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Market Mechanics:

A Guide to U.S. Stock Markets

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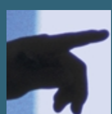

Although the inner workings of the stock market are fascinating, few introductory texts have the space to describe them in detail. Furthermore, the U.S. stock markets have been changing so rapidly in recent years that many books have not yet caught up with the changes. This quick note provides an up-to-date view of how the U.S. stock markets work today. This note will teach you about:

- The functions of a stock market;
- Stock markets in the United States, including Nasdaq and the NYSE;
- The difference between limit and market orders;
- How stock trades take place; and
- Lots of other interesting tidbits about the stock market that you wanted to know, but were afraid to ask.

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Market Mechanics: A Guide to U.S. Stock Markets

DISH EBAY ERICY ERTS ESRX FISV FLEX GENZ GILD GMST HGSI ICOS IDPH IDTI IMCL IMNX INTC INTU ITWO

What a Stock Market Does

The stock market provides a mechanism where people who want to own shares of stock can buy them from people who already own those shares. This mechanism not only matches buyer and seller, but it also provides a way for the buyer and seller to agree mutually on the price. Note that when you buy shares in a *publicly traded* company such as Microsoft, you are not buying the shares from the company itself. You are buying the shares from another investor who already owned the shares. This is what economists call a *secondary market* for shares.

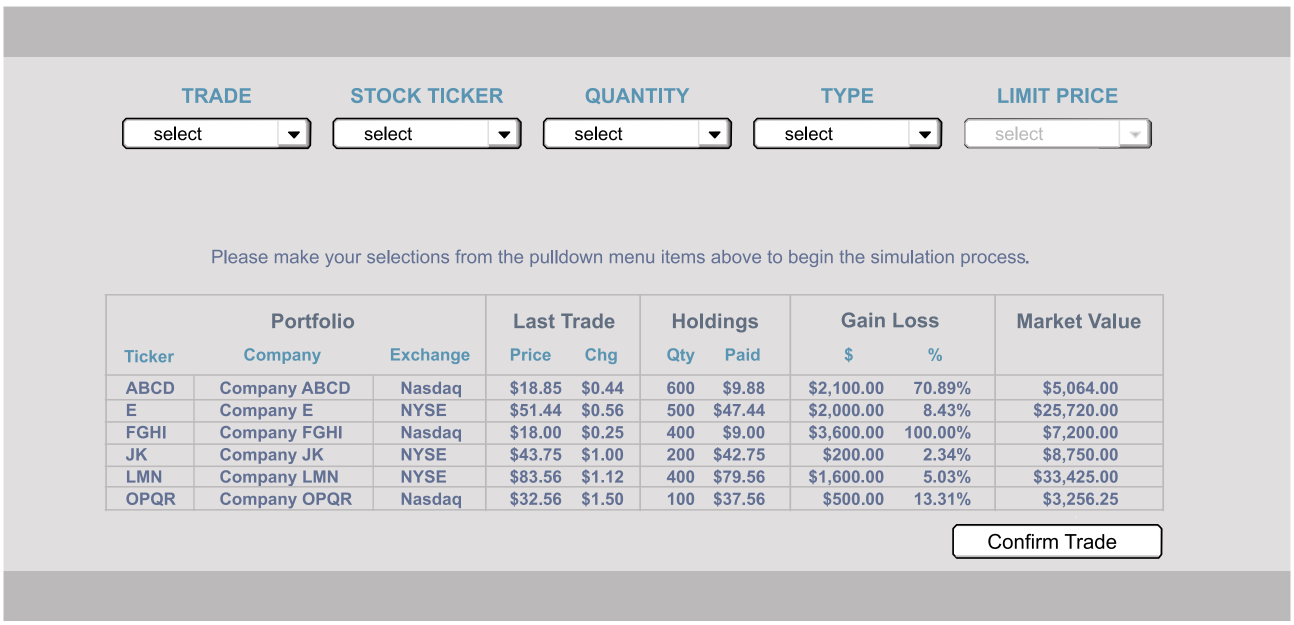
This is different from the *primary market* in which the company sold the shares directly to investors in the first place. The *initial public offering* (IPO) occurs when the company first sells shares to the public and arranges for the secondary trading of its shares.

Financial markets perform a number of vital economic functions in our economy. First, the primary market provides promising companies with the capital they need to invest in growing their businesses. Second, financial markets provide investment opportunities to investors. Third, stock prices provide important signals about where the most productive opportunities are. These signals channel *capital* to the areas that investors think are most productive. Finally, the financial markets provide important risk-management tools by letting investors diversify their investments and transfer risk from those less able to tolerate risk to those who can better tolerate risk.

What Happens When You Place a Stock Order?

