Chapter 1.2

Determining Share Values

Contents

DETERMINING SHARE VALUES

Share prices move up and down, then up and down, and it is this price movement that motivates people to trade shares and CFDs. After all, if share prices didn't move up and down then you couldn't make any money trading shares and CFDs, and you wouldn't be here.

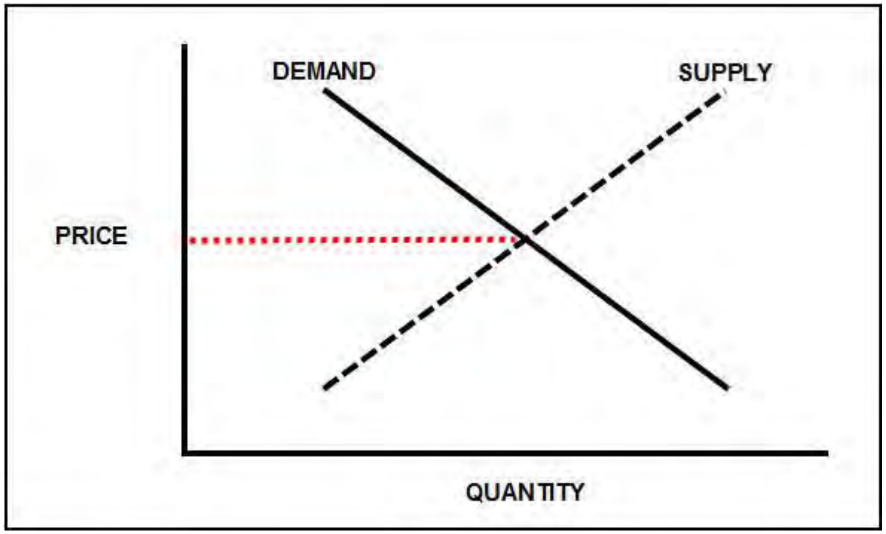
The question is what causes share prices to move up and down? Why is a share worth one price one moment and another price a few seconds later? The answer is there are many reasons shares move up and down. These can be anything from earnings announcements to economic recessions. But it all depends on the forces of supply and demand. To be successful you have to pay attention to the big picture and avoid getting caught focusing on only one or two factors.

To help you understand why share prices move up and down in value we will look at the following:

SUPPLY AND DEMAND IN THE SHARE AND CFD MARKETS

Share and CFD prices are driven by the forces of supply and demand. Supply is driven by the number of shares or CFDs that is available to the investing public. Demand is driven by the desire of traders to buy or sell a share or CFD.

Here you can see a typical supply and demand chart. Demand is represented by the line that is sloping downward from left to right, and supply is represented by the line that is sloping upward from right to left. The point at which these two lines cross represents the price the market will accept for the share or CFD.



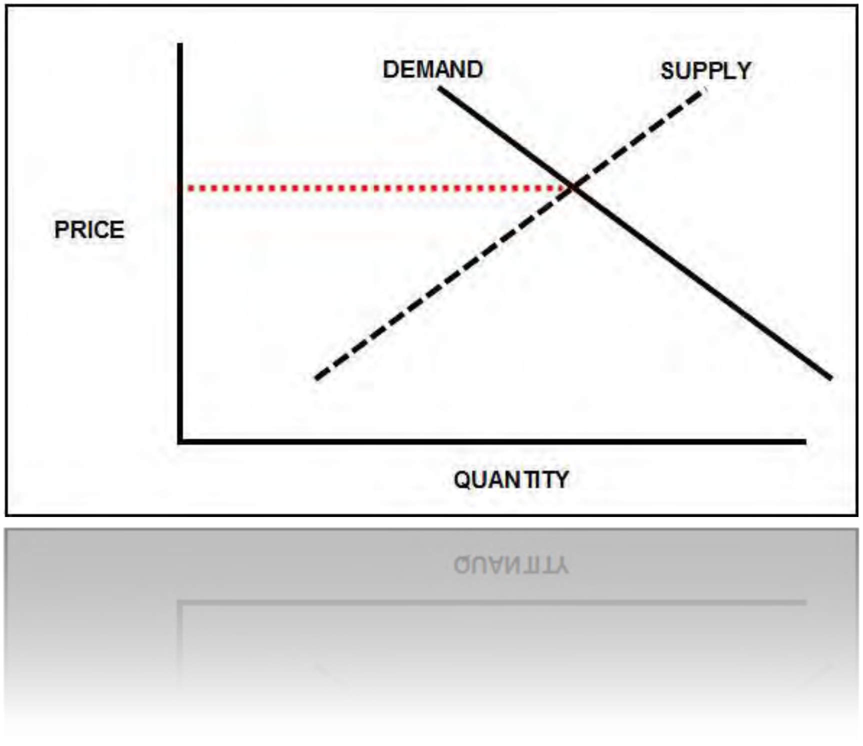
Both supply and demand can increase and decrease depending on various market conditions. We are going to look at how the following can impact on the value of a share or CFD:

