

SAMPLE MATERIALS

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LESSON 8 HOW TO BUY AND SELL STOCKS AND BONDS

MIDDLE SCHOOL

8 HOW TO BUY AND SELL STOCKS AND BONDS

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Lesson Description

In this lesson the students learn about the financial markets in which stocks and bonds are bought and sold. They read about the high transaction costs that individual investors would experience if there were no financial markets. They perform a play that illustrates how an individual stock transaction is made in an organized financial market. Finally, the students discuss the options available for buying and selling stocks and bonds.

Financial markets bring buyers and sellers of stocks and bonds together. These markets provide information about available trading partners and competitive prices. Today, investors have several alternative ways of buying and selling in financial markets.

Concepts

- Bond
- Broker
- Dividend reinvestment plan (DRIP)
- Financial markets
- Investor
- Stocks

Objectives

Students will:

1. Explain how financial markets help investors.
2. Describe how a transaction is made in an organized stock market such as the New York Stock Exchange.
3. Evaluate options available to investors for buying and selling stocks and bonds.

Time Required

45 minutes

Materials

- A transparency of Visual 1
- A copy of Activity 1 for each student
- A copy of Activity 2 for each of the 8 actors in the play
- Optional: Props for the play (newspaper, 4 telephones, 2 order forms and 4 computers)

Procedure

1. Tell the students that they are going to learn how investors buy and sell stocks and bonds. Stocks and bonds are bought and sold in financial markets. For example, at the New York Stock Exchange (NYSE), the oldest and largest stock exchange in the United States, about a billion shares of stock are traded each day. In the United States, about half of the publicly traded stocks are listed on exchanges such as the NYSE or other exchanges with a physical location. The other half are traded through a network of brokers throughout the country. This network is referred to as the over-the-counter (OTC) market. Bonds normally trade on the OTC market. Individuals who want to buy or sell stocks or bonds use the services of brokers to trade their securities in these markets.

2. Tell the students that without financial markets individuals would find it very difficult to trade their stocks and bonds. **Distribute a copy of Activity 1** to each student. After allowing time for reading, *ask:* How do financial markets help sellers like Veronica and buyers like Ron? *These markets reduce the costs of trading for sellers like Veronica and buyers like Ron. Markets provide information about potential trading partners and supply more than one buyer or seller so that competition can establish a price satisfactory to both parties in the transaction.*

3. Tell the students that they will act out a play; the play shows how an actual stock market trade is made. Select students to play the following roles: Moderator, Veronica Vargas, Veronica's Stockbroker, Ron Rosenthal, Ron's Stockbroker, two Order Room Clerks and the Johnson & Johnson Specialist. Give each actor a copy of the play (Activity 2). Set the stage in five areas from left to right: one area each for Veronica, Veronica's stockbroker, the Johnson & Johnson trading post, Ron's stockbroker and Ron. In Veronica's area and Ron's area, place a chair and a telephone. In each stockbroker's area, place a chair and computer for the stockbroker and, a short distance away, a chair and computer for the order room clerk. At the Johnson & Johnson trading post, place a chair and a computer for the specialist. Have the students perform the play.

4. When the play ends, tell the students that consumers today have a number of options for buying stocks and bonds. **Display Visual 1.** Tell the students that in the play, Ron Rosenthal's broker was a full-service broker. He advised Ron on what stock to buy. Ron told the broker about his investment objectives — he wanted a stock that was relatively safe and stable — and the broker suggested a stock that met those objectives. The broker had access to the invest-

ment research done by the research department of the firm. Investors who use a full-service brokerage firm usually can get copies of the firm's research reports. Also, full-service brokerage firms usually have other financial products for sale, such as various types of bonds. These brokerage firms charge a commission on every purchase or sale.

Veronica Vargas may have used either a full-service broker or a discount broker. Discount brokers take buy and sell orders from customers, but they provide little or no investment advice. Consequently, discount brokerage firms do not maintain research departments. Compared to full-service brokers, discount firms charge a lower commission for each transaction they make. Many firms charge a flat fee for making a transaction, rather than a percentage of the value of the stock.

When the Internet emerged, buyers gained a new option for buying stocks and bonds. Many discount brokers have now opened online offices. Commissions on these transactions are even lower than the charges of a conventional discount broker, since the transaction can now be made without directly involving a broker.

Many large companies offer dividend reinvestment plans, called DRIPs. A stockholder can choose to take his or her dividends in the form of shares of the company's stock rather than receive a dividend check. Shares of stock can be acquired in this way without paying a commission, although the shares will be taxed, just as a dividend check would be.

5. **Ask:** What kind of investor would benefit most from dealing with a full-service broker?

Someone who is not very knowledgeable about what stocks to buy and does not want to take the time to research individual stocks.

Closure

1. To review the lesson, **ask:**

- What is the New York Stock Exchange?

The New York Stock Exchange is the oldest and largest stock exchange in the world.

- Less than half of all stocks are traded on exchanges like the New York Stock Exchange. How are the rest traded?

The other stocks are traded on the over-the-counter market, which is a network of brokers rather than a physical location.

- What role do brokers play in buying and selling stocks?

