MODULE 1 · LESSON 3

Reading the Market

Indexes, bull and bear markets,
types of stocks, and dividends.

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Prerequisite: Lesson 2 — What Is the Stock Market?

For education only — not investment advice.

About This Lesson

Turn on financial news and you'll hear: “the S&P; 500 gained 1.2%, the Dow slipped, the Nasdaq led tech higher.” After this lesson, those sentences will actually mean something. You'll understand what indexes measure, what bull and bear markets are, how stocks are categorized, and what dividends really do for you.

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

1. Explain what a market index is and how one is built.
2. Describe the S&P; 500, Dow Jones, and Nasdaq — and what each one measures.
3. Read an index headline and know whether it was a big day or a quiet one.
4. Distinguish bull markets from bear markets.
5. Classify stocks by size (large/mid/small-cap) and style (growth vs. value).
6. Explain dividends and compute dividend yield.

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

1 — What Is a Market Index?

There are thousands of stocks. Nobody can watch them all — so the market summarizes itself with **indexes**: baskets of representative stocks whose combined movement is tracked as a single number. An index is a **thermometer for a slice of the market**.

How one is built (simplified): take the prices of the basket's stocks, combine them with a weighting rule, and express the result as a number. When the basket's stocks rise on average, the index rises.

A 3-stock index in 30 seconds

Basket: AAA at $100, BBB at $50, CCC at $25. Simple average index = (100 + 50 + 25) / 3 = **57.5**.

Next week AAA jumps to $110 (+10%), others flat. New index = (110 + 50 + 25) / 3 = **61.7** (+7.2%).

Real indexes are fancier — most weight big companies more heavily — but the idea is identical: **one number summarizing many stocks.**

2 — The Big Three U.S. Indexes

Index	What it holds	What it tells you	Quirk to know
S&P 500	About 500 large U.S. companies	How big American business is doing overall	Weighted by company size — giants move it most

Index	What it holds	What it tells you	Quirk to know
Dow Jones	30 huge, established companies	The health of corporate America's blue chips	Only 30 stocks, and weighted by price — a $500 stock sways it more than a $50 one
Nasdaq Composite	Thousands of Nasdaq-listed stocks	How growth & tech stocks are doing	Tech-heavy — when tech rallies or crashes, the Nasdaq leads

When someone says "the market was up today," they usually mean the **S&P 500** — it's the default scoreboard. The Dow is the oldest and most quoted on TV; the Nasdaq is the growth/tech gauge.

Points vs. percent: read the right number

Headlines shout points ("Dow up 400!") but **percent is what matters**. A 400-point move on a 40,000 Dow is +1% — a normal day. The same 400 points when the Dow sat at 4,000 would have been +10% — historic. Rule: **always convert to percent before deciding a move was "big."**

Exercise — decode the headline

"S&P 500 closes at 5,800, up 58 points."

(a) What is the percent move? (b) Big day or quiet day? (c) If the Nasdaq fell 1.5% the same day, what might that suggest about tech stocks vs. the broader market?

3 — Bull vs. Bear Markets

Markets move in long cycles, and each regime has a name:

- **Bull market:** a prolonged rise — commonly defined as **+20% from a recent low**. Driven by growing profits, optimism, and buying. Everything feels easy; beginners mistake it for skill.
- **Bear market:** a prolonged fall — commonly **−20% from a recent high**. Driven by shrinking profits, fear, and selling. This is where Lesson 1's risk rules earn their keep.
- **Correction:** a −10% dip inside an otherwise rising market — normal, frequent, and not a bear market.

Two facts worth memorizing: **bull markets have historically lasted much longer than bear markets**, and no one rings a bell at the turning points — the labels are only obvious in hindsight. Your job is not to predict the regime; it's to **size risk for the possibility you're wrong** about it.

The beginner's trap in each regime

• **In bull markets:** “I can't lose!” — beginners add risk at the top, then meet their first bear market with an oversized account. Respect Lesson 1's 1–2% rule especially when winning.

• **In bear markets:** “It's all rigged, I'm quitting.” — beginners sell everything at the bottom and miss the recovery. Bear markets are when disciplined investors do their best buying — slowly, in small sizes, with a plan.

4 — Types of Stocks: Size and Style

Saying “I bought a stock” is like saying “I bought a vehicle” — the category matters. Two classifications run the investing world:

By size (market cap)

Category	Typical market cap	Personality
Large-cap	Above ~$10 billion	Established giants; steadier, often pay dividends
Mid-cap	~$2–10 billion	Growing companies; a blend of growth and stability
Small-cap	Below ~$2 billion	Young/aggressive; bigger swings, bigger potential — and bigger risk

By style

- **Growth stocks:** companies expected to grow fast (often tech). Investors pay high prices for future promise — thrilling in bull markets, brutal when expectations break.
- **Value stocks:** companies trading cheaply relative to their earnings or assets (often banks, industrials). Less exciting, often steadier, frequently pay dividends.

