Name ______________________ Date ______________

Understanding the Stock Market

One of the symbols of prosperity in the 1920s was the booming stock market. Corporations issue stock to raise money. A corporation declares its aim to offer a certain number of shares of stock for sale. An investment bank arranges to have the shares sold. People who think that the value of the shares will increase over time buy them. The money the buyers pay—minus a percentage that the bank keeps—goes to the corporation.

Corporations issue stock for various reasons. They may need money to expand into a new line of business. They may want to buy another company.

Each person who buys a share of stock owns a piece of the corporation. These stockholders have certain rights. They have the right to receive information about the corporation's finances. They can attend stockholder meetings and vote for people to serve on the company's board of directors. They also receive dividends. When the corporation earns profits, its directors declare a dividend. This is a sum of money paid on each share of stock owned. The corporation sends dividend checks to each and every stockholder.

Stockholders benefit from owning stocks in two ways. First, they receive dividends. Second, they gain if the value of the stock goes up. Shares of stock in thousands of corporations are traded every day. The value of each share can go up or down. Sometimes factors such as the overall health of the economy or government actions affect the price of a share. The performance of the corporation itself has a big impact on its stock price. If a company's profits are increasing and its managers are competent, investors will usually bid up the value of that stock. If a company is having hard times or losing out to competitors, its stock price will fall.

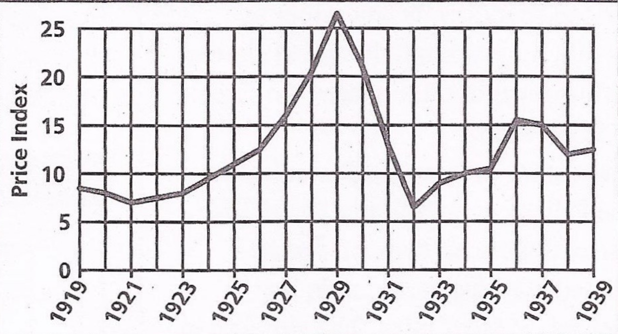
In the 1920s, stock prices rose steadily. From May 1928 to September 1929, the average stock price soared by 40 percent.

Because stock prices were rising, many people began to buy shares. By 1929, about 4 million Americans owned stock. Stock brokers made it easy for people to own shares. Brokers allowed people to buy on credit (borrowed money). Buyers only had to pay 25 percent of the stock price in cash. The other 75 percent they could owe. Buyers typically planned to pay it back in the future, when they sold the shares at a higher price. If the stock price fell, though, these buyers would be in trouble. They would have to pay back the money that they borrowed, even though the stock was no longer worth as much.

This process was called "margin buying." It was hugely popular during the stock market boom of the late 1920s.

Then, on October 28 and 29, 1929, stock prices fell dramatically. The Dow Jones Industrial Average lost nearly one-fourth of its value in October 1929.

By the middle of November, investors had lost $30 billion in the stock market. Investors who had bought stocks on credit could not pay back their loans. In turn, many stockbrokers and banks went bankrupt because they could not collect back the money they had lent to investors. This stock market crash helped to cause the Great Depression, which lasted from 1929 until World War II.



Source: *Historical Statistics of the United States, Colonial Times to 1970*