MODULE 1 · LESSON 2

What Is the Stock Market?

Why it exists, how exchanges work,
and how prices are actually set.

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Prerequisite: Lesson 1 — Why Most Traders Fail.

For education only — not investment advice.

About This Lesson

In Lesson 1 you built the foundation: mindset and risk management. Now we open the hood. This lesson answers the questions every beginner secretly has but rarely asks: **what is the stock market, physically?** Where do prices come from? Who are you actually trading with?

By the end of this lesson you will be able to:

1. Explain why the stock market exists and who it serves.
2. Describe what a share of stock represents.
3. Explain, in plain English, how a company goes public (IPO).
4. Describe what a stock exchange does (NYSE, Nasdaq).
5. Explain how prices are set — bids, asks, and supply and demand — tick by tick.
6. Read a basic stock quote and compute a company's market capitalization.
7. Place a paper market order and a paper limit order, and explain the difference.

Plan on 45–60 minutes, plus the worksheet at the end.

1 — Why the Stock Market Exists

Imagine you start a company making solar backpacks. Orders are flooding in and you need $10 million for a factory. You have two classic choices:

- **Borrow it** (a loan or bonds): you get cash, but you must pay it back with interest — even if the business struggles.
- **Sell pieces of the company**: you get cash, and you never have to pay it back. In exchange, investors own a slice of the business and share in its future profits.

The stock market is the **marketplace where those pieces — shares — are bought and sold**. It serves two sides:

- **Companies** raise money to grow without taking on debt.
- **Investors** get the chance to own part of businesses and grow their money as those businesses grow.

Without the stock market, you'd have to personally know a business owner to invest in a company — and good luck selling your slice later. The market makes ownership **divisible, standardized, and tradable**.

2 — What a Share Actually Is

A **share of stock** is a unit of ownership in a company. If a company has 10 million shares outstanding and you own 100, you own 100 / 10,000,000 = **0.001%** of the company. Small slice — but real ownership, with real rights:

- **A claim on profits:** if the company does well, your slice becomes more valuable, and you may receive **dividends** — cash payments from profits.
- **A vote:** common shareholders typically vote on big decisions, like electing the board of directors.
- **A claim on assets:** if the company were sold or liquidated, shareholders get what's left after debts are paid (which is why stocks are riskier than bonds — you're last in line).

Common vs. preferred stock

Most of what you'll ever trade is **common stock** — the standard ownership share described above. **Preferred stock** is a hybrid: it usually pays a fixed dividend and gets paid before common stock, but it typically has no voting rights and less price upside. Unless stated otherwise, this academy always means common stock.

The pizza principle

A company is a pizza cut into 10 million slices. You buy 100 slices. You don't control the pizzeria, but if it opens 50 new locations, every slice — including yours — is worth more. If it burns down, your slices lose value. **Stock price follows business value over time.** Day to day it wiggles on sentiment; year to year it tracks reality.

3 — How Companies Go Public: The IPO

Companies start **private** — owned by founders and early investors. To sell shares to the public, a company holds an **IPO (Initial Public Offering)**:

1. The company hires investment banks (**underwriters**) who examine the business and set an initial price.
2. On IPO day, a fixed number of new shares are sold to the public for the first time.
3. From then on, those shares trade freely on an exchange — the company itself doesn't get money from later trades; investors are simply swapping slices among themselves.

Why go public? **To raise large amounts of money at once** for growth — factories, hiring, research — without borrowing. The tradeoff: public companies must disclose their finances quarterly and answer to thousands of shareholders.

Common beginner confusion: when you buy Apple stock today, your money goes to the previous owner of those shares — not to Apple. Apple got its money at the IPO (and later offerings). The everyday market is a **secondary market**: investors trading with investors.

4 — Stock Exchanges: Where It All Happens

A **stock exchange** is the organized marketplace where buyers and sellers meet — today, almost entirely electronically. The two giants in the U.S.:

- **NYSE (New York Stock Exchange):** the oldest and largest; many big, established companies list here.
- **Nasdaq:** electronic-first; home to many technology companies.