One way to understand the stock market better is to explore the process of trading a stock step-by-step. Suppose that you wanted to buy 500 shares of a common stock. In this example, we will use the mythical firm Company ABCD Inc., whose *ticker symbol* just happens to be ABCD. In order to buy this stock, you have to find someone willing to sell you the shares. If your cousin or your next-door neighbor wants to sell you the shares, that is fine. There is no law in the United States that requires an individual to go through a registered broker in order to buy or sell shares of stock. However, most of the time investors need help to find the other side of the trade, which is what brokerage firms do. (And most brokerage firms won't sell you shares in nonexistent firms, but that neighbor might!)

For a simple retail order, the investor tells the brokerage firm what he or she wants to do. This can be done in person, over the phone, through the mail, or via the Internet. For example, you might click on your broker's web site and find a screen that looks like this:



Portfolio			Last Trade		Holdings		Gain Loss		Market Value
Ticker	Company	Exchange	Price	Chg	Qty	Paid	$	%	
ABCD	Company ABCD	Nasdaq	$18.85	$0.44	600	$9.88	$2,100.00	70.89%	$5,064.00
E	Company E	NYSE	$51.44	$0.56	500	$47.44	$2,000.00	8.43%	$25,720.00
FGHI	Company FGHI	Nasdaq	$18.00	$0.25	400	$9.00	$3,600.00	100.00%	$7,200.00
JK	Company JK	NYSE	$43.75	$1.00	200	$42.75	$200.00	2.34%	$8,750.00
LMN	Company LMN	NYSE	$83.56	$1.12	400	$79.56	$1,600.00	5.03%	$33,425.00
OPQR	Company OPQR	Nasdaq	$32.56	$1.50	100	$37.56	$500.00	13.31%	$3,256.25

What this information says is that the last reported trade in ABCD stock took place at $18.85. Right now, the best bid is also $18.85, which means that someone is willing to pay $18.85 for up to 10,400 shares of ABCD. If you owned this stock and wanted to sell it immediately, you could sell up to 10,400 shares right now at that $18.85 price. The ask price (sometimes called the offer price) indicates that someone is trying to sell up to 1,000 shares of ABCD at $18.88. If you wanted to buy immediately, you could buy up to 1,000 shares at $18.88. Thus, a market order to buy 500 shares would likely be filled at a price of $18.88. The difference between the bid and ask price is known as the *bid-ask spread*, and represents part of the cost of trading stock. Another way to remember the difference between bid and ask prices is to think of the bid price as the price you get when you "trade-in" the stock and the higher ask price as the price you pay when you buy something at the retail price.

Market Orders

On this page, you enter what you want to do – in this case, buy 500 shares of ABCD. So far, so good. But at what price? If you want your broker to get you the stock fast at the best price available at the moment, you would place a *market order*. What price are you likely to get? You can find out before you place the order by getting a quote that shows the current *bid* and *ask prices*. For example, the quote for ABCD might look like this:

Bid price: $18.85 > **Bid size:** 10,400

Ask price: $18.88 > **Ask size:** 1,000

{**Last trade: $18.85**}

Reading the Stock Table

YTD % CHG: The stock price percentage change for the calendar year-to-date, adjusted for stock splits and dividends over 10%.

52 WEEKS HI LO: The highest and lowest reported prices in the last 52 weeks.

SYM: The "ticker" symbol, an abbreviation that uniquely identifies the stock. Brokerage firms and markets usually use these abbreviations to make sure that there is no confusion about the security in question, because many stocks have similar sounding names.

DIV: The annual dividend expected to be paid by the firm.

YLD %: The annual dividend divided by the share price as a percentage.

PE: The PE is the Price-Earnings ratio, which is calculated by dividing the closing stock price by the latest 12 months of earnings, if the company had positive earnings. The PE is a quick "back-of-the-envelope" measure of how expensive the stock is compared with its current earnings. Generally, investors are willing to pay more for stocks with good prospects for future growth, and such stocks therefore have higher PE ratios.

VOL 100s: The reported share volume in lots of 100 shares.

LAST: The last reported price from the regular trading day, which currently ends at 4:00 p.m.

NET CHG: This shows the difference between the most recent closing price and the closing price for the day before.

YTD %CHG	52 Weeks Hi	52 Weeks Lo	SYM	DIV	YLD%	PE	VOL(100s)	LAST	Net CHG
+12.4	28.15	9.50	(ABCD)	1.00	5.31	35	12,345	18.85	0.44
-2.5	37.95	29.25	(OPQR)	0.60	1.20	13	5,678	32.55	–0.80

If $18.88 is acceptable to you, you might go ahead and place a market order and would probably get it filled at $18.88. Of course, if someone else snaps up those 1,000 shares before your order arrives, the price you get could be slightly higher. Conversely, you will sometimes get a better price than you expected, called "price improvement," if someone willing to sell at a lower price shows up just as your order arrives.

