Stock Markets Guides

Author: Nishit Kumar

Stock Market Terminology Explained

As a beginner at stock trading and investing, it might be quite intimidating for you to open a trading app or website for the first time because of all the technical terms and stock market terminology.

Not only this, but you might also be finding it difficult to navigate through trading guides, analyst articles, or pretty much anything else you need to be an effective trader effectively. This is because you have not understood basic trading terms yet.

In this article, you will find an explanation for some of the stock market terminology that traders and investors use most often.

Commonly Used Stock Market Terminology

Bid

As explained in the previous article, stock prices are determined at the equilibrium point between the demand and supply curves for that particular stock.

In a more practical sense, trades are executed when the price at which someone is willing to sell their shares is less than or equal to the price at which someone is willing to buy them.

In this context, the bid price is when a buyer is prepared to pay for any particular stock. If there are any sellers at this price, then your trade will be executed. Otherwise, your trade will show as a pending order until your bid can be met.

Ask

The asking price is the exact opposite of the bid price, as in, it is the price at which sellers are willing to sell their shares of a particular company.

When there is a match between the bid and ask prices, trade is carried out. There are several buyers and sellers for any stock at any given point in the market, and therefore bid and ask prices can be matched very easily.

Spread

When you are trading stocks on the market, you will deal with people you have never met in your life. Therefore, barring a lucky coincidence, it is quite likely that the bid and ask prices will not be identical.

The difference between the bid and ask price when a trade is executed is called the spread on that particular trade.

But where does this spread go? The broker takes the spread as their fee for arranging the transaction. For example, say your bid price is $13.25, and the asking price is $13.10, then the broker pockets these $0.15 as their fee.

Buy

There are two parts to the execution of a trade, buying and selling. These can be done in any order, and the trade will be profitable if the buying is done at a lower price and selling at a higher price.

Buying is the act of purchasing shares of a company, and it is usually the first part of any trade, also called “taking a position in the company”.

Sell

Selling is the second half of a buy trade, and as the name suggests, it refers to the sale of the shares that you purchased earlier. This can be done in one of two situations:

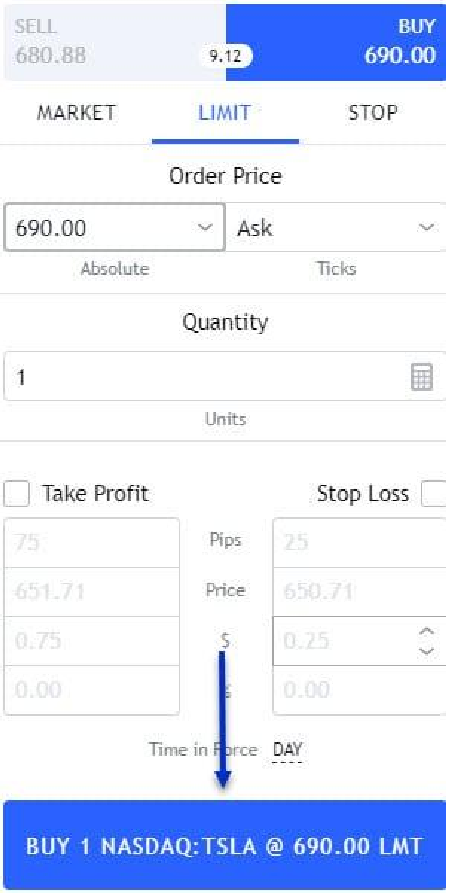
1. When share prices have gone up, and you wish to sell your shares to book a profit.
2. When the share prices are falling, you wish to sell your shares to minimize your loss.

Stock Symbol / Ticker

While trading different stocks day in and day out, it might not be easy or convenient for you to remember the names of all the companies you have positions in. For this reason, whenever companies register with the stock exchange, they are allotted a ticker/symbol representing the company.

For example, Apple's ticker is AAPL, Alibaba's ticker is BABA, and so on. These tickers make it easy to display share information on charts because no space is wasted in writing long company names.

Another advantage of this is that traders can quickly search up stocks that they want to trade in by entering the ticker instead of the company's name. This greatly adds to the speed of trading at times where every second is crucial.



Annual Reports

As a shareholder, you’re a part-owner in the company, and therefore you’re entitled to know how the company is doing financially.

Because shareholders of the company keep changing daily as the shares are traded in the market, companies found an easier way to let everyone know their financial position. At the end of every accounting period, say a year or a quarter, companies prepare an annual report and release it on the Internet for everyone to see.