What the exchange actually does for you:

1. **Matches buyers with sellers** in milliseconds, fairly and in order.
2. **Publishes prices** so everyone sees the same market — transparency you don't get in private deals.
3. **Enforces rules** — listing standards, trading halts on wild swings — so the game isn't rigged.
4. **Guarantees settlement:** when you buy, you actually get the shares (handled behind the scenes in two business days).

You never interact with the exchange directly — your **broker** routes your orders there. Think of the broker as your agent and the exchange as the marketplace floor.

5 — How Prices Are Set: Bids, Asks & Supply and Demand

This is the most important section in the lesson. **No one sets stock prices.** There is no committee, no formula, no boss. Every price you see is simply **the last price at which a buyer and a seller agreed to trade.**

The bid and the ask

- The **bid** is the highest price buyers are currently willing to pay. (Example: $50.00)
- The **ask** (or offer) is the lowest price sellers will currently accept. (Example: $50.05)
- The gap between them is the **spread** — here, $0.05. It is the market's transaction cost, and it is smallest on heavily traded stocks.

A trade, tick by tick

XYZ shows bid $50.00 / ask $50.05.

• You place a **market buy** for 10 shares → you pay the ask: 10 × $50.05 = **$500.50**. Done instantly.

• Your friend places a **market sell** for 10 shares → she receives the bid: 10 × $50.00 = **$500.00**.

The “price” of XYZ is now whatever the last trade printed — $50.00 or $50.05. Multiply this by millions of traders and you get the constant flicker of live prices.

Supply and demand moves the price

Why does a stock rise from $50 to $55 over a week? Because at $50, **more people wanted to buy than sell**. Buyers kept lifting the ask; sellers raised their asks as demand persisted; each new trade printed a little higher. Falling works in reverse: more sellers than buyers, and the bid gets walked down.

- **Good news** (strong earnings, new product) → more buyers → price rises.
- **Bad news** (lawsuit, weak sales) → more sellers → price falls.
- **No news, strong mood** → prices still move, because expectations and emotions are supply and demand too.

The key insight: price is not value handed down from above — it is a live vote, re-counted every second, in dollars.

Exercise — be the market

ABC stock: bid $30.00 (200 shares) / ask $30.10 (150 shares).

(a) You market-buy 100 shares. What price do you pay, and what is the total?

(b) Then a wave of sellers hits and the bid drops to $29.70. You market-sell your 100 shares. What do you receive? What is your profit or loss?

(c) In one sentence: who decided ABC's price at each moment?

6 — Reading a Stock Quote

A quote packs a company's market story into one row. Learn to read it and you'll never feel lost looking at financial pages again.

Field	Example	What it means
Ticker	XYZ	The stock's short code.
Last price	$50.25	Price of the most recent trade.
Change / % change	+$1.25 (+2.55%)	Move since yesterday's close.
Volume	4.2M	Shares traded today — activity level.
Market cap	$502.5M	Total company value: price × shares outstanding.
P/E ratio	18.5	Price ÷ yearly earnings per share — how much you pay per $1 of profit.
52-week range	$38 – $61	Lowest and highest price in the past year — context.
Dividend yield	1.2%	Yearly dividend ÷ price — income return if you hold.

Market cap in 10 seconds

XYZ: $50.25 per share × 10 million shares outstanding = **$502.5 million** market cap.

Market cap is the company's price tag. Comparing prices across stocks is meaningless ($500 stock vs. $5 stock) — comparing **market caps** tells you which company is actually bigger.

7 — How You Actually Buy: Brokers & Order Types

You can't walk onto the exchange floor. You trade through a **broker** — a firm that routes your orders to the market via an app or website. Opening a brokerage account is like opening a bank account, but for investments. (Use a reputable, regulated broker; paper-trade first, per Lesson 1.)