Limit Orders

On the other hand, suppose that you are willing to be patient and think that you might be able to get a better price. You could tell your broker the maximum price that you are willing to pay, in which case your order is called a *limit order*, because you have placed a limit on what you are willing to spend. You would also tell your broker how long the order is valid. A day order expires at the end of the normal trading day. A good-'til-canceled order does not expire until you cancel it, although many brokers will automatically cancel such orders if they are not filled within 30 or 60 days.

For example, you could place a limit order to buy 500 shares of ABCD at $18.50 per share. Such an order is less than what others are willing to pay right now, so it would not be filled immediately. If, however, the market price came down a bit, this order might get filled. On the other hand, if the price goes up, then the order may never be filled. This is the trade-off with a limit order: you might get a better price by being patient, or your order may never get filled at all.

Trade Execution

Well, placing an order is one thing, but what happens next? Your broker is under a legal obligation to make sure that you get the *best execution* for your order. If ABCD is listed on The Nasdaq Stock Market®, your broker can send the order to a market maker, an order-matching facility called an *alternative trading system* (ATS) or an *electronic communications network* (ECN), a regional stock exchange, or, if the firm has order entry authorization, directly into the Nasdaq trading systems. Market makers are businesses that make a living by buying stock when others want to sell, and by selling when others want to buy. Just like a shopkeeper, they often keep inventory on hand to provide their customers with immediate service. They make their money by buying at the low bid price and selling at the higher ask price, along with profits and losses on the inventory that they hold. Because the average bid-ask spread on a Nasdaq National Market® stock is less than five cents, one market maker describes his business as one of "picking up nickels and dimes in front of the steam roller of rapidly changing stock prices." There are over 300 market-making firms in the Nasdaq® market. Some market-making firms make markets in only a few select stocks, and others make markets in thousands of stocks. Many of these market-making firms also have retail brokerage and investment banking operations, and the market-making to support these other business lines. The average Nasdaq stock has over 10 market makers competing for business in that stock, and many of the largest stocks have over 50 market makers.

The Nasdaq Stock Market gathers the quotes from all of these market participants, both market makers and ATSs, and displays them in the Nasdaq quote montage. The quotes from the individual participants can be viewed on the Nasdaq Workstation. Nasdaq also provides systems that link all of these participants together, so that your broker can route your order electronically to a market maker or ECN, and so that other participants can also trade with each other electronically.

Typically, your broker decides where to send your order. Some brokers, called direct access brokers, allow you to choose how your order will be processed. Most individuals, however, let their brokers do the work of choosing how to process the order.

At any given time, several market makers may be quoting the best price. In addition, other market-making firms often guarantee that they will match the best price, whatever it happens to be at that moment. How does your broker choose where to send the order? Like other businesses, market-making firms compete not only on price but also on other factors of execution quality, such as the speed of filling orders, accuracy of those orders, and quality of customer service (when problems do arise). Some market makers will not only agree to match the best price, but also to trade in larger sizes than the best quote in the market, the so called "depth improvement." Some large brokerage firms are vertically integrated and act as market makers as well as brokers. They feel they can serve their customers faster and with less chance for error by filling the orders in-

What is an ECN?

You may have heard a lot about ECNs and the Nasdaq marketplace. ECN stands for electronic communications network, a facility that matches customer buy and sell orders directly through a computer. There are several ECNs within the Nasdaq market that compete to provide the best service for their customers. The rise of ECNs demonstrates how the open architecture of the Nasdaq marketplace allows innovative firms with different technologies to compete in trading stocks.

ECNs accept orders directly from their own subscribers in addition to customer orders routed from other brokerage firms. Suppose a customer (or his or her broker) submits an order electronically to buy 100 shares of ABCD at $18.75 per share. The ECN would display this order in its computer system. ECNs let their paying subscribers see their entire order books, and some, like Island and Archipelago, display their order books on the web. The ECNs also display their best bid and offer orders (the top of their order book) in the Nasdaq quote montage so that other market participants can see them.

In this example, the ECN would add the order to buy 100 shares of ABCD at $18.75 per share to its book. If another person wanted to sell those shares at $18.75, he or she would electronically submit an order to the ECN to sell the shares at $18.75. The ECN then matches the buy and sell orders, and the trade is complete. ECNs make their money by charging fees to people who trade using their systems.

To the right is an example of the order book in ABCD from a typical ECN:

Note that there are orders to buy ABCD at $18.83, the ECN's best bid, and to sell ABCD at $18.90, the ECN's best ask price. These are not necessarily the best prices in the whole market, just the best prices in the book of that particular ECN. The ECN then transmits its best bid and offer into the Nasdaq quote montage so that all market participants, not just the ECN's subscribers, can see the best bid and offer quotes in the entire market.

