Market Talks
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STOCKS · BEGINNER · LESSON 9 OF 15

Why Stock Prices Move

Supply and demand, earnings and expectations, company news, the wider market, interest rates and investor mood: the forces behind every price move

12 min read 8 quiz questions with answer key

STOCKS · BEGINNER · LESSON 9 OF 15

Why Stock Prices Move

IN ONE SENTENCE

In the short run, a stock moves whenever buyers are more eager than sellers or the other way round. What makes them eager is mostly new information about what the company will earn in the future, compared with what investors already expected. Company news, the moves of the whole market, interest rates and investor mood all play a part, and over the long run, share prices tend to follow a company's profits.

More eager buyers or more eager sellers

In Lesson 3 you saw the mechanics: a price rises when buyers keep taking the asks, and falls when sellers keep hitting the bids. Every price move, no matter what causes it, happens this way.

So the real question is *why* buyers or sellers become more eager at a particular moment. A stock does not rise because "there are more buyers than sellers". For every share bought, one is sold, so the number of shares bought and sold is always equal. What changes is **urgency**. When good news arrives, buyers are willing to pay more and sellers want more before they let go, so the price moves up until the two sides agree again. When bad news arrives, the opposite happens.

The rest of this lesson looks at the main kinds of news and forces that change that balance.

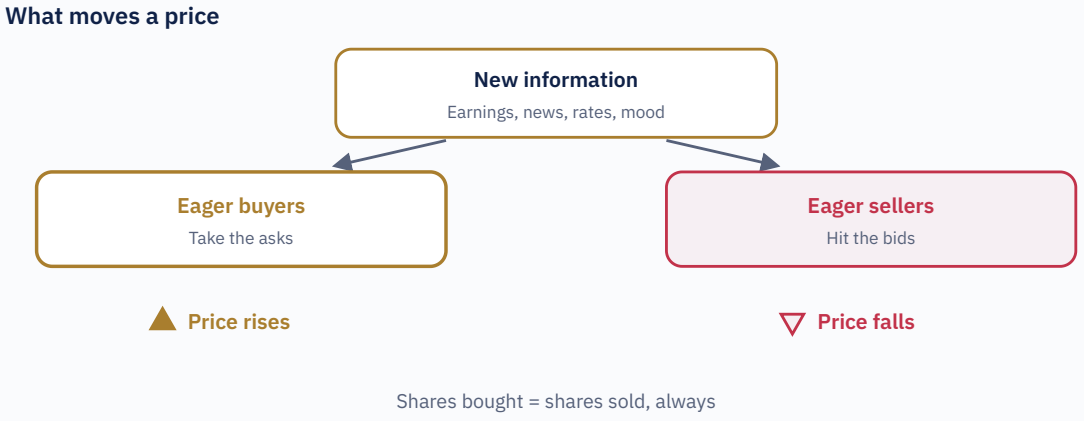

Figure 1. New information changes how eager buyers and sellers are. The price moves until they agree again.

Prices look to the future

As you saw in Lesson 1, a share is a piece of a business, so its value depends on what the business will earn. The important word is **will**. Investors are not paying for last year's profits, which have already been earned and spent. They are paying for the profits they expect in the coming years.

This explains much of what happens on the market:

- A company can be losing money today and still be very valuable, if investors believe it will earn a lot later.
- A company can report a record profit and still see its shares fall, if investors expected even more.
- Prices react quickly to anything that changes the view of the future: new products, a new competitor, a change in interest rates or a sudden crisis.

In other words, share prices move when **expectations** change. A price already reflects what most investors know and believe. Only **new** information, or a change in how investors judge the old information, moves it.

Earnings: results against expectations

Four times a year, listed companies publish their results, a period known as **earnings season**. Before each report, analysts who follow the company publish estimates of its sales and its earnings per share (EPS), and the average of these estimates is called the **consensus**.

