same. These companies are identical in every way.

One day, Meredith is walking down the street and happens upon the Pretty Pies store.

Meredith: *(Walk down the street toward Pretty Pies store. Go up to Pretty Pies.)* Hello, I need a pie.

Pretty Pies owner: I have great pies. I know you will like them. See? *(Hold up pretend pie.)* They have a golden brown crust and are overloaded with fruit.

Meredith: This IS a great pie. I'll take it! By the way, how long have you been doing this?

Pretty Pies owner: About two years.

Meredith: Is it a good business?

Pretty Pies owner: The best!

Meredith: How good is it?

Pretty Pies owner: Last year, I made a lot of money. People come from all over to buy my pies.

Meredith: Do you own this store by yourself?

Pretty Pies owner: Yes, it's all mine. But, I wouldn't mind having an investor. If I had a little more money, I could do some things around here to make the store even better.

Meredith: I have $1,000 I would like to invest. I could give it to you; then, if you are profitable at the end of the year, you could give me a part of the profit.

Pretty Pies owner: Okay. You give me $1,000. *(Act like you're writing something down on paper.)* Let me give you this piece of paper called a stock. It says you own part of my business. If I make a profit, I'll share some with you.

Meredith: Great. See ya. *(Leave the store and go back to your original spot.)*

Narrator: Just as Meredith leaves the store, here comes Lydia down the street.

Lydia: *(Walk down the street toward Perfect Pies. Go up to Perfect Pies.)* Hi, I would like to buy a pie.

Perfect Pies owner: I have great pies. I know you will like them. See? *(Hold up pretend pie.)* They have a golden brown crust and are overloaded with fruit.

Lydia: This IS a great pie. I'll take it! By the way, how long have you been doing this?

Perfect Pies owner: About two years.

Lydia: Is it a good business?

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Lydia: Great. See ya. *(Leave the store and go back to your original spot.)*

Narrator: A year passed, and both business owners made improvements to their businesses, using the $1,000 investment each had received. Once again, the two businesses received identical revenue, had identical costs, and earned identical profits. Each business owner scheduled a visit with his or her respective investor.

Meredith: *(Walk to Pretty Pies.)* Hi, how did things go this year?

Pretty Pies owner: We had great success. I appreciate your financial investment and your faith in my business. I would like to give you $500 as your part of the profit.

Meredith: Wow! I just made $500 for just a $1,000 investment. Do you realize that is a 50 percent return on my money?

Pretty Pies owner: Yes. You deserve it for wisely investing in my company.

Meredith: Thank you very much. I am glad to be a shareholder in your company. I'll be back next year to see how you're doing.

Pretty Pies owner: I'll be here. I hope to give you another 50 percent return! (Walk back to your original position.)

Narrator: Just as Meredith was leaving Pretty Pies, Lydia was arriving at Perfect Pies.

Lydia: (Walk to Perfect Pies.) Hi, how did things go this year?

Perfect Pies owner: We had great success. I appreciate your financial investment and your faith in my business. I could give you $500 as your part of the profit, but I would like to take a large part of my profit and your profit and buy a second crust-making machine and a fruit-slicing machine. If I had these machines I could double the number of pies I make. I would be producing twice as many pies each hour, so I could offer my pies at a lower price. People would buy their pies here instead of buying them from my competitor next door. Next year, we would have a much larger profit to share.

Lydia: That makes sense. Go ahead and do that. I'll be back next year to see how you're doing.

Perfect Pies owner: I'll be here. I hope to give you a 100 percent return! *(Walk back to your original position.)*

Narrator: A few months later, Meredith and Lydia ran into Kendall at a holiday party. They talked about the things that young adults talk about—their jobs, their apartments, and their cars. They also talked about how expensive it is to buy furniture, maintain their cars, and pay their bills. Finally, the subject turned to earning money.

Kendall: I work 40 hours each week, and I make $15.00 per hour. That's enough to pay my rent, buy food, maintain my car, and add small amounts of money to my savings account, but I don't have money left over to buy some of the fun things I would like to have. I would like to find a way to make money, but I don't want to work more hours. I guess there is no way to earn money without working more.