There are several ECNs in the Nasdaq market. The two biggest are Instinet, owned by Reuters, and Island. Other major ECNs include Archipelago, REDI-Book, Bloomberg, and Brut. As with the exchanges themselves, there is likely to be considerable consolidation among ECNs, and ECNs themselves may apply for exchange registration. For instance, in November 2001, Archipelago and REDI-Book announced an intent to merge under the name Archipelago, less than one month after the SEC approved Archipelago's application for exchange status. Altogether, about one-third of Nasdaq's volume passes through ECNs. Some people erroneously think that ECNs have "taken" this volume from Nasdaq. However, by giving investors additional ways to trade, ECNs have actually added significantly to the trading volume in Nasdaq-listed stocks.

ECN	*Percent of Nasdaq Share Volume 2001*
Instinet	13.30%
Island	8.80%
REDIBook	4.10%
Archipelago	2.30%
B-Trade	1.80%
Brut	1.70%
Attain	0.20%
Nextrade	0.20%
Market XT	0.10%
GlobeNet	0.00%
Total	32.50%

Source: Nasdaq

ABGX ADBE ADCT ADLAC ADRX ALTR AMAT AMCC

Snapshot of ECN Book for ABCD

BUY ORDERS		*SELL ORDERS*	
SHARES	PRICE	SHARES	PRICE
1,000	18.83	3,800	18.90
1,000	18.80	1,600	18.90
1,000	18.80	1,000	18.90
5	18.75	1,000	18.90
500	18.75	1,000	18.90
700	18.75	100	18.90
80	18.75	1,500	18.90
600	18.75	200	18.90
1,000	18.75	5,000	19.00
11	18.75	420	19.00
100	18.75	500	19.00
580	18.75	100	19.00
370	18.75	300	19.00
385	18.60	100	19.00
250	18.60	500	19.00

house (matching, of course, the best price in the market) and not sending the order out to another market maker. In this way, they can earn not only brokerage commissions, but also any trading profits. The competition between market makers for orders is so intense that some market makers even share part of their trading profits with the brokerage firms that send them orders, a practice often referred to as "payment for order flow."

Your broker has a legal obligation to get you the best possible execution for the trade and will weigh a variety of these factors in choosing where to send your order. Sometimes the brokerage firm routes the order to the market maker or alternative trading system (ATS), such as an ECN, that is displaying the best price. Some firms find it more efficient to route all orders in a given stock to a single market maker who promises to match the best price at the moment rather than try to chase after the market maker who just happens to have the best price at the moment, because those shares may be gone before the order gets there.

What if you place a limit order instead of a market order? Obviously, if your limit price is "away from the market," that is, not close to the prices at which the stock is currently trading, you may not get the rapid fill that you would get with a market order. Just as with market orders, there are numerous market makers and ECNs competing for the order. Your broker has a strong financial incentive to send the order to the market maker or ECN that offers the best chance of filling the order. After all, if the limit order is not filled, your broker does not get a commission. If the limit price on your order is better than the best price currently in the market, then the market maker or ECN with the order is legally required to display that quote through the Nasdaq system so that other investors can find out about it and perhaps trade with it. Also, under the Manning rules (named after an arbitration case that established the rule), a customer order takes precedence over market makers trading for their own inventory, so that a market maker holding a customer order has to fill that order if it trades at the same price or better.

After the trade is executed, the parties to the trade report the trade to Nasdaq, which transmits the information to the outside world through data vendors. The trade details are passed on to *Depository Trust and Clearing Corporation* (DTCC) so that *settlement* can take place after the trade, currently on the third business day thereafter (or "T+3").

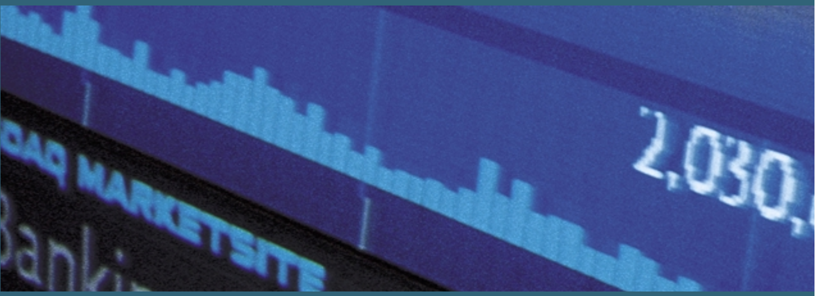
What if you wanted to trade a stock that was not Nasdaq-listed? Then a different, but still similar, process is used. Suppose you wanted to buy 500 shares of a stock listed on the New York Stock Exchange (NYSE), Company E, Inc., (ticker symbol: E). You would enter the order just as you would for a Nasdaq-listed stock, but the trading process is a little different. Your broker still chooses where to send the order, but the broker has different choices. NYSE-listed stocks trade not only on the NYSE, but also on the *Nasdaq InterMarket*SM (formerly known as the Third Market), several regional stock exchanges, and ATSs/ECNs. These different exchanges are connected via the *Consolidated Quotation System* (CQS) which displays quote information, and the *Intermarket Trading System* (ITS) which allows one exchange to send trading interest to another exchange. After the trade, the participants report the trade details to the *Securities Industry Automation Corporation* (SIAC), which disseminates the information to the outside world through data vendors. Just as with Nasdaq trades, a trade in an NYSE-listed stock settles through DTCC.