Brokers assist their clients in making transactions in organized financial markets. Brokers charge fees for providing their services. Full-service brokers provide investment advice.

- What are DRIPs? What is the advantage of a DRIP program?

DRIPs stands for dividend reinvestment plans. Some large companies offer these plans. They allow shareholders to receive dividends in the form of company stock rather than cash. This allows shareholders to acquire more stock without paying broker fees.

2. Tell the students to imagine that they have money they would like to invest in stocks or bonds. Ask each student to write one or two paragraphs telling what method he or she would use to make the investment, and to give reasons for his or her decision.

Assessment

Multiple-Choice Questions

1. An order to buy or sell a stock at the market means to buy or sell the stock
 - a. at an organized financial market, such as the New York Stock Exchange.
 - b. as long as the price does not exceed a certain limit.
 - c. *at whatever price is currently set by the market.*
 - d. in the over-the-counter market.
2. The over-the-counter market
 - a. *handles about half of publicly traded stocks.*
 - b. only handles bonds.
 - c. is located in Chicago, Illinois.
 - d. can be used directly to buy or sell stocks or bonds by any investor who has access to the Internet.
3. In stock market trading, a specialist in McDonald's stock is
 - a. an investor who only owns McDonald's stock.
 - b. a McDonald's employee responsible for issuing shares of McDonald's stock.
 - c. *a broker on the floor of a stock exchange who matches buy and sell orders for McDonald's stock.*
 - d. any broker who buys or sells McDonald's stock for clients.
4. What does a full-service broker do that a discount broker does not do?
 - a. Makes transactions in organized financial markets
 - b. Charges a commission
 - c. Makes transactions in the over-the-counter market
 - d. *Gives investment advice*

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Essay Questions

1. How do financial markets like stock exchanges and the over-the-counter market help investors?

Such markets help buyers and sellers locate other buyers and sellers who want to exchange with them. By providing competition, markets establish prices that are satisfactory to both buyers and sellers.

2. Explain the advantages and disadvantages of using a full-service broker to buy stocks and bonds.

Full-service brokers provide information and advice, saving the investor the time needed to acquire expertise in selecting investments. However, the investor must pay higher commissions than those paid to a discount broker to obtain these services.



LESSON 8 VISUAL 1

WHERE TO BUY STOCKS AND BONDS

Full-service brokerage firms:

- Give investment advice
- Offer a wide variety of financial products and services
- Charge higher commissions

Discount brokerage firms:

- Do not give investment advice
- Offer a limited number of financial products and services
- Charge lower commissions

Buying online:

- Buyers pay lower commissions
- Buyers can more easily compare brokerage services

Dividend reinvestment plans (DRIPs):

- Many large companies offer DRIPs
- Stockholders are paid dividends in the form of stock
- No commission fee is charged



LESSON 8 ACTIVITY 1

HOW TO BUY AND SELL STOCKS AND BONDS

What Would We Do Without Stock Markets?

A market brings people who have something to sell together with people who want to buy. People who have pumpkins to sell need to connect with people who want to buy pumpkins. Buyers of automobiles have to get together with sellers of automobiles. A market is not always one physical location; it's any kind of organization or arrangement that makes it easier for buyers and sellers to contact each other.

People who want to buy and sell stock find ways to use organized stock markets. These are places where buyers and sellers meet to trade securities or where buyers and sellers trade securities through electronic networks.

The New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) are places where stocks are bought and sold at a physical location. Only members of these exchanges may buy and sell stock for the public. The members and the corporations listed on the exchange must follow certain rules. The NYSE is the oldest, largest and most prestigious of these markets. About 2,800 companies trade on the NYSE.

Increasingly, people trade stocks over sophisticated electronic networks known as the over-the-counter market (OTC). The NASDAQ Stock Market is the world's largest electronic network. It lists approximately 3,700 companies and trades more shares per day than any other U.S. equity market. Like the NYSE, AMEX and other exchanges, NASDAQ-listed companies must meet certain requirements.

Imagine a stockholder — let's call her Veronica Vargas — who owns 100 shares of Johnson & Johnson stock. (Johnson & Johnson is a company that makes baby powder and many other products.) Veronica has owned these shares for several years, but now she wants to sell them to get cash that she'll apply toward a down payment on a house.

Since we are imagining that there are no stock markets, Veronica has to find a buyer herself. She also has to figure out how much to charge for her shares, since she can't look the price up in the stock market pages of her local newspaper. First she calls her Aunt Elida, who is quite well off, but Aunt Elida isn't interested. Then she tries her next-door neighbor. He is interested, but he will pay only \$20 per share, and Veronica is sure that the stock is worth more than that.

Meanwhile, just a few blocks from where Veronica lives, Ron Rosenthal would love to buy some Johnson & Johnson stock. He has money to invest, and he considers Johnson & Johnson to be a highly profitable company. He'd be willing to pay at least \$60 a share. But he doesn't know Veronica, and he has no idea that she has Johnson & Johnson stock to sell. In fact, he doesn't know anyone who owns Johnson & Johnson stock.

QUESTION FOR DISCUSSION

How do financial markets help sellers like Veronica and buyers like Ron?