When results come out, the market compares them with the consensus. Results above it are a **beat**, and results below it are a **miss**. But the share price reacts to more than the headline number. Investors also look closely at **guidance**, the company's own forecast for the coming quarters, because it tells them about the future. The Intermediate level covers earnings season in detail.

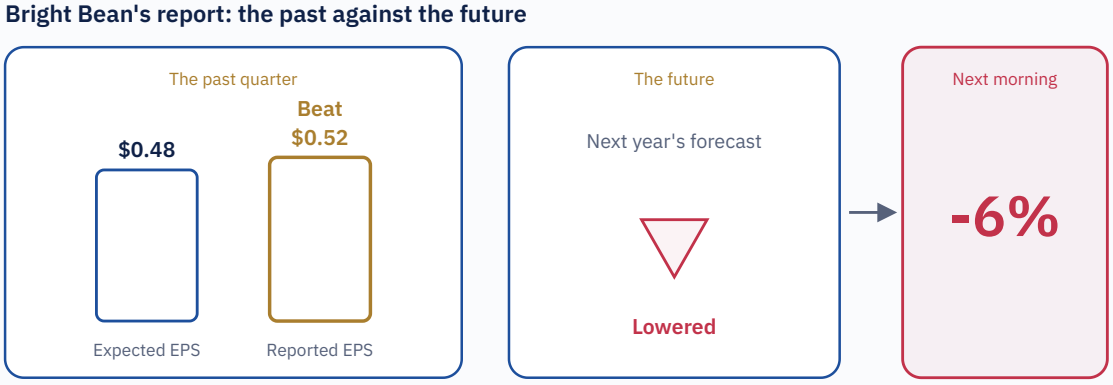

Figure 2. Bright Bean beat the estimate for the past quarter, but its weaker outlook for the future sent the shares lower.

EXAMPLE: A BEAT THAT STILL FALLS

Analysts expect Bright Bean (our imaginary BRBN from Lesson 6) to report EPS of **$0.48** for the quarter. After the close, it reports **$0.52**, a clear beat. But in the same report, it lowers its forecast for next year, because coffee bean costs are rising. The next morning BRBN opens **6% lower**. The good news was about the past quarter. The bad news was about the future, and the future is what investors are paying for.

Company news

Besides earnings, many kinds of company news can move a stock, often sharply:

- **Products and contracts:** a successful launch, a failed drug trial or a large new customer.
- **Deals:** when a company agrees to be bought, its shares usually jump towards the offer price, because the buyer normally pays more than the market price. The buyer's shares sometimes fall.
- **Management:** the arrival or sudden departure of a chief executive.
- **Legal and regulatory events:** fines, lawsuits, investigations or new rules for the industry.
- **Analyst views:** an upgrade or downgrade by a well-known analyst can move a stock for a day or two.
- **Index changes:** when a company is added to a major index such as the S&P 500, index funds must buy its shares, which can push the price up around the date of inclusion.

The size of the move depends on how surprising the news is and how much it changes the expected profits. News that was widely expected often moves the price very little, or not at all.