Stock Markets in the U.S.

The largest primary stock markets in the United States are The Nasdaq Stock Market (Nasdaq), the New York Stock Exchange (NYSE), and the American Stock Exchange (Amex). The companies that issue stock to the public choose where they will list their stock for trading. This

Foreign Stocks in the U.S.

Investors can buy shares in hundreds of leading foreign companies just as easily as they can buy stocks in U.S. companies through American Depository Receipts (ADRs). Normally, it is difficult and expensive for U.S. investors to trade foreign shares because they would have to deal with foreign markets that are open at different times, and then deal with the problems of settling trades in other countries in different currencies. An ADR program simplifies the process dramatically. An ADR is a U.S. security issued by a bank that represents an ownership interest in the foreign security. Unlike the foreign security, the ADR trades in the U.S. just like a regular U.S. stock. ADR trades can be executed easily through regular brokerage channels and are denominated in dollars. Furthermore, shareholders receive their annual reports in English and receive their dividends in U.S. dollars.



Depository Trust and Clearing Corporation (DTCC)

Although some investors may think that a trade is finished immediately after they click "place order," it really isn't. A job is never finished until the paperwork is done. Even though the buyer and seller have agreed on the price and quantity to be traded, the money has not yet been exchanged for shares of stock. This process, called settlement, usually takes place in the United States on the third business day after the trade, fondly known as "T+3." The Depository Trust and Clearing Corporation (DTCC) handles the post-trade processing that results in the exchange of cash for the shares. DTCC also operates a vault underneath Manhattan that stores most of the physical stocks and bonds in the United States. If you leave your stock in a brokerage account, where it is held in *street name*, your brokerage firm usually stores the stock in its account at DTCC. Thus, when the time comes to deliver the stock to another investor, the transaction can be done through a simple book-entry on DTCC's computers, without having to move physical paper stock certificates. This reduces costs substantially.

means that they apply to have their shares traded on the market and are willing to abide by the investor protection rules of that market. In addition, they must prove that they meet the *listing requirements* for that market, as well as pay a listing fee to the chosen market.

An investor may trade shares in some companies that are not listed on any market. These companies either do not qualify for trading on a stock market, or they have decided for other reasons not to apply for listing. An *over-the-counter* (OTC) security, generally, is any equity that is not listed or traded on a national securities exchange or market. Such issuing companies, if they have filed registration statements with the *Securities and Exchange Commission* (SEC), can be traded on the *OTC Bulletin Board®* (OTCBB), which carries dealer quotes for those stocks.

Stock Markets in the U.S. by Trading Volume, 2001

MARKET	*Total Share Volume (in thousands of shares)*	
The Nasdaq Stock Market	471,216,589	56.42%
New York Stock Exchange	307,509,256	36.82%
Chicago Stock Exchange	30,374,550	3.64%
American Stock Exchange	16,316,745	1.95%
Boston Stock Exchange	6,287,000	0.75%
Philadelphia Stock Exchange	2,100,000	0.25%
Pacific Exchange	1,452,965	0.17%
Total	**835,257,105**	**100.0%**

Sources: Nasdaq, NYSE, Chicago, Boston, Pacific

Although Nasdaq operates the Bulletin Board, the OTCBB serves as a fully separate quotation medium for subscribing members, not an issuer listing service, and should not be confused with the Nasdaq market. OTCBB securities are traded by a community of market makers that enter quotes and trade reports through a highly sophisticated, closed computer network, which is accessed through Nasdaq Workstation II™. The OTCBB is unlike Nasdaq in that it does not impose listing standards, does not provide automated trade executions, does not maintain relationships with quoted issuers, and does not have the same obligations for market makers. Investors may also trade the shares of companies that are not even registered with the SEC, through the Pink Sheets LLC, a privately owned company whose Electronic Quotation Service provides an Internet-based, real-time quotation service for OTC equities and bonds.

Investors can and do trade stocks in a variety of different markets, regardless of where the stock is officially listed. Thus, one can trade an NYSE-listed stock not only on the NYSE, but also through the Nasdaq InterMarket or the regional stock exchanges such as Boston, Chicago, Cincinnati, Philadelphia, and Archipelago (launched in 2002 through the union of the Pacific Exchange and Archipelago ECN). However, the NYSE and the American Stock Exchange have chosen to trade only stocks that officially list on their own exchanges.

