Market Talks
EDUCATION CENTER

STOCKS · BEGINNER · LESSON 3 OF 15

How the Stock Market Works

What happens between tapping "buy" on a trading app and owning the shares: brokers, exchanges, the order book, market makers and settlement

12 min read 8 quiz questions with answer key

STOCKS · BEGINNER · LESSON 3 OF 15

How the Stock Market Works

IN ONE SENTENCE

The stock market is a network of exchanges and other trading venues where buyers and sellers meet through brokers. Every venue keeps a list of orders, called the order book, and a trade happens when a buyer and a seller agree on a price. After the trade, a clearing house makes sure the shares and the cash change hands, which in the US takes one business day.

A marketplace for shares

In Lesson 2, John bought Figma shares on his trading app from another investor. But John never met that investor, never agreed a price with them and never sent them any money directly. Several professional firms did that work for him in less than a second.

The **stock market** is not one building. It is a network of trading venues, connected by computers, where orders to buy and sell shares meet. The best known venues are **stock exchanges** such as the New York Stock Exchange (NYSE) and Nasdaq in the United States, the London Stock Exchange or the Tokyo Stock Exchange. Lesson 4 looks at the world's major exchanges.

The market is busy. According to SIFMA, an average of **17.6 billion shares** changed hands every trading day in the United States in 2025, a record. Behind each of those trades is the same basic process, and understanding it explains a lot about how prices move.

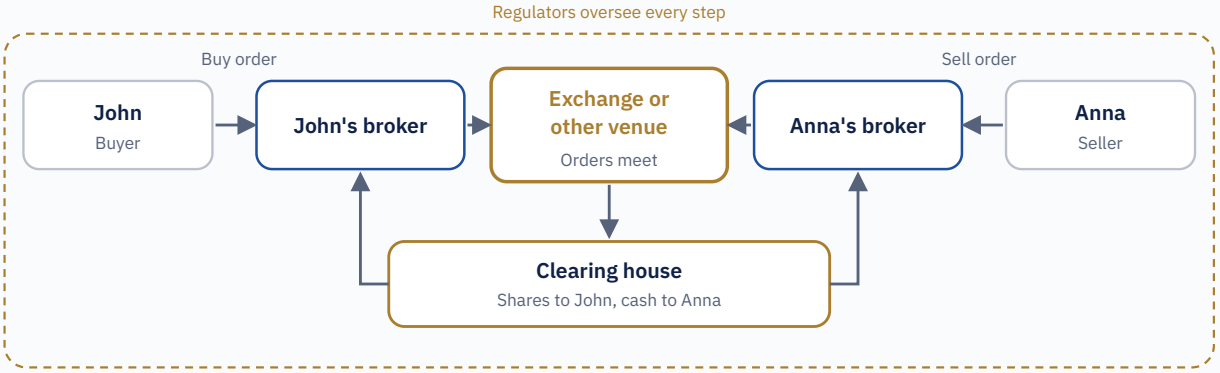


Figure 1. John and Anna never meet. Their brokers send their orders to a trading venue, where they are matched, and a clearing house completes the exchange.

Who does what

Five types of firm make the market work:

- **Brokers.** Individuals cannot send orders straight to an exchange. They open an account with a **broker**, a licensed firm that passes their orders to the market, holds their shares and cash, and sends them statements. Most people now use an online broker or a trading app.
- **Exchanges and other venues.** These are the marketplaces where orders meet. Each one runs a computer system that matches buyers with sellers according to strict rules.
- **Market makers.** Firms that are always ready to buy and to sell a stock, so that there is someone on the other side of your order even when no other investor is. You will meet them later in this lesson.
- **Clearing houses.** After a trade, the clearing house stands between the buyer and the seller and makes sure that both sides deliver: the shares to the buyer and the cash to the seller.
- **Regulators.** Government agencies that write and enforce the rules, such as the Securities and Exchange Commission (SEC) in the United States, the Financial Conduct Authority (FCA) in the UK and national regulators in the European Union, coordinated by ESMA.

Most of this is invisible to the investor. John taps "buy", and a few moments later the shares appear in his account. But each of these firms plays a part, and some of them earn money from his trade.

The order book: bid, ask and spread

Every trading venue keeps a list of the orders waiting to be filled, called the **order book**. It has two sides:

- **Bids** are orders to buy. Each bid says how many shares someone wants and the highest price they will pay.
- **Asks**, also called offers, are orders to sell. Each ask says how many shares someone has and the lowest price they will accept.

The highest bid and the lowest ask are the most important numbers on the screen. In the example in Figure 2, the best bid is $100.00 and the best ask is $100.05. The gap between them, $0.05, is called the **spread**. If you want to buy straight away, you pay the ask. If you want to sell straight away, you receive the bid. Lesson 6 shows where to find the bid, the ask and the spread on a stock quote.