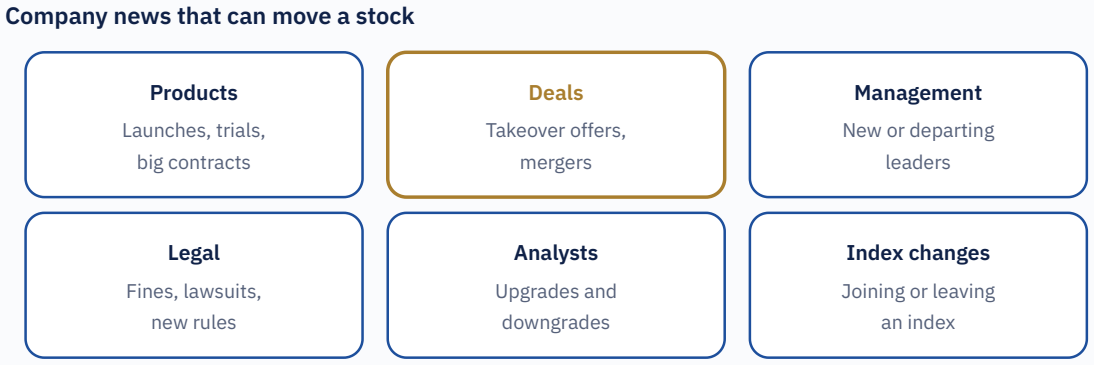

Figure 3. The main kinds of company news that can move a share price.

The whole market and the sector

Individual stocks rarely move alone. On most days, the largest single influence on a stock is the direction of the **whole market**. When the S&P 500 falls 2% on a bad day, most stocks fall with it, whatever their own news. Stocks in the same **sector** also tend to move together: if one large chip maker reports strong demand, other chip makers often rise too.

Analysts measure how much a stock usually moves with the market using a number called **beta**:

- A beta of **1** means the stock has tended to move about as much as the market.
- A beta of **1.5** means it has tended to move about one and a half times as much, in both directions. Fast-growing technology companies often have high betas.
- A beta of **0.5** means it has tended to move about half as much. Utilities and food producers often have low betas.

Beta is based on the past and is only an average. On any single day a stock can move very differently. But it is a useful reminder that owning a high-beta stock means riding bigger waves when the whole market moves.

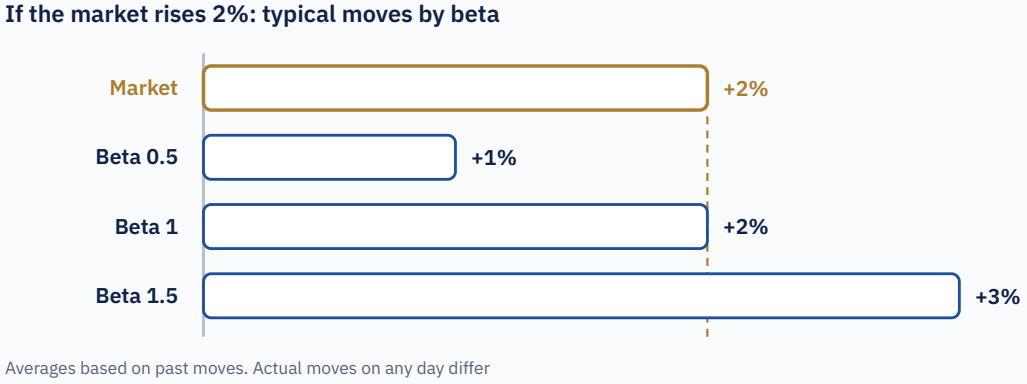

Figure 4. Beta shows how much a stock has tended to move compared with the market.

Interest rates and the economy

Some forces move almost every stock at once. The most powerful are **interest rates**, set mainly by central banks such as the US Federal Reserve (the Fed). Rates matter for stocks in three ways:

- **Competition:** when savings accounts and bonds pay more, stocks become less attractive by comparison.
- **Costs:** higher rates make borrowing more expensive for companies and their customers, which can slow growth and cut profits.

- **Value of the future:** higher rates make profits expected many years from now worth less today. That is why fast-growing companies, whose profits lie mostly in the future, are often hit hardest when rates rise.

2022 is a clear example. The Fed raised its main interest rate seven times, from near zero to **4.25% to 4.50%**, to fight high inflation. The S&P 500 fell **19.4%** that year, its worst year since 2008, and technology stocks fell even more. Economic data, such as jobs, inflation and growth figures, move markets mainly because they change what investors expect the central bank to do next.