How the Different Markets Work

The Nasdaq Stock Market

The Nasdaq Stock Market trades the most stocks and reports the highest share volume of any U.S. stock market. The basic philosophy of Nasdaq is one of "open architecture." Participation is not limited to any fixed number of participants. Any firm that meets the basic requirements can join. This allows a large number of firms with widely different business models and trading technologies to plug into the Nasdaq network and compete on an equal basis.

Ten Largest Nasdaq Market Makers, 2001

MARKET MAKER	*Market Participant Identifier*	*# of Nasdaq Issues Traded*	*Total Share Volume (000s)*
Knight Securities	NITE	4,122	27,760,571
Salomon Smith Barney Inc.	SBSH	1,149	22,056,105
Morgan Stanley & Co., Inc.	MSCO	1,302	21,958,196
Schwab Capital Markets L.P.	SCHB	1,982	21,176,533
Merrill Lynch, Pierce, Fenner	MLCO	962	19,860,470
Goldman, Sachs & Co.	GSCO	529	18,744,320
Credit Suisse First Boston Cp	FBCO	712	17,951,191
Herzog, Heine, Geduld, LLC	HRZG	3,766	16,578,127
Spear, Leeds, & Kellogg	SLKC	4,337	15,228,529
Lehman Brothers Inc.	LEHM	665	12,983,104

These participants include over 300 market makers, who operate much like shopkeepers, buying inventory to sell to their customers. Market makers, also known as dealers to their customers, add *liquidity* by being willing to buy or sell the stock for their own account at all times. Market makers in a particular stock are required at all times to

Who Regulates the Market?

A stock market needs a good police force to keep the criminals out. Financial markets are natural magnets for crime because of the large amount of money involved. Fraudsters may try to sell stock in bogus companies to unsuspecting investors. Other criminals might be tempted to manipulate the stocks of legitimate companies illegally for their own gain.

Multiple levels of regulation protect investors in the U.S. In addition to the normal civil and criminal prohibitions on fraud, the selling of securities in the United States is highly regulated by the state and federal governments. The SEC is charged with the primary task of policing the stock market. The SEC has broad powers under U.S. securities laws to set rules, police stock exchanges, and punish evildoers who would besmirch our markets.

However, U.S. securities law realizes that the government can't do the job alone, and so it relies heavily on self-regulation of the industry. The idea is that the financial services industry understands its business better than the government, so that the industry itself can set up an organization that sets the rules of conduct and takes action against those who break the rules.

In the United States, all brokerage firms must belong to a self-regulatory organization (SRO). It is up to the SRO to monitor the activities of its members to make sure that they are in compliance with the appropriate rules and regulations. If the SRO finds that someone has violated the rules, it can fine them or even expel them from the business.

Stock markets such as Nasdaq, the NYSE, and the Amex are SROs because they must monitor the trading in their markets to prevent shenanigans. These markets devote a large number of resources to policing the trading in their markets.

NASD serves as the SRO for brokerage firms that are not members of the NYSE. Not only do firms need to be members of an SRO, but also individual brokers must be registered, be fingerprinted, and pass an examination. NASD Regulation, a subsidiary of the NASD, maintains the qualification, employment, and disclosure histories of the more than half-a-million registered securities employees of member firms through the automated, electronic Web Central Registration Depository (CRD℠) system. Access to Web CRD is available through the NASDR web site, www.nasdr.com.

post their bid and ask prices into the Nasdaq network, where they can be viewed and accessed by all participants. This means that there will always be someone willing to buy when you want to sell, and someone willing to sell when you want to buy, so that your trades can be filled quickly and efficiently. The average Nasdaq stock has over 10 market makers.

In addition to traditional market makers, the Nasdaq network also connects other trading systems such as ATSs/ECNs and the Primex Auction System™. ATSs/ECNs provide electronic facilities for investors to trade directly with each other at pre-set prices, without going through a market maker. They operate simply as order-matching mechanisms and do not maintain inventories of their own. For those market orders or marketable limit orders seeking price validation, Nasdaq offers the Primex Auction System. Primex replicates a competitive trading crowd in an extended digital environment. Any Nasdaq market participant, including market makers, order-entry firms, and ATSs/ECNs, may voluntarily expose orders to the system's electronic crowd of bidders, who compete for the execution. Primex is available for Nasdaq-listed securities and exchange-listed securities traded in the Nasdaq InterMarket. Nasdaq has an exclusive license with Primex Trading N.A., LLC, to operate the Primex Auction System as a facility of its market for U.S. equities.

The flexibility of the Nasdaq network means that innovators with new trading technologies or strategies can implement them quickly in the Nasdaq marketplace. Some of these innovators succeed, and some do not.