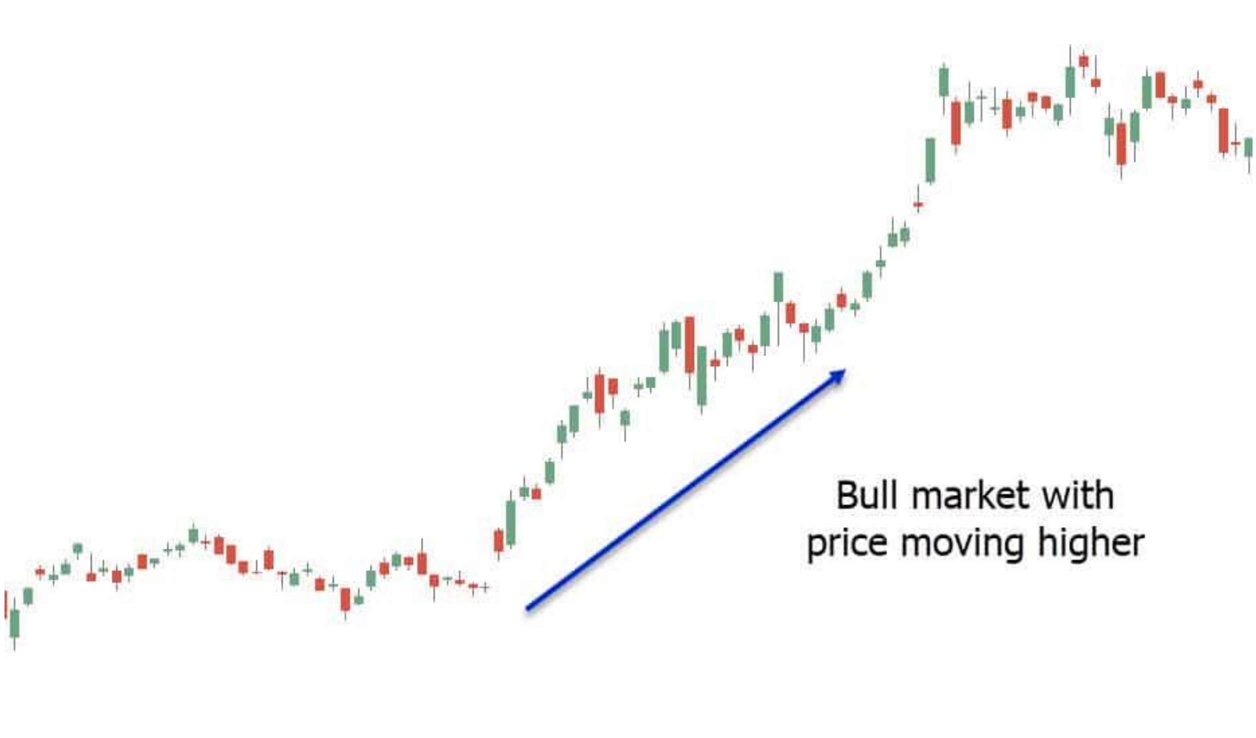
This annual report contains statements from the company management, detailed accounts for the period, and a comparison to the company’s performance in the previous years.

Bull Market

The stock market can go in one of two directions: it will either go up or down.

During a given time period, if the market is consistently going upwards, it is said to be a bull market. In macroeconomic terms, this is said to be a period of economic boom and prosperity since companies are doing well.

Subsequently, any individual or corporation that expects a share price to go up is bullish on the stock.



Bear Market

A bear market is the opposite of a bull market; in any period where the markets are consistently going downwards, it is a bear market. This generally coincides with times of recessions, and the economy as a whole starts performing poorly in bearish markets since companies no longer have the confidence of their shareholders.

Subsequently, any individual or corporation that expects a share price to fall is bearish on the stock.

Volatility

On any given day, stock prices move up and/or down.

The extent to which these prices change depends on the demand and supply for the particular stock. The volatility of a stock is the measure of how much prices move up and down in a given time period. Highly volatile stocks see large fluctuations daily and are often characterized as high-risk, high-reward stocks.

On the other hand, low volatility stocks do not move so much on a day-to-day basis and are comparatively more stable investments.

Volume

Out of the total number of shares of a company that exists, only a small number are traded in the market in a given period of time.

A majority of the company's shares will be held by long-term investors, promoters, and the management of the company, and these shares are not traded on a day-to-day basis. The volume of a stock is the number of shares traded on any given day or any other unit of time.

As a general rule of thumb, the higher a stock's volume, the more liquid it is said to be. This is because if you own shares of a company with a very high volume of stocks being traded, you will find it much easier to sell off your shares when you want to because there are lots of buyers in the market.

Averaging Down

Averaging down is a trading strategy that enables a trader to do one of two things:

1. Maximize their profits on a given trade.
2. Minimize their losses on a given trade.

When you average down on a stock, you keep buying shares of a company as the prices continue to fall. This results in your average entry price falling as your orders increase.