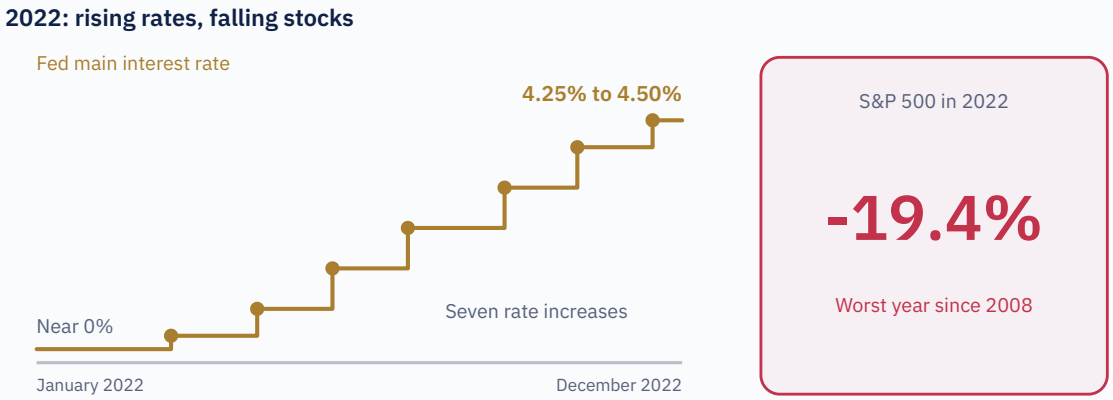

Figure 5. In 2022 the Fed raised rates seven times, and the S&P 500 had its worst year since 2008.

Investor mood: fear and greed

Investors are people, and people are not always calm. When prices are rising and everyone seems to be making money, optimism can push prices well above what profits justify. When fear takes over, investors sell almost anything, and prices can fall far below what the businesses are worth. This changing mood is called **market sentiment**.

The early months of the COVID-19 pandemic showed how fast sentiment can swing. From its high on **February 19, 2020** to its low on **March 23, 2020**, the S&P 500 fell about **34%** in just over a month, as investors feared a deep, long recession. Then central banks and governments stepped in with huge support, and the index climbed back to a new record high by **August 2020**, less than six months after the low.

Investors who sold in panic near the bottom locked in heavy losses and often missed the recovery. Sentiment can push prices to extremes in both directions, which is one reason why having a plan, as later lessons explain, matters so much.

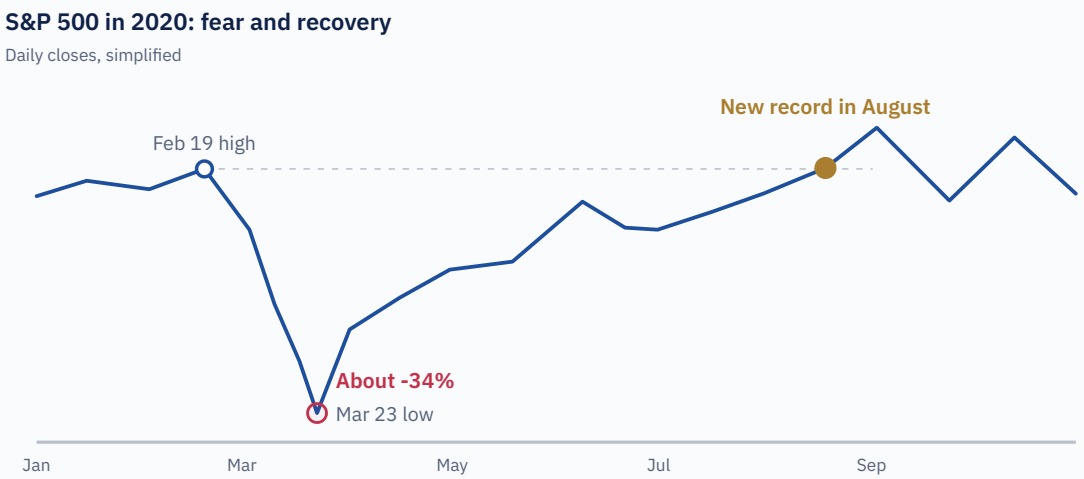

Figure 6. In 2020 the S&P 500 fell about 34% in just over a month, then recovered to a new high by August.