The Nasdaq Stock Market itself does not buy or sell stock. What Nasdaq does is to provide systems that link all of the liquidity providers in a given stock together where they can compete with each other. Nasdaq also gathers the trade and quote information from all of these participants and passes it on to data vendors who ship it out to the investment community. Note that as a fully computerized market, Nasdaq itself does not have a central trading floor. It has a primary data center in Trumbull, CT, with a fully redundant back-up facility in Rockville, MD. Nasdaq's headquarters are located in New York, NY, with additional offices in Washington, DC; Rockville, MD; Chicago, IL; Menlo Park, CA and several international locations.

Nasdaq operates two market segments – the Nasdaq National Market, which trades household-name stocks such as Microsoft and Intel, and The Nasdaq SmallCap Market℠ for smaller stocks that are not yet big enough for the Nasdaq National Market. Nasdaq also provides a venue for off-floor trading of exchange-listed stocks via the Nasdaq InterMarket, connecting Nasdaq market participants to the Intermarket Trading System (ITS)- the system used by the NYSE and all regional exchanges for directed orders between exchanges.

Nasdaq was developed by the National Association of Securities Dealers, Inc. (NASD) to improve the transparency of what was then known as the over-the-counter market for unlisted stocks. The name Nasdaq was originally an acronym for National Association of Securities Dealers Automated Quotation system. Nasdaq began trading in 1971 and introduced the National Market System (NMS), predecessor to the Nasdaq National Market, in 1982. In 1985, Nasdaq launched the Nasdaq-100 Index, representing the largest non-financial domestic and international issues listed on The Nasdaq Stock Market, based on market capitalization, and by 1995, Nasdaq had surpassed the New York Stock Exchange in reported trading volume. In early 2000, NASD members voted overwhelmingly to restructure the organization and give the green light to spin Nasdaq off and validate the return of NASD to its original mission as a member-based organization. Nasdaq is now a private, for-profit corporation that is owned by its shareholders, who are mostly major financial service firms. An IPO is likely.

New York Stock Exchange

On the New York Stock Exchange (NYSE), all trades in a single stock take place in a single physical location on the NYSE's *trading floor* in New York. At that location, a member of the exchange known as a *specialist* oversees the trading in that stock. The specialist has an obligation to maintain a "fair and orderly market" and acts as both a market maker and an auctioneer. Just as with Nasdaq market makers, the specialist is required to post bid and ask quotes at all times. The specialist also acts as an auctioneer try-

What the Numbers Mean

Virtually no newscast is complete without a quick update on the stock market. Almost invariably, newscasters will mention what happened to "The Dow," and "The Nasdaq" indices. Actually, there are literally thousands of different indices that try to measure what happened to the entire stock market or to different groups of stocks. Here are some of the more common ones:

Dow Jones Industrial Average

The Dow Jones Industrial Average (DJIA), or "The Dow" is the oldest commonly quoted index of stock prices in the United States. It consists of a simple average of the prices of 30 major U.S. stocks, including major household names like Microsoft and Intel. Dow Jones and Company, publishers of the Wall Street Journal, picks the 30 companies and adds up the price of each stock and then divides the sum by a number called the divisor. The divisor changes over time in order to correct for the effects of stock splits and changes in the members of the index. Presently, all stocks included in the Dow are companies listed on the NYSE or Nasdaq.

Nasdaq Composite

Unlike the DJIA, which covers only 30 stocks, the Nasdaq Composite℠ Index covers all common stocks listed on Nasdaq – approximately 4,100 stocks. Each stock is weighted by its market capitalization, so that a large company like Microsoft has a larger weight in the index than a smaller company. The index started out with a value of 100 in 1971.

S&P 500

The Standard and Poor's 500 index contains 500 of the largest U.S. firms. Like the Nasdaq Composite Index, it is capitalization-weighted. This index is a common benchmark for evaluating the performance of investment managers.

ing to match the orders of other customers that are sent to the NYSE floor. The specialist oversees the *order book* of orders that are electronically routed to the floor of the NYSE.

In addition to the specialist, there are numerous floor brokers who negotiate larger orders face-to-face for their customers. Typically, a floor broker receives an order from a brokerage firm and then walks over to the specialist post where the stock is traded. The floor broker then negotiates with the specialist and any other floor brokers interested in the same stock to try to fill the order. Smaller orders on the NYSE are usually routed electronically to the specialist's order book.

New York Stock Exchange Specialist Firms, 2001

Specialist Firm	*# of Common Stocks*	*% of Common Stocks*	*% of Volume*
LeBranche & Co.	591	23.0%	28.5%
Spear Leeds & Kellogg	502	19.5%	20.2%
Fleet Meehan	422	16.4%	18.3%
Wagner Stott Bear	347	13.5%	16.0%
Van Der Moolen	308	12.0%	10.2%
Performance	134	5.2%	1.1%
Susquehanna	117	4.5%	2.8%
Lyden Dolan Nick & Co.	80	3.1%	1.5%
Walter N. Frank & Co.	74	2.9%	1.4%
Total	2,575	100.0%	100.0%

NYSE membership is limited to 1,366 members, who collectively own the NYSE. In order to become a member, one has to purchase a membership, called a "seat," from another member who wants to sell. Memberships have recently been selling in the neighborhood of $2 million. Seats also may now be leased from their owner. However, purchasing a seat does not mean that you get to sit down. Few NYSE members actually sit down for long during the trading day.