Neither style is “better” — they take turns leading, which is exactly why **diversification across categories** (Lesson 4) beats betting on one.

5 — Dividends: Getting Paid to Own

Some companies share profits directly with shareholders as **dividends** — usually cash paid quarterly. If you own 100 shares of a stock paying $0.50 per quarter, you collect $50 every three months just for holding.

Dividend yield: the key number

Dividend yield = annual dividend ÷ stock price. A stock paying $2.00/year at a $50 price yields 4%. Yield lets you compare income across stocks — but read the cautions below first.

Dividend math, worked

You own **200 shares** of DIV Corp at **$40** ($8,000 position). It pays **$0.40/quarter**.

Quarterly check: 200 × $0.40 = **$80**. Annual: **$320**.

Dividend yield: ($0.40 × 4) ÷ $40 = $1.60 ÷ $40 = **4%**.

Your total return = price change **plus** dividends collected. A flat stock paying 4% still paid you.

Three dividend truths beginners miss

1. **Dividends aren't free money.** On the ex-dividend date, the stock price typically **drops by about the dividend amount** — the cash came out of the company's value. You got $80, but your shares are worth ~$80 less that morning.
2. **Sky-high yield = danger flag.** A 12% yield usually means the price collapsed because the market expects the dividend to be cut. Investigate before chasing yield.
3. **Growth companies often pay nothing.** They reinvest profits instead. No dividend doesn't mean a bad stock — it means a different strategy.

Exercise — yield check

Stock A: price $25, pays $0.25/quarter. Stock B: price $100, pays $1.00/quarter.

(a) Compute each annual dividend and yield. (b) Which pays more income per $1,000 invested? (c) If Stock A's price falls to $20 with the dividend unchanged, what happens to its yield — and should that excite you or worry you?

6 — Putting It Together: Decode the News

Let's translate three real-style headlines with everything you've learned:

Headline clinic

“S&P 500 up 0.3% as investors await jobs report.”
Translation: the broad market barely moved (+0.3% is a quiet day); traders are waiting for news before betting.

“Nasdaq drops 2.1% on chip-stock selloff.”
Translation: a real down day (−2%+ is notable), concentrated in tech — growth stocks leading the fall.

“Dow hits record as value stocks rally; small-caps lag.”
Translation: the 30 blue chips are strong and cheap-looking stocks are in favor, but smaller companies aren't participating — a narrow rally, worth noting with caution.

7 — Beginner Mistakes This Lesson Prevents

1. **“The Dow is up, so my stocks must be up.”** The Dow is 30 stocks. Your portfolio is its own universe — check your holdings, not the TV chyron.
2. **Chasing whatever's hot.** Small-cap growth leading this year doesn't mean it leads next year. Styles rotate; diversification beats prediction.
3. **Buying for the dividend alone.** That 11% yielder is usually a value trap with a coming dividend cut. Yield is a clue, not a thesis.
4. **Panicking at “correction” headlines.** A 10% dip is routine maintenance for markets, not the end of the world — your Lesson 1 rules were built for exactly this.

Worksheet

1. In your own words: what is a market index, and why does the market need them?
2. The S&P 500 closes at 6,000, up 90 points. What is the percent move — big day or quiet day?
3. Name the three major U.S. indexes and, for each, one sentence on what it measures and one quirk.
4. Define bull market, bear market, and correction — with the percentages.
5. A stock has a $1.5 billion market cap. Large, mid, or small-cap? What personality should you expect?
6. Explain growth vs. value stocks to a friend, with one example trait of each.
7. A stock at $60 pays $0.75/quarter. Compute the annual dividend and the yield. If the price drops to $45 with the dividend unchanged, what's the new yield — and is that good news?
8. Write your own one-line “translation” of this headline: “S&P 500 flat as Nasdaq gains 1% on strong earnings.”

Key Takeaways

1. An index is one number summarizing a basket of stocks — a thermometer for a slice of the market.
2. S&P; 500 = broad large-cap scoreboard; Dow = 30 blue chips (price-weighted quirk); Nasdaq = tech/growth gauge.
3. Read percent, not points: percent tells you whether a move was actually big.
4. Bull market ≈ +20% from lows; bear market ≈ −20% from highs; a −10% correction is normal.
5. Stocks come in sizes (large/mid/small-cap) and styles (growth/value) — diversify across them.

6 Dividend yield = annual dividend ÷ price. Dividends are real cash, not free money — prices adjust on ex-date.

7 Extreme yields are usually warning flags, not gifts.

What's Next

In **Lesson 4 — Getting Started Safely**, the final lesson of Module 1, you'll put it all into practice: choosing a broker, setting up paper trading, building your first watchlist, and the diversification habit that protects everything you've learned.

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.