

# How to Buy and Sell Stocks and Bonds

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## 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

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

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## The Stock Market Play

*Cast of Characters (8): Moderator, Veronica Vargas, Veronica's Stockbroker, Ron Rosenthal, Ron's Stockbroker, Two Order Room Clerks, 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.

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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: Veronicas stockbroker fills out an order to sell 100 shares of Johnson & Johnson and takes it to the firms 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.

