Lesson 4: How the Stock Market Works

Part 2

Student Guide Pages: 121-122

Lesson Objectives: By the end of this lesson, your students should be able to:

- explain stock market indexes
- explain mutual funds

Lesson Summary:

Currently, there are thousands of stocks available in the United States alone. It's too cumbersome to look at every single stock individually to see where the economy is at and to guess where it's headed, so *stock market indexes* were created. These are lists of publicly traded companies designed to represent a sector of the economy or even the economy as a whole. There are indexes for small companies, healthcare companies, big companies, foreign companies, and so on. The most famous is the *Dow Jones Industrial Average*; you've probably seen this quoted daily in the global media. Apparently, when the Dow goes up, the market as a whole is doing well; conversely, when it goes down, the market as a whole is also faltering.

Buying individual companies can be costly, risky, and time consuming. This is why most people purchase *mutual funds*. These are money pools in which several thousand investors surrender the management of their money to a manager who invests on behalf of the fund. Naturally, the manager charges a fee for this. A very popular mutual fund is the *index mutual fund*, because it has no manager since a computer chooses the stocks; therefore, the fees are low.

Review Questions:

- Why do index mutual funds often outperform those managed by a living, breathing human being?
  Answer: Because you have to pay all living, breathing human beings for their work! Remember that fees cut directly into your investment profits, so the lower the fees, the better your investments do. Because index mutual funds don't require a manager and staff, their fees are very low, and those savings get passed on to you in the form of increased profits!

- How are the fees on mutual funds calculated?

Answer: Usually, this is a percentage of the money in the fund. For instance, if a fund has $100 million in it, the manager might take a 1 percent annual fee, which, in this case, would be $1 million.

Homework Assignment:

Ask students to research a mutual fund. Top-performing mutual funds can be searched just like stocks on websites like Yahoo! Finance. What are the fees? What does the fund invest in? Does anyone already own one?

Class Activity:

As a class, build a fake mutual fund. Students can suggest stocks to put in the fund. Ask them to quickly explain their suggestions, then ask the class to vote on which ones should make it into the fund. Based on those stocks, what type of fund do you have? A tech fund? A consumer products funds? A healthcare fund? A food-manufacturing fund?

Additional Information:

www.etrade.com **www.scottrade.com**

www.fidelity.com **www.edwardjones.com**

www.vanguard.com **www.troweprice.com**

All these companies above can help your students with a Roth IRA and mutual funds. We receive no compensation or referral fee for mentioning them here.

Fun Facts:

The first mutual fund is often credited to a Dutch merchant named Adriaan van Ketwich, because he created an investment trust in 1774. Ketwich most likely thought offering diversification would increase the appeal of the fund to smaller investors with minimal amounts of money. The name of Ketwich's fund, *Eendragt Maakt Magt*, translates to "unity creates strength."

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