The amount of shares waiting at each price is called **depth**. Large, popular stocks usually have thousands of shares waiting at every price and a spread of just one cent. Small, rarely traded stocks may have only a few orders and a wide spread, which makes them more expensive to trade.



Figure 2. The order book lists sellers' asks above and buyers' bids below. The gap between the best ask and the best bid is the spread.

How a trade happens and why prices move

A trade takes place when a buyer and a seller agree on a price. On an exchange, a computer called the **matching engine** does this automatically. Orders at a better price go first, and orders at the same price are filled in the order they arrived.

Suppose John sends an order to buy **300 shares at the market price**, which means at the best price available right now. Only 200 shares are offered at $100.05, so the matching engine fills those first. The remaining 100 shares are bought from the next seller, at $100.10. John pays an average of about $100.07 per share, and the last trade price moves up from $100.05 to $100.10.

This is how prices move. When buyers are more eager than sellers, they keep taking the cheapest asks and the price climbs. When sellers are more eager, they keep hitting the highest bids and the price falls. Nobody sets the price of a stock. It is simply the price of the latest trade between a willing buyer and a willing seller. Lesson 7 explains other order types, such as limit orders, that let you choose the price instead.



Figure 3. A market order fills at the best price first and then moves to the next level. Taking the asks pushes the price up.

EXAMPLE: THE COST OF CROSSING THE SPREAD

Anna buys 1,000 shares at the ask of $100.05 and, a moment later, changes her mind and sells them at the bid of $100.00. The share price has not moved at all, yet she has lost **$0.05 × 1,000 = $50**, plus any fees. Every time you buy and sell straight away, you pay the spread. That is why very frequent trading in stocks with wide spreads can be costly.

Market makers keep the market moving

What if John wants to buy at a moment when no investor happens to be selling? That is the job of a **market maker**. A market maker is a firm that constantly quotes both a bid and an ask in a stock, for example "I will buy at $100.00 and sell at $100.05". It is ready to trade with anyone who accepts those prices.

The market maker earns money from the spread. If it buys 100 shares from one investor at $100.00 and sells 100 shares to another at $100.05, it keeps $5. Across millions of trades a day, those small amounts add up. The risk is that the price moves against the shares it holds before it can sell them, so market makers adjust their quotes constantly, often using very fast computer systems.

For investors, market makers provide **liquidity**: the ability to buy or sell quickly at a price close to the last one. Without them, spreads would be wider and orders would take longer to fill, especially in less popular stocks.

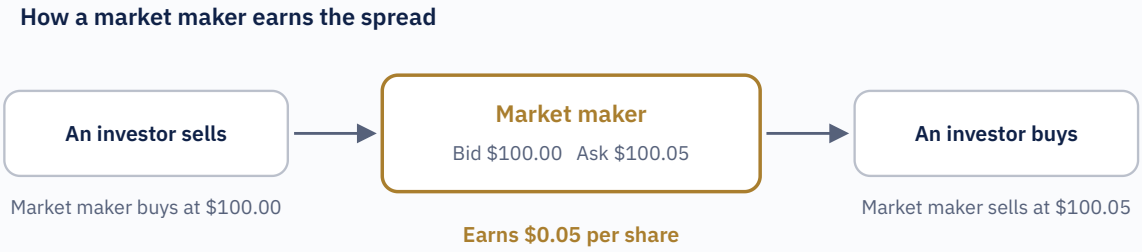


Figure 4. A market maker quotes a bid and an ask at all times. Buying at the bid and selling at the ask earns it the spread.

Not every trade happens on an exchange

In the United States, a stock listed on the NYSE does not only trade on the NYSE. The same shares trade on more than a dozen competing exchanges, and also **off-exchange**. There are two main kinds of off-exchange trading:

- **Wholesalers.** Many retail brokers send their customers' orders to large market-making firms, which fill them from their own inventory, often at a price slightly better than the best price on the exchanges.
- **Dark pools.** Private trading systems, mostly used by large institutions, where orders are not shown to the public before they trade. This lets a fund buy or sell a big block of shares without alerting the whole market.

Off-exchange trading has grown steadily. According to Cboe, it reached **50.6% of all US stock trading volume in 2025**, the first year in which more than half of all shares traded away from the exchanges. All of these trades must still be reported publicly, and US rules require brokers to seek the best available price for their customers' orders.



Figure 5. In 2025, for the first time, more than half of all US stock trading took place away from the exchanges.

After the trade: clearing and settlement

When John's order is filled, the price and the number of shares are fixed, but the shares and the money have not moved yet. Two more steps follow:

- **Clearing.** A central clearing house records the trade and steps in between the two brokers. It becomes the buyer to every seller and the seller to every buyer, so that if one broker fails, the other side still gets what it is owed. In the US, this is done by the National Securities Clearing Corporation (NSCC), part of the DTCC.
- **Settlement.** The shares are delivered to the buyer's broker and the cash to the seller's broker. Only then is the trade complete.