Short-term noise and long-term value

From day to day, stock prices can look random. They react to headlines, rumours, large orders and changes in mood, and many of these moves fade within days. Over years, however, the picture is different: a company whose profits grow strongly tends to see its share price rise, and one whose profits shrink tends to see it fall.

The investor Benjamin Graham, who taught Warren Buffett, described this with a famous image: in the short run the market is like a voting machine, counting how popular a stock is, but in the long run it is like a weighing machine, measuring what the business is really worth.

Both views matter. Traders work with the short-term moves: news, momentum and the balance of buyers and sellers, which the Intermediate level explores through charts and volume. Long-term investors focus on profits and value. Knowing which game you are playing, and which forces drive it, is the first step to making sense of any price move.

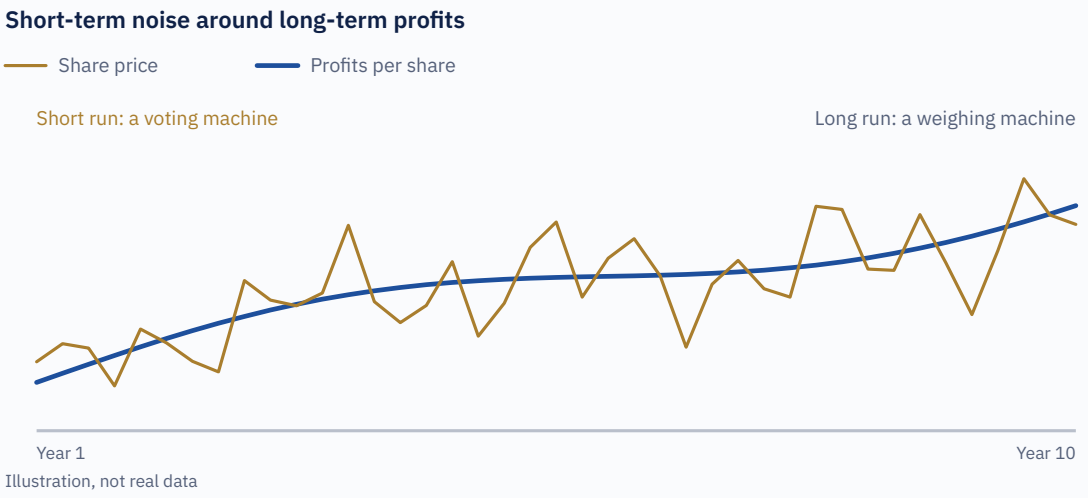

Figure 7. Over short periods prices swing around, but over the long run they tend to follow profits.

Why this matters for traders

- **Trade the surprise, not the news.** Prices move on the difference between what happened and what was expected. Know the consensus before an earnings report.
- **Check the market first.** A weak index can drag down a stock with good news. Many traders look at the S&P 500, the Nasdaq-100 and the sector before any single stock.
- **Watch the calendar.** Earnings dates, central bank meetings and key economic data are known in advance, and they are when the biggest moves and gaps tend to happen.
- **Sentiment overshoots.** Moves driven by fear or excitement often go further than seems reasonable, in both directions. Size positions so that you can survive them.

Key terms

Expectations	What investors on average already believe about a company's future. Prices move when expectations change.
Earnings season	The weeks each quarter when most listed companies publish their results.
Consensus	The average of analysts' estimates for a company's results.
Beat and miss	Results above (beat) or below (miss) the consensus estimate.
Guidance	A company's own forecast of its future sales or earnings.

Sector	A group of companies in the same industry, such as banks, energy or technology.
Beta	A measure of how much a stock has tended to move compared with the whole market.
Interest rates	The cost of borrowing money, influenced mainly by central banks such as the Fed.
Market sentiment	The overall mood of investors, from fear to optimism.

