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Understanding the Markets

What the acronyms signify & what affects investors.

Provided by Frank DeMaio*

Dow. NASDAQ. S&P 500. Fear index. NYSE. Commodity prices. Earnings. Economic indicators. These are the gauges and signposts of investing, but if you stopped most people on the street, you'll find they have only a hazy understanding of what these terms signify or reference. If you've ever been left dizzy by the jargon of the financial world, here is a brief article that may help clarify some of the arcana. Let's start on Wall Street.

The major U.S. indices. The Dow Jones Industrial Average tracks how 30 publicly owned companies trade on a market day – the "blue chips", 30 titans of U.S. and global business chosen by the *Wall Street Journal,* most not actually industrial. The NASDAQ Composite records the performance of 3,000+ companies on the NASDAQ Stock Market (see below), including many technology firms. The S&P 500 logs the performance of 500 leading publicly traded companies across ten different sectors (business/industry categories), as determined by financial research giant Standard & Poor's (there was actually a Mr. Poor, hence the name).[1,2]

At the end of the trading day, these indices settle or "close" at a price level. The Dow is a price-weighted index – that is, its value each trading day rides up or down on the price movements of its 30 components. By contrast, the S&P 500 and NASDAQ (and most other stock indices) are cap-weighted, meaning the index value reflects the total market value of the companies in the index and not simply the prices of individual components. The S&P 500 has both a price return and a total return (the total return includes dividends).[1,2]

While the nightly news tells everyone what the Dow did today, many seasoned investors pay more attention to the S&P 500, which represents about 70% of the value of the U.S. stock market. There are other indices that also grab Wall Street's attention. Investors watch the Russell 2000 (which lists the "small caps", usually newer and younger firms than found in the predominantly "large-cap" S&P 500) and the Wilshire 5000, which tracks stocks of almost every publicly owned company in America (6,000+ components). Eyes are also on the "fear index", the CBOE VIX (Chicago Board Options Exchange Volatility Index), which measures investors' expectations of volatility (read: market risk) in the S&P 500 for the next 30 days. Important multinational indices (the MSCI World and Emerging Markets indices, the Global Dow, the S&P

Global 100, and many more) and foreign indices (Japan's Nikkei 225, Germany's DAX, China's Shanghai Composite and many others) also get a look.[2,3,4,5]

The stock exchanges. Stocks trade on exchanges, with the most prominent in America being the New York Stock Exchange (NYSE), the "big board" at which celebrities are seen ringing the opening or closing bell. Other notable U.S. stock and securities markets include the American Stock Exchange (AMEX), the CBOE and the NASDAQ Stock Market. While the NYSE trading day runs from 9:30am-4:00pm EST, pre-market and after-hours trading also occurs as investors respond to earnings announced after or before the bell or overseas developments.

The bond market. Further decentralized trading occurs here, conducted by institutional and individual investors, governments and traders buying, selling and issuing government and corporate bonds. Bond prices fall when bond yields rise, and vice versa. Interest rate changes affect the bond market more than any other factor; credit rating adjustments and changes in the appetite for risk (i.e., a race to or retreat from stocks by investors) can also play roles.

What moves the markets up and down? Information – or more precisely, the way large institutional investors respond to it. Things really move when the equilibrium of the market is upset by either positive or negative breaking news – it could be a geopolitical development, a natural disaster, a central bank decision, a comment from a Federal Reserve official or the Treasury Secretary, it could be many things. It could be earnings reports – corporate earnings are sometimes called the "mother's milk" of stocks, and when two or three big companies beat estimates, Wall Street may see big gains that day.

The markets also respond to an ongoing stream of economic news releases from the federal government and other organizations. Federal Reserve policy announcements (interest rate adjustments, the implementation or cessation of stimulus efforts) get the most attention, and the Labor Department's monthly employment report finishes second. Other critical monthly releases include the Commerce Department's consumer spending report, the Bureau of Labor Statistics Consumer Price Index measuring consumer inflation, and monthly reports on existing home sales (from the National Association of Realtors), new home sales (from the Census Bureau) and home values (via the S&P/Case-Shiller Home Price Index).

There are other key reports: the occasionally contradictory consumer confidence surveys from the University of Michigan and the Conference Board (the CB poll is more respected, as it surveys 5,000 people; the Michigan poll surveys only 500, but asks many more questions) and the Institute for Supply Management's monthly purchasing manager indexes assessing the health of the manufacturing and non-manufacturing sectors of the economy (these are simply surveys of purchasing managers at businesses, minus hard data).[6,7]

Hopefully, this makes things a little less mysterious. It takes a while to get to know the financial world and its pulse, but that knowledge may reward you in tangible and intangible ways.

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Citations.

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