LESSON 8 ACTIVITY 2

THE STOCK MARKET PLAY

Cast of Characters: Moderator, Veronica Vargas, Veronica's Stockbroker, Ron Rosenthal, Ron's Stockbroker, Two Order Room Clerks, Johnson & Johnson Specialist

Props: Newspaper for Veronica; telephones for Veronica, Ron and the two Stockbrokers; order forms for the two Stockbrokers; computers for Veronica's Stockbroker, the two Order Room Clerks and the Johnson & Johnson Specialist

Moderator: Most individuals buy stocks and bonds through brokerage firms. These firms are members of exchanges that trade stocks or bonds at physical locations like the New York Stock Exchange or through computer networks such as the NASDAQ. Let's see how Veronica Vargas, who has 100 shares of Johnson & Johnson to sell, makes a connection with Ron Rosenthal, who wants to buy 100 shares of Johnson & Johnson.

Veronica: (*Reading the financial pages of a newspaper*) The price of Johnson & Johnson looks good. Yesterday it closed at \$59.75. If I sell 100 shares now, I can combine it with my savings at the bank and have enough money to make a down payment on a house. I'm going to call my stockbroker and find out what the stock is selling for right now. (*Enters the number on telephone*) Hello, Stockbroker? Would you please tell me the current price of Johnson & Johnson?

Veronica's Stockbroker: (*Answering the telephone*) Certainly, Ms. Vargas. Let me check for you. (*Looks at computer*) The last sale of Johnson & Johnson was \$60.

Veronica: Great! Please sell 100 shares for me.

Veronica's Stockbroker: Do you want to sell at the market or do you want me to enter a limit order?

Moderator: An order to buy or sell at the market tells the broker to take the best price being offered on the trading floor of the New York Stock Exchange. A limit order tells the broker to buy or sell at a given or better price.

Veronica: Sell it at the market.

Veronica's Stockbroker: I should be able to confirm the sale right away. I'll call you back in a few minutes.

Moderator: Meanwhile, Ron Rosenthal has decided that he has more cash than he needs in his money-market savings account. It's good to have some cash for emergencies, but money in the stock market is likely to earn a higher rate of return in the long run.

Ron: (*Enters the number on telephone*) Hello, Stockbroker. I'm interested in buying shares of a company that's stable and will grow in the future. I have about \$6,000 to invest. Can you give me a recommendation?

Ron's Stockbroker: Well, one good idea is Johnson & Johnson, which is selling right now for about \$60 a share. This company has been around a long time and it sells products that consumers buy in good times and bad.

Ron: That sounds like just what I want. Please buy 100 shares for me.

Ron's Stockbroker: Do you want to buy at the market price or should I enter a limit order?

Ron: Buy it as long as the price is \$61 or less.



LESSON 8 ACTIVITY 2 (CONTINUED)

THE STOCK MARKET PLAY

Ron's Stockbroker: All right. I'll call you back as soon as the order goes through.

(Both brokers begin to write on forms.)

Moderator: Veronica's stockbroker fills out an order to sell 100 shares of Johnson & Johnson and takes it to the firm's order room. At the same time, Ron's stockbroker fills out an order to buy 100 shares of Johnson & Johnson and takes it to the firm's order room.

(Both brokers take the forms they have filled in to their respective order rooms.)

Veronica's Stockbroker: *(To the order room clerk)* Please make this trade.

Order Room Clerk: Johnson & Johnson trades on the New York Stock Exchange. I'll send this order on the electronic brokerage system to the Johnson & Johnson specialist.

Ron's Stockbroker: *(To the firm's order room clerk)* Please send this order to the Johnson & Johnson specialist.

(Both order room clerks type on their computers.)

Moderator: Stock exchanges have various locations, called trading posts, where different stocks are traded. Each post has a specialist assigned to it. One of the jobs of a specialist is to match buy and sell orders at current market prices. The specialist in Johnson & Johnson sees Veronica's and Ron's orders on the electronic workstation.

Specialist: I see that I have an order to sell 100 shares of Johnson & Johnson and also an order to buy 100 shares of the same stock. The last sale of Johnson & Johnson was at 60 and 20 cents. I'll make that transaction and send confirmation to both brokers. *(Types on computer keyboard)*

Moderator: Large trades are usually made by representatives of member firms called floor brokers. Floor brokers go to the specialist's post to bargain, but small purchases and sales go directly to the specialist's computer.

Veronica's Stockbroker: *(Enters the number on telephone)* Hello, Ms. Vargas?

Veronica: *(On the telephone)* Yes.

Veronica's Stockbroker: I've just received confirmation of your sale at \$60.20. I'll send you a confirmation of the sale and a check for \$6,020, less my broker's commission.

Veronica: That's wonderful. I can start shopping for a house now.

Ron's Stockbroker: *(Enters the number on phone.)* Hello, Mr. Rosenthal. This is your stockbroker. We bought 100 shares of Johnson & Johnson for you at \$60.20. I'll get confirmation in the mail to you today. You'll need to pay us \$6,020, plus my broker's commission.

Ron: That's great. I'm sure I've made a wise investment. I'll send you a check immediately.