-	Increasing demand
-	Increasing supply
-	Decreasing demand
-	Decreasing supply

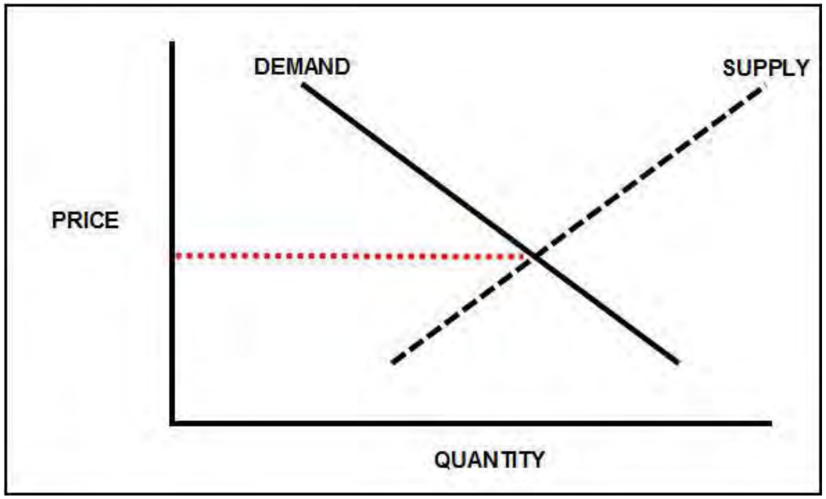
How Increasing Demand Affects Share and CFD Values

Increasing demand for a share or CFD increases the value of that share or CFD.

Looking at the supply and demand chart to the right you can see that, as demand increases, the demand curve moves further to the right on the chart. As it moves further right, the point at which the demand curve crosses the supply curve also moves higher and higher. This tells you that increasing demand for a share or CFD increases the value of that share or CFD.



Demand for a share or CFD can increase when companies announce better-than-expected earnings for the quarter or the year. For example when Apple Inc. (AAPL:xnas) announced the earnings boost the company had received thanks to incredible sales of Apple's new gadget, the iPod, traders jumped in to buy the share in the hopes the company would continue to have stellar earnings.



How Increasing Supply Affects Share and CFD Values

Increasing supply of a share or CFD decreases the value of that share or CFD.

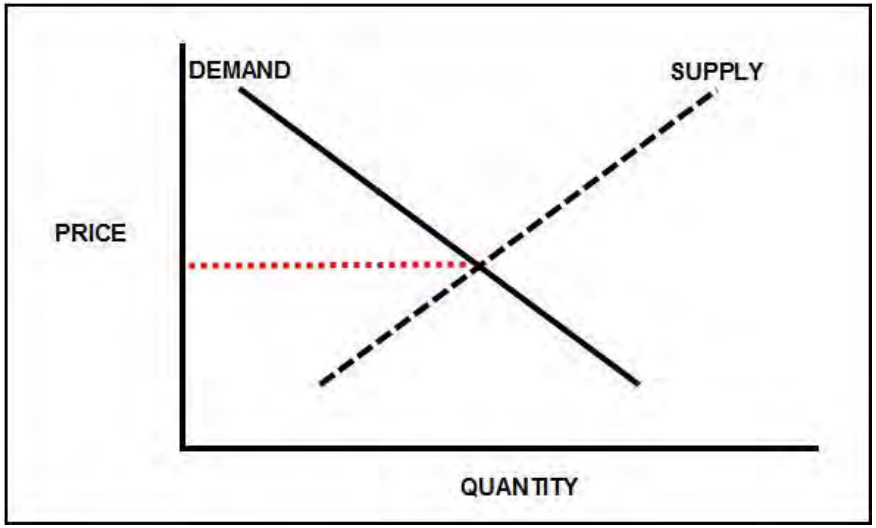
Looking at the supply and demand chart to the right, you can see that as supply increases, the supply curve moves further to the right on the chart. As it moves further right, the point at which the demand curve crosses the supply curve also moves lower. This tells you that increasing supply of a share or CFD decreases the value of that share or CFD.