Key takeaways

1. Every price move comes from a change in how eager buyers and sellers are. The number of shares bought and sold is always equal.
2. Share prices look to the future. They move when expectations about a company's future profits change.
3. Earnings move stocks by how they compare with the consensus, and guidance about the future often matters more than the past quarter.
4. Company news, the whole market, the sector, interest rates and investor sentiment all push prices. In 2022, rising rates helped send the S&P 500 down 19.4%.
5. In the short run prices can swing with mood and headlines, but over the long run they tend to follow profits.

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 is it not quite right to say a stock rose "because there were more buyers than sellers"?

- (A) Because every share bought is also sold, so the numbers are equal. What changes is how eager each side is
- (B) Because only sellers can move prices
- (C) Because prices are set by the exchange
- (D) Because buyers never affect the price

2. What are investors mainly paying for when they buy a share?

A Last year's profits
B The share certificate
C The company's office buildings only
D The company's expected future profits

3. Analysts expect EPS of $0.48 and the company reports $0.52. What is this called?

A A miss
B A beat
C A gap
D Guidance

4. Bright Bean beats estimates but cuts its forecast for next year. Why might its shares fall?

A Beats always make shares fall
B The exchange punishes beats
C Lower guidance changes expectations about future profits, which matter more than the past quarter
D Because the report came after the close

5. A stock has a beta of 1.5. If the market rises 2%, what would you expect on average?

A It falls 3%
B It rises about 1%
C It rises about 3%
D It does not move

6. Why do rising interest rates often hurt fast-growing companies the most?

A They pay the most dividends
B They have no customers
C They are not allowed to borrow
D Much of their value comes from profits far in the future, which are worth less today when rates are higher

7. What happened to the S&P 500 in 2022 as the Fed raised rates from near zero to 4.25% to 4.50%?

A It rose 19.4%
B It was unchanged
C It fell 19.4%
D It fell 80%

8. From February 19 to March 23, 2020, the S&P 500 fell about 34%. When had it recovered to a new record?

A Within about five months, by August 2020
B Ten years later
C It never recovered
D The next day

Answer key

1 A

Because every share bought is also sold, so the numbers are equal. What changes is how eager each side is

Every trade has a buyer and a seller. Prices move because one side is more eager than the other, so the price shifts until they agree again.

2 D

The company's expected future profits

A share's value depends on what the business will earn. Past profits are already earned; prices move when the view of the future changes.

3 B

A beat

Results above the consensus estimate are a beat. Results below it are a miss.

4 C

Lower guidance changes expectations about future profits, which matter more than the past quarter

Investors pay for future profits. A weaker outlook can outweigh a good past quarter.

5 C

It rises about 3%

A beta of 1.5 means the stock has tended to move about one and a half times as much as the market, so about 3% for a 2% market move. It is only an average.

6 D

Much of their value comes from profits far in the future, which are worth less today when rates are higher

Higher rates reduce the present value of distant profits, and growth companies' profits lie mostly in the future.

7 C

It fell 19.4%

The S&P 500 fell 19.4% in 2022, its worst year since 2008, as the Fed raised rates seven times to fight inflation.

8 A

Within about five months, by August 2020

After central banks and governments stepped in, the index reached a new record high in August 2020. Panic sellers near the bottom missed the recovery.

SOURCES

- Associated Press, S&P 500 closes out dismal year with worst loss since 2008 (December 30, 2022): https://www.fox13now.com/news/national/s-p-500-closes-out-dismal-year-with-worst-loss-since-2008
- Reuters, Say goodbye to the shortest bear market in S&P 500 history (August 2020): https://www.investing.com/news/stock-market-news/say-goodbye-to-the-shortest-bear-market-in-sp-500-history-

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- Nasdaq, Glossary: Beta: https://www.nasdaq.com/glossary/b/beta

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