



No-Frills Money Skills Video Series

Episode 3: Get Into Stocks (8:58)



View Episode 3 at <https://www.stlouisfed.org/education/no-frills-money-skills-video-series/episode-3-get-into-stocks>.

1. What is a stock?

A stock is a share of ownership in a company; ownership in the company is equal to the number of shares owned by the shareholder relative to the total number of shares owned by all members. Stocks are often traded publicly. A publicly traded company issues stock that is traded on a stock exchange, such as the New York Stock Exchange.

2. For what two purposes do people generally buy stocks?

People generally buy stocks to earn capital gains or to receive dividends. Capital gains are the money earned when an asset increases in value from the time it is purchased to the time it is sold. That is, when you sell an asset for more than you paid for it, you earn capital gains. A dividend is a share in the company's profit—it is money you are paid when you are a stockholder.

3. What are some reasons company owners might decide to “go public” and issue stock?

A company owner may issue stock to raise money for expansion because the money could be difficult to obtain from another source.

4. What is a major cost a company incurs by selling stock?

When a company sells stock, it gives up sole ownership of the company and therefore must share the profit and control (management) of the company with its stockholders.

5. What are some differences between owning common stock and preferred stock?

Common stockholders are considered company owners and may vote in matters affecting the company. Preferred stockholders do not have voting rights in the company but receive dividends before any return is paid to common stockholders. In the event of liquidation—that is, the company sells its assets and closes its doors—preferred stockholders would receive payment before common stockholders.

6. What is investment risk?

Investment risk is the uncertainty that an investment will gain, or even retain, its value.

7. What is the general relationship between risk and potential reward when investing?

In general, the higher the risk of loss of principal for an investment, the greater the potential reward, and, conversely, the lower the risk of loss of principal for an investment, the lower the potential reward. To attract buyers, the seller of a potentially risky investment must offer a higher return than the buyer could potentially earn on a less-risky investment. In other words, when the risk of potential loss is high, people expect greater returns. When the risk of potential loss is lower, people are willing to accept lower returns.