Supply of a share or CFD can increase when a major share-market index removes a share from the index. For example Honeywell (HON:xnys), an industrial supply manufacturer, used to be a component of the Dow Jones Industrial Average. However, as economic conditions made Honeywell a less significant share in the broader market the Dow Jones decided to remove it from its premier index. As a result of this delisting many fund managers who maintain portfolios based on the Dow Jones Industrial Average were forced to sell their shares of Honeywell, increasing the supply of Honeywell shares for sale in the market.

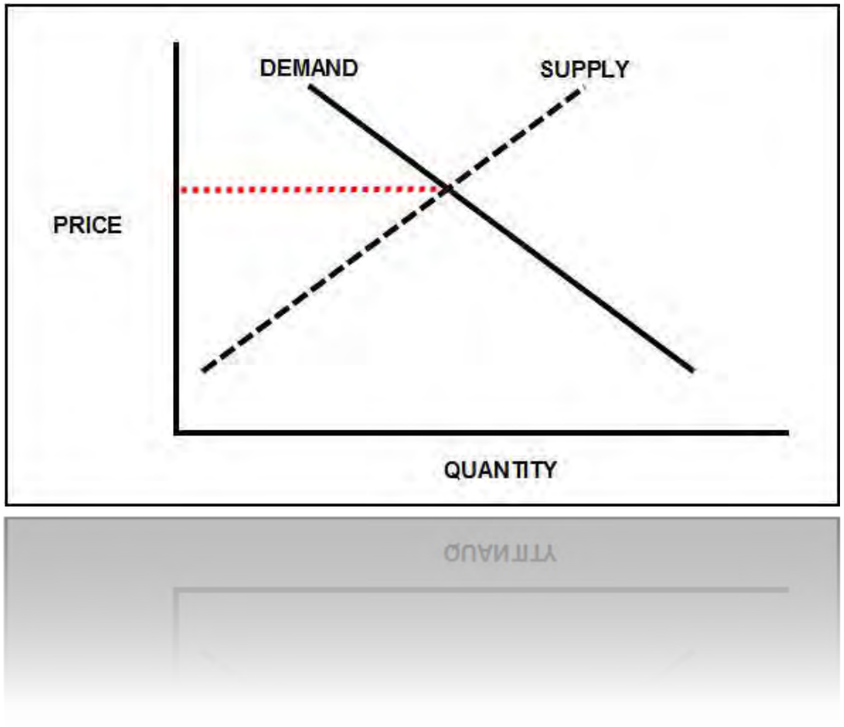
How Decreasing Demand Affects Share and CFD Values

Decreasing demand for a share or CFD decreases the value of that share or CFD.

Looking at the supply and demand chart to the right, you can see that as demand decreases the demand curve moves further to the left on the chart. As it moves further left, the point at which the demand curve crosses the supply curve also moves lower. This tells you that decreasing demand for a share or CFD decreases the value of that share or CFD.



Demand for a share or CFD can decrease as traders hear bad news or rumours about a company. For instance the international pharmaceutical manufacturer Merck & Co. (MRK:xnys) was forced to withdraw its blockbuster arthritis drug Vioxx, in 2004 due to reports of increased heart-attack risks for patients taking the drug. As you can imagine, traders were concerned that the loss of revenue from Vioxx sales and the possible losses from litigation would dramatically affect Merck's profitability. As a direct consequence of that demand for Merck's share faded.



How Decreasing Supply Affects Share and CFD Values

Decreasing supply of a share or CFD increases the value of that share or CFD.

Looking at the supply and demand chart to the right, you can see that as supply decreases the supply curve moves further to the left on the chart. As it moves further left, the point at which the demand curve crosses the supply curve also moves higher. This tells you that restricting the supply of a share or CFD increases the value of that share or CFD.

Supply for a share or CFD can decrease as companies buy back their shares. Companies with extra cash on hand that feel their share is trading at a low price will often buy back their own shares to drive the value of the share higher and make an investment in the company.