Meredith: Actually, you CAN earn money without working more hours. There was a bit of risk involved, but I did it by investing in a pie company.

Lydia: You invested in a pie company? What a coincidence. So did I! My pie company is doing great!

Meredith: So is mine.

Kendall: I would like to find an investment like yours.

Meredith: I might be interested in selling you my share of the pie company—for the right price.

Lydia: I might be interested in selling you MY share of the pie company—for the right price.

Kendall: I would like to invest in one of the pie companies. *(Turn to face Meredith.)* Should I invest in your company? *(Turn to face Lydia.)* Or should I invest in your company? *(Turn to face both Lydia and Meredith.)* Tell me about your companies.

Lydia: The company I invested in is doing very well.

Meredith: So is mine.

Lydia: Mine is highly profitable and will earn even greater profits next year.

Meredith: So will mine.

Kendall: I don't want to cause an argument. Just tell me this. How big a return have you received on your investment?

Lydia: I haven't received a return because my pie company used the money to buy two machines that will make more pies.

Meredith: I received a 50 percent return.

Kendall: Wow! A 50 percent return?

Narrator: *(Ask the class:)* Which pie company stock did Kendall buy? (Pretty Pies.) Which company do you think will have earned more money, compared to the last year? *(Perfect Pies.)* Let's see what happened.

Meredith: *(Walk to Pretty Pies.)* Hi, how did things go this year?

Pretty Pies owner: We did well. We earned almost as much profit as we did last year. Some people who used to buy pies from me began to buy their pies next door. They said those pies were just as good and they didn't cost as much.

Meredith: I'm sorry to hear that.

Pretty Pies owner: It's okay. I still earned a profit and I can share it with you. Here is $200.

Meredith: That's nice. A 20 percent return is very good. Of course, it's not as good as last year's 50 percent return. Maybe it will be better next year. See you then. Bye. *(Walk back to your position.)*

Narrator: Just as Meredith was leaving the store, Lydia was arriving at Perfect Pies store.

Lydia: *(Walk to Perfect Pies.)* Hi, how did things go this year?

Perfect Pies owner: We had great success. Just as I had hoped, I was able to make twice as many pies, so I was able to offer them at a lower price. I sold pies to many people who used to get their pies from the company next door. I earned a very large profit. Here is a check for $1,000. This is your share of the profit I earned.

Lydia: Wow! That's a 100 percent return this year. I've never heard of a return that high.

Perfect Pies owner: Well, we hope to be just as successful next year, too!

Narrator: Other investors began watching the two companies. They saw that Pretty Pies store was not likely to earn more profit in the future. However, they were impressed with the Perfect Pies store. The investors expected this store's profit to grow more and more each year. So, the investors asked if they could also buy shares of the Perfect Pies store.

THE END *(Bow and take your seats.)*

With a partner, answer the following questions:

A. Why did Perfect Pies become more profitable than Pretty Pies?

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B. What will Pretty Pies have to do to compete with Perfect Pies?

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NAME: ______________________________ CLASS PERIOD: __________

Pie Potential

Pretty Pies and Perfect Pies began to sell stock. Research analysts from three brokerage firms began investigating the pie companies, looking for strong stocks for their customers. Unlike Kendall, they were unimpressed with the big dividend offered by Pretty Pies. On the other hand, they liked what they saw in the management of Perfect Pies. They appreciated Perfect Pies' focus on future growth as evidenced by the capital investment in the pie crust machine and the fruit slicing machine.

The research analysts urged their firms begin to recommend that their customers buy Perfect Pies stock. They weren't optimistic about the growth of Pretty Pies, however, and did not recommend Pretty Pies stock.

As the customers of the brokerage firms began to buy Perfect Pies, the stock price for Perfect Pies increased. This was like a signal to other potential stock buyers. As they saw the price of Perfect Pies stock increasing, they examined the information the researchers had analyzed and decided they also wanted stock in Perfect Pies. The stock price continued to go up.