For example, suppose a company share is trading at $100, and you buy 10 shares for a total of $1000. Then, the share price falls to $90, and you buy another 10 shares for $900. You now own 20 shares for a total investment of $1900, meaning that your average entry price is $95.

This means that you will profit from the trade as soon as the share price crosses $95, even though your initial investment was at $100.

Capitalization

The market capitalization of a company is the total value of all the shares of a company. It is calculated by multiplying the company's share price at any given moment and multiplying it with the total number of shares outstanding of the company.

Some companies with the largest market capitalizations (also called a market cap) are Apple, Microsoft, Facebook, and Aramco.

Blue Chip Stocks

Blue chip stocks refer to the largest companies that are being traded on any stock exchange.

These represent safer investments since these companies are so large that investing in them has very few risks.

These companies have huge market caps and a high volume of trading on any given day. They are among the most profitable companies being traded on the stock exchange, with the highest dividends paid out to investors. They are also popular with investors because they are market leaders in their respective industries.

IPO

Listing on the stock exchange is a way for companies to raise money from the public.

To do this, they offer their shares to the public in what is called an Initial Public Offering (IPO).

People are allowed to apply for the company's shares based on a prospectus that the company issues detailing all pertinent information. If the issue is over-subscribed, applicants are allotted shares on a pro-rata basis. Companies also usually hire underwriters who commit to buying shares of the company if the issue is under-subscribed. The company then gets listed on the stock exchange with its own ticker and can then be traded freely in the market.

Float

When a company goes public via an IPO, all the company's shares are not allotted to the public.

The company management usually retains a percentage of the shares being issued to maintain control of the company’s daily affairs.

In addition to this, employees are also sometimes offered shares as a part of their compensation at a discounted rate, with the condition that they are not allowed to sell these shares for a given lock-in period, usually 6 months. As a result, not all of the company's shares are available for trading on any given day.

The number of shares that can be traded freely on the stock market is called the company's float.

Secondary Offering

As mentioned earlier, issuing shares to the public is a way for companies to raise money.

After an IPO, if a company still feels that they need to raise more cash later, it can issue another round of shares to the public. This is called a secondary offering of shares, resulting in a dilution of ownership for the previous shareholders.

For example, if a company had initially issued 100,000 shares in an IPO, owning 10,000 shares would make you a 10% owner in the company. However, if the company issues another 100,000 shares, then your 10,000 shares only represent 5% of the company's total ownership.

This might lead to discontentment among existing shareholders, so to avoid this, companies usually have rights issues, where existing shareholders are given an option to get more shares in proportion to the number of shares that they currently hold so that their stake in the company remains unchanged.

Rights issues are generally carried out at discounts to the market price of the shares.

Day Trader

A day trader is a type of trader who opens and closes positions on the same day.

Day traders do not carry forward positions from one day to another, and all their positions are shut down at the close of the market.

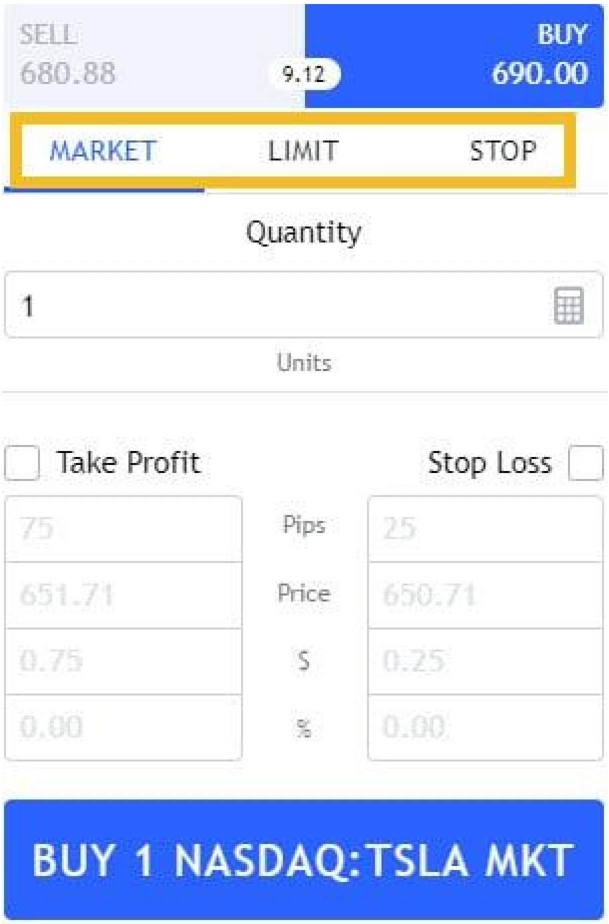
Limit Order

There are two main types of orders that you can place on the stock market when trying to open or close a position: a limit order and a market order.

