

## The Journey Begins

We know firsthand that the easiest way to begin the journey into option trading is to approach it as you would a world of its own that gives up its secrets one at a time. Many people, even those who trade stocks regularly, consider the stock market itself a big mystery, an enigma, which is why we think it's the best place to begin. What's actually behind the symbols and numbers you see on the crawls at the bottom of the TV screen or in the columns of fine print you see in the newspaper?

To reduce the stock market to its simplest terms, the best image we can come up with is our family's gift store, a place where buyers and sellers (Kirkland's) come together to make exchanges. So, a shopping exchange—or transaction—where goods are offered at prices people are willing to pay, and the stock exchange as a whole, have much in common. The difference is that exchanges or transactions on the stock market are less tangible, and in addition, the perceived value of a stock often has little to do with actual worth. No matter, the concept of an exchange remains the same.

As you incorporate the aspects involved in the stock market one at a time, it starts to feel as familiar and comfortable as a retail gift store that you've owned for 20 years. But, you don't have to leave the house to conduct your business.

Your trading experiences take place conveniently on the internet.

## The Market- A Living Entity?

It is easy to feel overwhelmed if you allow yourself to think of the stock market as an abstract and baffling concept, we found it helpful to think of the market as a living being. Instead of thinking of it as being comprised of mathematical equations, it's made up of companies (including their stock and its products or services, employees and associates) that move around in groups. As a living entity, the market: inhales, or expands, and exhales, or contracts, and at times it holds its breath. Said another way:

- ✓ During times of expansion, the market increases in value or “puts on weight” and prices go up.
- ✓ During times of contraction, its value (weight) goes down as if “losing weight.”
- ✓ When the market holds its breath, it maintains its value or weight, and moves sideways.

You might wonder, what brings on fluctuations in the markets? Simply said, while buyers and sellers come to an agreement on price, they do not

always agree on value. When it comes to stocks, a trade takes place when one buyer is eager to sell stock at the same time another buyer wants to make a purchase. Quite often, when or after a stock drops in price, a trader is anxious to get rid of the equity, while another trader sees the drop in price as an opportunity to purchase an undervalued stock at a bargain price.

Value versus price is subjective. One company's stock price may trade at sixteen times its annual earnings and will be considered undervalued with room to grow. Another company's stock may trade at eight times its earning and will be considered overpriced and at its peak. There are other influences that illustrate this difference in evaluation. An analyst group (Goldman Sachs, for example) may upgrade a stock based on their expectation of future earnings for that company and the next day, the stock's price will soar. Nothing has actually changed to bring about this increase in value, except an expectation, a belief that good things are apt to happen. If this hope is not realized, the stock will drop back to its actual worth or even below that level for a time, until the next event. A company's reported earnings may disappoint analysts and traders, but if the company's outlook for the coming quarter is encouraging, the stock may still rally into the next quarter. Value and price are separate concepts.

## **Stocks = A Share of the Action**

Today's exchanges offer any number of investment choices—specific methods or vehicles through which you put money to use to make profits, earn interest, preserve value, create portfolio growth, and so forth. Wall Street and the stock market is where individual investors (people and companies) own a share of the action and own a share of the risk, too. Ownership is measured in increments or units called *stocks*. When companies sell shares of stock, they are selling a small portion of ownership in that business or conglomerate of businesses.

When you buy 100 shares of stock of one of the major U.S. corporations, such as Apple (AAPL) or Taco Bell (YUM) or Nike (NKE), you are a shareholder. For as long as you hold the stock, the value of your *portfolio*, defined as your investments, regardless of type, gains value or loses value as the price of that stock or equity goes up and down. If you paid \$25 per share and a year later, your stock traded at \$35 per share, your portfolio value has increased by \$1,000. If the stock is trading at \$20 a share, then your portfolio is \$500 lighter.

Many well established stocks pay their investors *dividends*, which is the way they distribute the profits. If your 100 shares of stock (which for discussion sake I'll say is priced at \$50) pay a \$2 dividend per share, then every quarter, you will receive \$200, which you can reinvest or take as income.

Please understand these are basic definitions and provide the structure and function of stocks. The way stocks work in the everyday world of the stock

exchange is a more complex issue. For example, if I'm limited to studying and choosing among, let's say, 50 companies, then I could keep track of what companies are profitable and which are going out of business, and who is merging with whom, and so forth. But, in the U.S. alone, thousands of companies sell shares of their stock, and the profitability of these companies is influenced by factors that no one individual or event can control. That's why financial services companies, including brokerage firms, hire analysts whose job involves watching trends and using complex formulas to determine short-term and long-term profitability.

Before long you will have the resources at your disposal to be able to determine these trends and evaluate the potential movement of specific stocks or other equities for yourself.

## **Bullish or Bearish**

If Google or some other major industry comes to your town and brings new jobs and adds money to the economy, then chances are the other businesses in your area will experience an increase in business. If your town loses a major employer, the other local businesses may report a decrease in business because less money is circulating.

So, too, economic trends influence Wall Street and stocks have a herd effect, so to speak. When economic trends are on the rise and equities are increasing in value because investors are confident in the economic future of the market, then we're said to be in a *bull market* or traders are said to be bullish. On the other hand, in times of great economic distress or uncertainty, or a dramatic event makes the market "jittery," then stocks may decline in value and analysts say we're in a *bear market* or traders are bearish.

Stocks rise and fall on a daily basis, and you don't assign the terms "bull" or "bear" based on one day or a week's performance. And the terms are relative, as well. The market can be "bearish" for a period of time when other economic forecasts seem uncertain. On the other hand, the market can turn "bullish" when certain indicators point to economic expansion. (These indicators and trends are a study in themselves, but for now, the general definitions will do).

A great many other terms are part of the language of the broad and specialized world of option trading and investing as a whole, but for now, these basic definitions are enough "material" to begin understanding where option trading fits into the big picture.