The two order types every beginner must know

- **Market order:** "buy/sell right now at the best available price." Fast and certain to fill — but on a fast-moving or thinly traded stock, the price can slip between click and fill.
- **Limit order:** "buy/sell only at this price or better." You set a **limit buy** below the current price, or a **limit sell** above it. Price is guaranteed (or better), but the order only fills if the market reaches your price.

Market vs. limit, side by side

DEF trades at bid $40.00 / ask $40.08.

• **Market buy, 50 shares:** fills immediately at $40.08 → **$2,004.00**.

• **Limit buy at $39.90, 50 shares:** nothing happens yet. If DEF dips to $39.90, you fill at $39.90 or better → **$1,995.00 or less**. If it never dips, no trade — and that's fine.

Beginner rule of thumb: **use limit orders** while learning. They force you to name your price instead of chasing the market.

Two more you'll meet soon (covered fully in the trading module): **stop-loss orders**, which sell automatically if a price falls to your exit level — your Lesson 1 safety net — and **take-profit orders**, which lock in gains at your target.

8 — What Moves Prices Day to Day

Zoom out and only a few forces matter:

- **Earnings & company news:** profits, guidance, products, scandals — the fundamentals repriced.

- **Economic news:** interest rates, inflation, jobs reports. When rates rise, future profits are worth less today, and stocks broadly fall.
- **Supply and demand flows:** big funds buying or selling can push prices regardless of news.
- **Sentiment:** fear and greed move markets short-term — which is exactly why Lesson 1 came first.

You don't need to predict any of this yet. You need to understand that **price is the scoreboard, not the game** — it records what millions of participants just decided, all at once.

9 — Beginner Mistakes This Lesson Prevents

1. **“The stock is $500, so it must be expensive.”** Price alone means nothing — a $500 stock can be cheap and a $5 stock can be wildly overpriced. Compare market caps and earnings, not prices.
2. **“I'll buy because it's going up.”** Chasing price without knowing why it's moving is how beginners buy tops.
3. **Using market orders on thin stocks.** Wide spreads + market order = instant, invisible loss. Limit orders exist for a reason.
4. **Thinking the market is a casino.** Casinos have fixed odds against you. Markets reward research, patience, and risk management — the edge is available, but only to the prepared.

Worksheet

1. In your own words (2–3 sentences): why does the stock market exist? Who are the two sides it serves?
2. A company has 25 million shares outstanding at $12.40. What is its market cap? Show the math.
3. GHI quote: bid $22.10 / ask $22.18. (a) You market-buy 200 shares: total cost? (b) You instead place a limit buy at $22.05 and it fills: total cost? (c) How much did the limit order save you?
4. Explain the difference between a market order and a limit order to a friend who has never traded. Use the bid/ask in your explanation.
5. A stock jumps 8% in a day on no news. Using this lesson, give two possible supply-and-demand explanations.
6. Look up any real stock quote. Write down its ticker, price, % change, volume, market cap, and P/E. In one sentence: is today an up day or down day, and how active is trading?

Key Takeaways

1. The stock market exists so companies can raise money and investors can own pieces of businesses.
2. A share is real ownership: a claim on profits, a vote, and a place in line if assets are sold.
3. Companies go public via IPO to raise large sums at once; everyday trading is investors swapping shares.
4. Exchanges match buyers and sellers, publish prices, enforce rules, and guarantee settlement.
5. No one sets prices — every price is the last agreed trade between a buyer and a seller.
6. Bid = what buyers pay; ask = what sellers demand; the spread is your transaction cost.
7. Market cap (price × shares) — not share price — measures a company's size.
8. Use limit orders while learning: name your price instead of chasing the market.

What's Next

In **Lesson 3 — Reading the Market**, you'll learn to see the bigger picture: market indexes (what the S&P; 500 actually measures), bull vs. bear markets, types of stocks, and dividends — so you can understand what the financial news is talking about.

Disclaimer

This lesson is for **educational purposes only** and is not investment advice or a recommendation to trade. Trading involves substantial risk of loss and is not suitable for every investor. Examples are hypothetical. Consider consulting a qualified financial professional about your own situation.