The time between the trade and settlement is written as **T+1**, T+2 and so on, where T is the trade date and the number counts business days. The United States moved from T+2 to **T+1 on May 28, 2024**, so a trade on Monday settles on Tuesday. The European Union, the UK and Switzerland plan to move to T+1 together on **October 11, 2027**. Your app shows the shares in your account right away, but settlement is what legally completes the transfer.

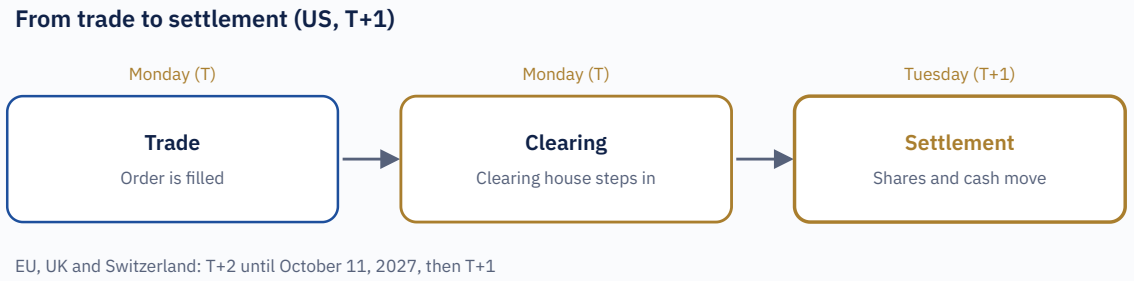


Figure 6. A trade is agreed in a moment, but the shares and cash only finally change hands at settlement, one business day later in the US.

IMPORTANT: WHAT PROTECTS YOUR ACCOUNT

Shares bought through a broker are normally held in your name, separately from the broker's own money. In the United States, if a member broker fails and customer assets are missing, the Securities Investor Protection Corporation (SIPC) protects each customer up to **$500,000**, including up to $250,000 in cash. Other countries have similar schemes with their own limits. None of them protects you against a fall in share prices. They only cover a broker's failure. Lesson 15 explains how to check that a broker is properly regulated.

Rules that keep the market fair

Stock markets only work if investors trust them. That is why they are among the most closely regulated places in finance. Listed companies must publish their financial results regularly and announce important news to everyone at the same time. Trading on secret company information, called **insider trading**, is illegal, and so is spreading false news to move a price.

Markets also have brakes for extreme days. In the United States, if the S&P 500 index falls 7% from the previous day's close, all stock trading stops for 15 minutes. A fall of 13% triggers a second 15-minute pause, and a fall of 20% closes the market for the rest of the day. These **market-wide circuit breakers** give investors time to take in the news instead of selling in panic. They were triggered four times in March 2020, at the start of the COVID-19 crisis. Individual stocks also have their own short trading pauses when they move too far too fast.

Exchanges only trade at certain times of day, unlike the forex and crypto markets. Lesson 8 explains regular trading hours and the extended pre-market and after-hours sessions.



Figure 7. If the S&P 500 falls far enough in one day, all US stock trading pauses or stops, giving investors time to take in the news.

Why this matters for traders

- **The spread is a cost on every trade.** Buying at the ask and selling at the bid means you start each trade slightly behind. Check the spread before trading small or rarely traded stocks.
- **Depth decides how far a large order moves the price.** A big market order can fill at several price levels, so the average price can be worse than the price you saw on the screen.
- **Price moves come from orders.** A stock rises when buyers keep taking the asks, and falls when sellers keep hitting the bids. Volume shows how much of this is happening.
- **Extreme days have rules.** Circuit breakers and single-stock pauses can stop trading suddenly, and a stop order may not fill until trading resumes, possibly at a very different price.

Key terms

Stock exchange	A regulated marketplace where buy and sell orders for shares meet and are matched.
Broker	A licensed firm that passes clients' orders to the market and holds their shares and cash.
Order book	The list of all buy orders (bids) and sell orders (asks) waiting to be filled at each price.
Bid	An order to buy, or the highest price a buyer is currently willing to pay.
Ask (offer)	An order to sell, or the lowest price a seller is currently willing to accept.
Spread	The gap between the best bid and the best ask.
Market order	An order to buy or sell straight away at the best price currently available.
Market maker	A firm that continuously quotes both a bid and an ask, ready to trade with other investors, and earns the spread.
Clearing house	A central firm that stands between buyers and sellers after a trade and makes sure both sides deliver.
Settlement (T+1)	The final exchange of shares and cash. T+1 means it happens one business day after the trade date.
Circuit breaker	A rule that pauses trading for a while after a very large price fall.