A limit order is an order that will only get fulfilled up to a certain limit. For example, suppose you place a limit order for buying 100 shares at $5 each, then the order will only be fulfilled if the shares at available at $5 or lower. These orders might take time to be fulfilled, as it takes time to find an asking price that is the same as your bid price.

Limit orders are set for prices lower than the current market price.

Limit orders might also be set for closing the position. For example, a limit order to close your position for $6 will ensure that the shares will only be sold if the bid price is higher than $6.



Market Order

The other type of order that you can place is known as a market order.

This is quite simple, and it allows you to open or close a position at the current market rate, whatever it may be.

For example, suppose you place an order for 100 shares of a particular company. If 50 shares are being sold at an ask of $5 and another 50 shares are being sold at an ask of $5.05, then a market order will immediately purchase both these lots. A limit order at

$5 will only purchase the first 50 shares and wait for another 50 shares to be available at $5 or lower before the entire order is executed.

Stockbroker

As a trader or an investor, you are not allowed to trade on the stock exchange directly.

Only members of a stock exchange are allowed to trade on the exchange, and these members are called brokers.

If you wish to buy and sell stocks, you need to find a broker and place your orders through them. Brokers then place your order at the exchange, and your order is executed if there is a counterparty available. In exchange for this, brokers charge a small fee, which might be in the form of a spread or a commission per trade.

Stock / Investment Portfolio

Put very simply; a portfolio is simply the list of the stocks that you have positions in at any given point in time.

Investors usually diversify their portfolios to ensure that they have shares in companies belonging to all main sectors to not miss out on growth in any major sector. However, every investor/trader has their own criteria for shares that they wish to include in their portfolio, and you should decide on yours too when you start trading.

Stock Index

If a trader or an investor wishes to understand how a country's economy is performing or how a sector has been doing recently through the stock market, they can do so through the use of indexes.

Stock indexes are indicators designed to show you how a large group of companies is performing.

Every exchange has its own index, which indicates how the largest companies being traded on that exchange have been performing, for example, the S&P 500.

There are also economy-specific indexes, which comprise the largest companies in a particular country, and are used to gauge the economy's performance as a whole, such as the Dow Jones, which includes 30 of the largest companies being traded in the US markets.

Most exchanges also have indexes based on specific sectors of the economy and separate indexes for the largest small-cap, mid-cap, and large-cap companies.

Dividend

Whenever a company makes a profit, there are three main uses that they put the money to.

The first is the payment of corporate taxes to the government, which is a compulsory expense. Then, companies retain a part of the profits as retained earnings. These earnings sponsor future expansion plans and operations of the company and serve as an internal source of finance. The rest of the profits are distributed among shareholders in dividends, allotted on a per-share basis.

Dividends serve as passive income for several individuals on the stocks they own. However, companies only pay out dividends if they are confident that they will be able to sustain their current level of growth in the future. Once they pay out dividends one year, investors will expect similar dividends in the future. Not being consistent with dividend payments can result in a negative image of the company.

Execution

There are two parts to entering or exiting a trade in the stock market: placing an order and getting executed.

Suppose you wish to buy 200 shares of a particular company. The first step will be to place an order (either limit or market) with your broker, along with your bid price. The broker then transmits this order to the exchange, where a counterparty (or multiple counterparties) selling 200 shares at an asking price similar to your bid price is found.

Once the counterparty has been found, your trade is then executed. The shares get transferred to you via your broker, and the money gets transferred to the counterparty.

Sector

A sector refers to a certain section of the economy that comprises companies that undertake the same business.

For example, the telecom sector comprises all companies in a particular geographical region or exchange involved in the telecom industry.

Margin

Margin refers to the ability to trade with money that you do not have.

Several brokers allow you to trade on margin, especially if you’re trading in CFDs or derivatives. For example, suppose your broker allows you to trade on a 10:1 margin; this means that you can purchase stocks and derivatives worth $1000 with an investment of $100.

Margin trading allows traders to make large gains without risking a huge amount of capital; however, it is also risky since there is a high risk of losing everything. Therefore, you should exercise caution when trading on margin.

Yield

Your yield is basically the return on your investment.

For stocks, this refers to the dividend you earn on the stocks, and it is expressed as a percentage of the total share price.

For example, if a $10 stock pays out $2 as dividends every year, then the yield on the stock is 20%. When calculating the yield on your stock, you should not consider the potential appreciation in the stock price since that is an uncertain gain.

Stock Market Terminology Recap

By reading this article, you have now gained a better understanding of the basic terms and jargon that traders use daily, which ensures that you will never feel intimidated again when you open your trading app.

While there are definitely several more important terms and phenomena that you need to know, this list covered the most basic ones and will definitely enable you to get a head start in the trading world.

Stock Markets Guides