

THE SHARE MARKET

Multiple choice

1. A
2. D
3. D
4. C
5. A

Matching terms

The body that is responsible for prosecuting fraudulent or unfair financial practices.	ASIC
The profit made when shares are sold for more than they were originally bought.	Capital gain
Measures the changes in the price and dividends of shares listed on the stock exchange.	All Ordinaries Index
A sequence of swings that occur in the economy's overall level of economic and business activity.	Business cycle
The market for the trade in equity ownership of companies.	Share market
The process of listing a company on the stock exchange and offering its shares to the public.	Float
Raising funds through selling ownership in a company.	Equity financing
Borrowing money that must eventually be repaid.	Debt financing

True or false

Select the alternative true or false that best answers the question. Place a tick in the space provided.

	True ✓	False ✓
1 When a shareholder sells his/her shares for more than they were originally purchased, the profit earned is known as capital gains.	✓	
2 The share market is exclusively a secondary market.		✓
3 The share market can act as an indicator of the state of a nation's economy.	✓	
4 If consumers expect the rate of inflation in an economy to increase, this will cause the inflation rate to fall.		✓
5 When shares are bought with the intention of selling them again quickly, this may lead to a 'speculative bubble'.	✓	
6 Equity financing increases debt levels in the economy.		✓
7 The funds raised through equity financing must eventually be repaid by the company, but only when the company is profitable.		✓
8 If the price of shares increase, the price of real estate is likely to fall.		✓
9 Changes in the share market are generally accepted as the primary cause of the business cycle.		✓
10 Toffee Apples Pty. Ltd. is likely to be a company listed on the stock exchange.		✓

Short answers

Question 1

Companies sell shares to investors in order to raise money for expansion. This is an example of a primary market. Additionally, individuals will later trade their shares in companies between themselves – the secondary market – with the aim of making capital gain on their investment.

Question 2

- i) Changes in the share market affect confidence in the economy and the wealth of consumers. This affects spending decisions and hence the level of economic activity
- ii) The share market provides a method of raising investment funds. An improvement in the market will mean it is easier for firms to expand by selling shares.
- iii) The ease with which companies can sell shares and raise finance on the share market will reduce the need for companies to borrow funds for expansion, reducing debt in an economy.
- iv) Changes in the demand for shares will influence the demand for other assets. There is an inverse relationship between share prices and other asset prices.

Question 3

Expectations that inflation will increase will cause people to buy goods now before prices increase. This will itself cause inflation. The increase in spending can then lead to reduced funds being available for spending on shares, resulting in a downturn in the share market.

Similarly, expectations of increases in the value of stocks can lead to actual increases in stock values, as consumers try to buy before the increase (in order to make capital gains). This increase in demand causes the share prices to rise.

Question 4

The share market is driven by the expectations of investors, and this can lead to the market becoming a self-fulfilling prophecy. A belief that the value of shares will increase, will cause increased demand and an increased price and an improvement in the market. This is a speculative bubble. Alternatively, a reversal of that belief can lead to falls in prices over time.

Question 5

Equity financing will only require firms to service the funds when they make a profit. This is in the form of dividends and the value of dividends is decided upon by the company. When money is borrowed, interest must be repaid irrespective of the profitability of the company.