As for Pretty Pies, the stock price never increased. The analysts who studied Pretty Pies assumed that the best-case outlook for Pretty Pies was that it would continue to make the same profit it had made before. The worst-case outlook was that it would not be able to compete with Perfect Pies and would go out of business.

Answer these questions:

A. Which company's stock did research analysts recommend?

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B. What was it about the Perfect Pies operations that impressed the analysts?

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C. What was the signal to other stock purchasers that Perfect Pies was a good investment?

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D. What was the signal to other stock purchasers that Pretty Pies was not a good investment?

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NAME: ________________________ CLASS PERIOD: ____________

Imperfect Pies

Businesses can face problems that cause only minor dips in profit—or problems that cause complete failure. Business decisions can affect how many goods a business will produce (the supply) or how many goods customers want (the demand). Events that can't be controlled by management can also affect the supply of and the demand for goods.

Read the following scenarios to determine what problems with supply or demand Perfect Pies, Inc. might face.

Scenario 1

The pie crust supervisor burst into the boss's office, shouting "I don't know what to do about the pie crust machine! It keeps tearing the crusts."

The boss asked, "What are our options?"

The supervisor responded, "We could get it fixed, but the machine is getting old, and it's difficult to get parts. Another option is to get a new machine, but that's going to be expensive."

The boss responded, "You forgot a third option. Let's just go back to making the pie crust by hand. We don't need a machine. I've got to go now; I've got a 2:00 p.m. golf game."

Questions

If the pie company goes back to making the crusts by hand, will the supply of pies increase or decrease?

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Is this a problem that can be controlled by management?

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Scenario 2

"This is a disaster!" exclaimed the fillings supervisor. "There are worms in the apples. I've ordered more from the growers, but now I've been told there are worms in all of the apples. We have a worm infestation! This is terrible! Thanksgiving is right around the corner, and we aren't going to have any apples for apple pies. We're going to lose a lot of money!"

Questions

If the pie company cannot get apples without worms, will the supply of apple pies increase or decrease?

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Is this a problem that can be controlled by management?

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Scenario 3

"Hey, you've lost some weight!" Claire said as she saw Madison come through the door.

"Yes," said Madison excitedly, "I lost it on the Pronly diet."

"I've never heard of that diet. Tell me about it," Claire said.

Madison explained, "It's the protein-only diet. You eat meats, cheese and beans. And, most important, you never eat pies! Everybody's doing it."

Questions

If the Pronly diet becomes popular, what will happen to the demand for apple pies?

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Is this a problem that can be controlled by management?

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NAME: ____ CLASS PERIOD: ____________

Mutual Funds

Directions: After reading the following description of mutual funds, brainstorm with your group to complete the assignment.

To reduce the risk of loss, many investors follow a plan to diversify their holdings. Investors put their savings dollars into different kinds of investments so that possible losses in one kind are balanced by gains in another. For example, an investor might hold a combination of technology, health care, and service industry stocks. An investor might also choose blue chip stocks as well as unproven, new, growth stocks.

Mutual funds are based on the idea of diversification. A mutual fund company uses investors' money to buy a variety of stocks. Small investors can thus invest in a greater number and variety of stock than they could have done if they were to buy stocks individually. The investor gains or loses based on the total fund's performance—the gains and losses of all the individual stocks in the fund.

People who can afford to accept greater risk will often choose mutual funds that buy stock in small or medium-size companies. People who cannot afford to accept high levels of risk will choose funds that buy stock in large, stable companies and other stable assets.

Assignment

Describe the kind of people who would be uncomfortable accepting high levels of risk and would, therefore, choose a mutual fund that buys stocks of large, stable companies, providing constant, relatively small returns. Hint: Think about age, income, and financial obligations.

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Describe the kind of people who would be willing to accept higher levels of risk in hopes of gaining a high return on their investments. Hint: Think about age, income, and financial obligations.

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