Now that you understand how changes in supply and demand can affect share and CFD prices, you need to understand what causes those changes in supply and demand. Or, rather, who causes those changes.

SHARE AND CFD MARKET PARTICIPANTS

The share and CFD markets bring many different groups and people together in one place to trade, and each one affects the forces of supply and demand. However, whilst these different groups and people may be coming to the same place to trade, no two market participants are exactly alike. Each market participant has a personal agenda and individual set of needs to consider when trading. Some market participants are looking to quickly get in and out of trades while others are looking to buy and hold shares or CFDs for long periods of time. Some market participants have huge sums of money they need to invest while others have smaller individual accounts. Understanding the needs and objectives of various market participants can help you better understand what is happening in the market and put yourself in a position to benefit from price movements.

For the purposes of this discussion we will divide the major market participants into two major groups:

-	Institutional investors
-	Individual investors

Institutional investors are large and professional investors who typically control huge sums of money. This group usually involve themselves in mutual funds, hedge funds, pension funds and so on. Since they are so large and influential, this is the group you should focus on when determining how you believe supply and demand will change in the future.

Individual investors are people like you who may trade shares and CFDs for a living or may just be trading shares and CFDs as a sideline to boost their income and net worth. This group need not play a significant role in your analysis.

Institutional investors drive the markets. Because they have so much money under their management they have the ability to move the price higher or lower when they decide to buy or sell shares. As you can imagine, a trader who is looking to buy perhaps 1,000,000 shares will drive prices more than a trader who is looking to buy just 100 shares.

Most institutional investors operate under strict mandates to follow certain trading rules and invest in specific asset classes. For example some funds are known as large-cap funds. This means they are only able to buy shares in companies that have a market capitalization of over $5 billion. As another example, some funds are known as technology funds. This means they are only able to buy shares in technology-based companies such as Microsoft (MSFT:xnas) or Google (GOOG:xnas).

Knowing what institutional traders are doing in their portfolios can help you to determine how the forces of supply and demand are going to change and how those changes are going to affect the share price. Of course unless you have a seat in their offices you are never going to know exactly what these institutional traders are doing. However, if you know what these institutional traders are watching when they make their trading decisions you can watch the same things and have a pretty good idea of what they might do next.

FACTORS THAT AFFECT SHARE PRICES

Many different factors affect share prices. A few key factors tend to play a more important role in determining the value of a share than others. Generally speaking, the following are the four factors that you should watch most closely:

-	Earnings and other fundamentals
-	Dividends
-	Economic announcements
-	General shifts in market/sector strength

Earnings and Other Fundamental Numbers

Company performance is a major driving force behind share prices. After all, when you buy a share you are buying a piece of the company which gives you the right to participate in its successes and failures. Naturally, if a company is performing well then more and more traders will be interested in buying that company's share. This will increase demand for the share and generally drive its price higher. If a company is performing poorly, however, fewer and fewer traders will be interested in buying that company's share. This will decrease demand for the share and generally drive its price lower.

When determining how well a company is performing, traders and analysts will look at various fundamental numbers (i.e. numbers derived from a company's balance sheet and income statement). Company earnings - the amount of money a company makes after it has paid all of its expenses - is typically the most important fundamental number that traders look at. However, there are other fundamental numbers such as the return on equity (ROE) and the price-to-book ratio that give traders an indication of the overall health of a company. You will learn more about company fundamentals in a later section.

Dividends

Companies can do one of two things when they make money: they can keep it and reinvest it in the company or they can pay it out to shareholders in the form of a dividend. Dividends are cash payments made to shareholders based on the number of shares owned. For example if a company with 1,000,000 shares issued paid a £5,000,000 dividend, each shareholder would receive £5 per share.

Traders place tremendous value on dividends because they know they will be receiving regular cash payments on their investments. Because dividends are prized so highly, a company can typically increase the value of its shares by paying a larger dividend (as long as the company's profits are growing as well). Shares from companies with increasing dividends generally enjoy price increases, while shares from companies with decreasing dividends generally see price decreases. Unfortunately fewer and fewer companies are actually paying dividends nowadays, choosing instead to keep the money in retained earnings to reinvest in the company.

Economic Announcements

Economic announcements are those announcements released by governments and other large groups regarding information that affect the economy as a whole, not just individual companies. This includes announcements such as interest-rate statements and gross domestic product (GDP).

