



About Stocks

Buying stock means taking an ownership or equity stake in a corporation. If you are a shareholder, you own an undivided interest in the assets of the corporation and may be paid a proportionate share of the company's earnings in the form of dividends.

Stocks are usually bought and sold in units called shares. A share's value, or share price, rises and falls based on how much people will pay for a share. People will pay money for the stock if they think the company will be successful. If it is, its stock will increase in value.

The amount you pay per share is, at first, set by investment banks during a company's initial public offering (IPO), and is determined by the company's value. For example, if a \$100 million company offers 10 million shares, its shares go for \$10 each. But that's just the starting point. The price of a share can go up and down over time.

Stocks are generally considered to be a riskier investment than bonds or cash. Stock prices tend to fluctuate more sharply—both up and down—than other types of asset classes. However, stocks can help you build long-term growth into your overall financial plan. History has repeatedly demonstrated that stocks, as an asset class, have outperformed every other type of investment over long periods of time.

Be sure to research a company before investing in its stock. You should understand its products or services, its market, as well as whether it has a sound balance sheet, cash-flow management, and competent directors and managers. You should also consider analysts' projected earnings estimates.

What makes a stock price go up and down?

There are many factors, including:

- How the company offering the stock is doing: Good news from a company, such as a new product launch or exceeding quarterly financial projections, tends to make a stock's price go up. Bad news, such as a product recall or lawsuits against the company, generally can cause the price to drop.
- World events: Major political shifts, natural disasters, wars and social unrest can all affect a stock's price. When people are uncertain about what's happening in the world, they're less likely to take on the high risk associated with stocks, so less money is put into the stock market.
- The U.S. economy: When the government enacts policies that seem to help the economy, such as tax breaks to spur consumer spending, stock prices are apt to rise. Policies that may hurt the economy, such as the Federal Reserve raising interest rates, can cause stock prices to decline.
- Market conditions: When people are optimistic about the economy and investing more money, a bull market can occur. During this time, stock prices rise faster than usual and people experience positive returns on their investments. But when people are pessimistic about the economy, a bear market can ensue, which brings falling stock prices.

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What makes a stock price go up and down? (continued)

- Supply and demand: A company offers a limited number of shares—that's the supply. People who want to buy the stock create the demand. When demand is high and supply is low (because shareholders are not selling), the stock's price goes up. When there is low demand and high supply, a stock's price goes down.

If you want to be a savvy investor, you can't just watch the ups and downs of your individual stocks (collectively known as your portfolio). You should also monitor the market's overall performance.

Stock exchanges

Places where stocks are bought and sold are called stock exchanges. The Dow, S&P 500, and NASDAQ Composite Index are stock indexes that are used to measure the upward or downward trends of stock values. The Dow consists of about 30 very large U.S. companies. The S&P 500 is 500 of the largest publicly traded U.S. corporations. In order to be traded, a stock has to be listed on an exchange. Different stocks list on different exchanges. The stocks of approximately 3,200 companies are traded on the NASDAQ exchange.

There are a number of Web sites where you can check stock prices for free. Keep in mind that information from the stock markets is not posted in real-time. There may be a short time delay, often as much as 20 minutes. These sites usually feature other information that can help you make investment decisions, such as interactive charts and recent company news. Many daily newspapers also list the closing stock prices from the previous day.

Getting started

In order to buy or sell stocks, known as making trades, you must go through a licensed broker. As a first step, you need to set up a brokerage account by contacting a brokerage firm and filling out an application. Every time you buy or sell a stock, your brokerage firm will typically charge you a service fee.

You can invest independently using an online discount brokerage firm. These firms will give you access to research tools to help you decide what stocks to buy, but will not provide advice or recommendations. This helps to keep the service fees low. Alternatively, you can invest with the guidance of a professional broker who will monitor your portfolio and give advice on what stocks you should invest in—but this help typically comes with higher fees.

But before you invest in stocks, consider visiting one of the many Web sites offering tools to research, select, and track stocks.

How do you make money in the stock market?

There is no guaranteed method for making money with stocks. Making your investments pay off takes a lot of work. You need to follow the financial news, use the Dow and S&P 500 to watch market trends, and thoroughly research companies you want to invest in.

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How do you make money in the stock market? (continued)

One way to earn money is to look for companies that pay dividends, which is a payment given to shareholders based on the company's profit. The amount of your individual dividend payment is based on the number of shares you own. So if the dividend pays \$5 a share and you own 250 shares, you'll receive a dividend payment of \$1,250. You can choose to keep the money or reinvest it to buy more shares of the company.

The basic goal is to buy low and sell high. The difference between your purchase price and your sale price is your capital gain—and that's your profit.

While it may be tempting, don't jump into buying a stock just because it looks cheap. Find stocks that are of good value, or even slightly undervalued (as recommended by your research), and buy as many shares as you can. Hold onto those stocks, watching their performance over time, and sell when the price is higher than what you paid for it. Sounds easy—but it takes strategy, diligence and time to master the technique.

Some investors use a strategy called dollar cost averaging, which can be implemented as a "constant dollar plan." With this practice, dollar cost averaging means adding the same amount of money to an investment account on a regular basis. By doing this, you purchase fewer shares when the share price is high, and more when the price is low. This generally results in a lower average cost per share than purchasing a constant *number* of shares at the same periodic intervals. However, dollar cost averaging does not ensure a profit or protect against loss.

Keep in mind that you will pay taxes on all the money you make in the stock market, whether you earn it from dividends or from capital gains.

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