Key takeaways

1. The stock market is a network of exchanges and other venues where buy and sell orders meet. Investors reach it through brokers.
2. Every venue has an order book. The best bid and best ask are the prices you can sell and buy at right now, and the gap between them is the spread.
3. A trade happens when a buyer and a seller agree on a price. Prices rise when buyers take the asks and fall when sellers hit the bids.
4. Market makers quote both sides and earn the spread, which keeps the market liquid. In 2025, more than half of US stock volume traded off-exchange.

5. After a trade, a clearing house makes sure the shares and cash change hands. US trades settle one business day later (T+1).

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. Why does an individual investor need a broker?

- A Because individuals cannot send orders straight to an exchange
- B Because brokers decide the price of every stock
- C Because only brokers can own shares
- D Because exchanges are closed to everyone except governments

2. The best bid is $100.00 and the best ask is $100.05. What is the spread?

- A $0.05
- B $100.00
- C $100.05
- D $200.05

3. You want to buy right now with a market order. At which price do you buy?

- A The best bid
- B The best ask
- C The midpoint, always
- D Yesterday's closing price

4. John buys 300 shares at the market price. 200 shares are offered at $100.05 and the next 400 at $100.10. What happens?

- A All 300 shares are bought at $100.05
- B 200 are bought at $100.05 and 100 at $100.10
- C The order is rejected
- D All 300 shares are bought at $100.10

5. How does a market maker usually earn money?

A From the spread between its bid and its ask
B From a fee paid by the regulator
C By receiving dividends only
D By setting the closing price

6. According to Cboe, what share of US stock volume traded off-exchange in 2025?

A About 5%
B About 25%
C About 50.6%
D About 95%

7. A US stock trade is made on a Monday. Under T+1, when does it settle?

A Immediately
B Monday evening
C Tuesday
D Wednesday

8. The S&P 500 falls 7% from the previous close during the trading day. What happens?

A Nothing happens
B All US stock trading pauses for 15 minutes
C The market closes for a week
D Only buying is allowed

Answer key

1 A

Because individuals cannot send orders straight to an exchange

Brokers are licensed firms that pass clients' orders to the market and hold their shares and cash. The price is set by trading, not by the broker.

2 A

$0.05

The spread is the gap between the best ask and the best bid: $100.05 minus $100.00 = $0.05.

3 B

The best ask

Buyers who want to trade straight away pay the lowest price a seller is asking for. Sellers who want to trade straight away receive the highest bid.

4 B

200 are bought at $100.05 and 100 at $100.10

The matching engine fills the best price first, then moves to the next level. John pays an average of about $100.07, and the last price moves up to $100.10.

5 A

From the spread between its bid and its ask

A market maker buys at its bid and sells at its higher ask. Buying at $100.00 and selling at $100.05 earns $0.05 per share.

6 C

About 50.6%

Off-exchange trading, through wholesalers and dark pools, reached 50.6% of US volume in 2025, the first time it was more than half.

7 C

Tuesday

T+1 means one business day after the trade date. The US moved from T+2 to T+1 on May 28, 2024.

8 B

All US stock trading pauses for 15 minutes

A 7% fall triggers the first market-wide circuit breaker, a 15-minute pause. A 13% fall triggers a second pause, and a 20% fall closes the market for the day.

SOURCES

- SIFMA, 10 Key Findings from SIFMA's 2026 Capital Markets Fact Book: https://www.sifma.org/news/blog/2026-capital-markets-fact-book-key-findings
- Cboe, 2025 U.S. Equities Year in Review: https://www.cboe.com/insights/posts/2025-u-s-equities-year-in-review
- SIFMA, Settlement cycles: T+1: https://www.sifma.org/issues/financial-risk-management/shortening-settlement-cycle
- The TRADE, UK confirms October 2027 alignment with EU and Switzerland for T+1 transition: https://www.thetradenews.com/uk-confirms-october-2027-alignment-with-eu-and-switzerland-for-t1-transition

- Investor.gov (US SEC), Stock market circuit breakers: https://www.investor.gov/introduction-investing/investing-basics/glossary/stock-market-circuit-breakers
- SIPC, What SIPC protects: https://www.sipc.org/for-investors/what-sipc-protects

Market Talks

CONTINUE LEARNING

Up next: Lesson 4 Major Stock Exchanges

This lesson is part of the Stocks course at the MARKET TALKS Education Center. Beginner lessons are free, each with a quiz and a downloadable PDF. Intermediate and Advanced lessons are for members.

Education Center
Lessons from first principles to advanced topics

Markets Analysis
Technical and fundamental analysis on major markets

Reports
Bitcoin, Gold, Silver, SPX and more

markettalks.info

Telegram @MARKET_TALKS

For education only. Nothing in this document is financial advice. © 2026 MARKET TALKS. You are welcome to share this PDF unchanged.