Most of the economic news that is going to be important to you as a share and CFD trader is scheduled months in advance. For instance you will know a year in advance when the U.S. Federal Open Market Committee (FOMC) is going to be meeting to discuss interest rate changes. Likewise in the UK the government's budgets and mini-budgets are scheduled well in advance of the actual event. This gives you plenty of time to research the likely content of announcements and position your portfolio accordingly.

Thursday, 29-Nov-2007

Time	Country	Event	Period	Consensus	Prior
7:00 AM		ILO Unemployment Rate	OCT	- -	- -
8:30 AM		GDP s.a. (QoQ)	3Q	- -	- -
8:30 AM		GDP w.d.a. (YoY)	3Q	- -	- -
8:55 AM		Unemployment Change (000's)	NOV	- -	- -
8:55 AM		Unemployment Rate (s.a)	NOV	- -	- -
9:00 AM		PPI (MoM)	OCT	- -	- -
9:00 AM		PPI (YoY)	OCT	- -	- -
9:30 AM		M4 Money Supply (MoM)	OCT F	- -	- -
9:30 AM		M4 Money Supply (YoY)	OCT F	- -	- -
9:30 AM		M4 Sterling Lending (BP)	OCT F	- -	- -
12:00 PM		NBNZ Business Confidence	OCT	- -	- -
1:30 PM		GDP Price Index	2Q P	- -	- -
1:30 PM		GDP Annualized	3Q P	- -	- -
1:30 PM		Personal Consumption	2Q P	- -	- -
1:30 PM		Initial Jobless Claims	24-Nov	- -	- -
3:00 PM		New Home Sales	OCT	- -	- -
3:00 PM		Help Wanted Index	OCT	- -	- -
3:00 PM		New Home Sales MoM	OCT	- -	- -
3:30 PM		EIA Natural Gas Storage Change	23-Nov	- -	- -

#ÏòÎ îò4òÁÄÅò provides an up-to-the-minute economic calendar so you can know exactly what news is scheduled to be released today, tomorrow and into the future.

A quick glance at the economic calendar lets you know about important upcoming events that have the potential to change or accelerate the movement of the currency pairs you are watching. These events might include announcements involving German unemployment data, U.K. money supply and U.S. gross domestic product (GDP).

Investment analysts, economists and other market participants are constantly analyzing upcoming economic announcements, trying to determine ahead of time what the news is going to be. Whilst no two analysts will arrive exactly the same conclusion, if you look across the various estimates you can determine what the average estimate is. This average estimate is also known as the "consensus estimate."

Knowing what this consensus estimate is will help you to take advantage of price movements once the economic announcement is released, because the consensus estimate will already be "priced in" to the value of the shares and CFDs you are watching. Here's how it works.

Once investors complete their analyses they start placing their trades to take advantage of where they believe currencies are going to move in the future. They don't wait until the announcement comes out. They want to be ahead of the market. So, by the time an economic announcement is released, most of the major market participants have already placed their trades.

If an economic announcement is released, and the number matches the consensus estimate, share and CFD prices will most likely not move very much. Since most of the big traders have already placed their trades, there are no new traders to jump in and move the shares and CFDs. If, however, the actual number from the economic announcement is higher or lower than the consensus estimate, the price of shares and CFDs will have to adjust either up or down to factor in the new economic information.

During this time, when market participants are scrambling to factor in the new information, you have an excellent opportunity to take advantage of the price movement.

General Shifts in Market/Sector Strength

Companies would like to think that their corporate performance is the only thing that should be driving their share price. Unfortunately for them, other forces in the general market can lift or lower share values regardless of what is happening within specific companies.

There's an old adage thatevery share and CFD trader ought to know: "A rising tide floats all boats." This means that when you are in a bullish market most shares are going to be going up because the market and the economy in general are going up and growing. On the other hand it also means that when you are in a bearish market most shares are going to be going down because the market and the economy in general are going down or shrinking.

Just as the market in general can be moving higher or lower, certain sectors within the market can also be moving higher or lower. For instance, healthcare shares may be moving higher at the same time retail shares may be moving lower. Bullish and bearish forces within individual sectors can have the same impact on the shares within those sectors as bullish and bearish forces can have on the overall market.

You will learn more about analyzing market and sector trends in a later section. At this point simply knowing that these forces exist most likely puts you well ahead of the majority of retail traders.

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