The New York Stock Exchange traces its history back to 1792, two years after the founding of the Philadelphia Stock Exchange. With the signing of the Buttonwood Agreement, 24 prominent brokers and merchants gathered on Wall Street, agreeing to trade securities on a common commission basis. In 1817, the group adopted a constitution with rules for the conduct of business, naming the resulting group the New York Stock & Exchange Board, and in 1863, shortened the name to the New York Stock Exchange. In 1903, after occupying various sites in the same neighborhood near Broad and Wall Streets, the NYSE opened the trading floor on 18 Broad Street, where it still conducts business today.

American Stock Exchange

The American Stock Exchange (Amex) evolved out of the brokers who stood on the curb outside the New York Stock Exchange to trade stocks that did not qualify for the NYSE. Indeed, even after the brokers moved indoors in 1921, they were known as The New York *Curb Exchange.* As on the NYSE, trading on the Amex is conducted through an advanced centralized specialist system, and memberships to trade are sold as "seats." Membership is limited to 807 regular members who transact business in equities and options, and 57 options principal members who execute transactions in options only. The Amex is the second-largest options exchange in the U.S., after the Chicago Board Options Exchange. (The CBOE also trades a few equity products.) The Amex pioneered *exchange traded funds* such as SPDRs (pronounced "spiders") and now does a substantial business in such funds, while continuing to operate a small equities business. In 1998, the American Stock Exchange merged with the NASD, and continues to exist as an independent entity under the NASD family of companies.

Regional Stock Exchanges

Years ago, stock exchanges naturally sprang up in many cities to accommodate the needs of local investors. Even cities like Wheeling, WV and Spokane, WA at one time had their own local stock exchanges. Advances in communication, such as the telegraph and telephone, reduced the need for so many exchanges, and many of them merged with other stock exchanges. However, a number of these so-called regional stock exchanges still survive. Although some of these exchanges have a few exclusive "local" stocks, these exchanges mostly compete in the business of trading the more active NYSE- and Nasdaq-listed stocks. The regional exchanges resemble Nasdaq market makers more than the NYSE floor. Although some of the regional exchanges still have physical trading floors, for the most part, their specialists are acting as dealers, filling electronically submitted orders from retail firms. The regional exchanges include the Boston, Chicago, Cincinnati, Pacific,

Extended-Hours Trading

The normal hours of operation of the U.S. stock market are currently from 9:30 a.m. to 4:00 p.m., Eastern Standard Time. However, investors can and do trade stocks outside these hours through a variety of means. Many ECNs offer trading outside of regular hours, and one of the largest ECNs, Instinet, usually operates around the clock. Some broker/dealers specialize in making markets after the regular markets close. Some brokerage firms offer retail investors the opportunity to participate in these after-hours trading sessions. The NYSE offers two after-hours crossing sessions. However, trading volume tends to be very small (and bid-ask spreads very high) outside of regular market hours because most investors want to trade when the rest of the market is open.

Disclosure of Order Execution and Routing Practices

Although your broker has a legal obligation to get the best execution possible, it has a variety of choices in routing your order. For the investor, the exact routing of an order is generally difficult to determine. In November 2000, the SEC adopted two rules to improve public disclosure of order execution and routing practices. Under Rule 11Ac1-5, market centers that trade national market system securities are required to make available to the public monthly electronic reports that include uniform statistical measures of execution quality. Under Rule 11Ac1-6, broker/dealers that route customer orders in equity and option securities are required to make publicly available quarterly reports that, among other things, identify the venues to which customer orders are routed for execution. In addition, broker/dealers are required to disclose to customers, on request, the venues to which their individual orders were routed. By making visible the execution quality of the securities markets, the rules are intended to spur more vigorous competition among market participants to provide the best possible prices for investor orders.

and Philadelphia exchanges. Interestingly enough, the Cincinnati Stock Exchange is located in Chicago. In late 2001, the SEC approved the launch of the Archipelago Exchange (ArcaEx), through the union of Archipelago ECN and the Pacific Exchange (PCX). Under the agreement, Archipelago will convert its advanced equity trading system into ArcaEx, a regulated facility of the Pacific Exchange, and a replacement for the PCX's current floor-based equities marketplace.

Stock Trading and the Internet Revolution

The Internet has revolutionized many industries. Indeed, it has revolutionized the stock market by allowing investors to place orders directly from their own PCs, which has brought brokerage commissions down dramatically. One question that naturally arises is whether the Internet will replace existing stock markets.

This is not likely anytime soon for several good reasons. The first is cost. The current markets are extremely efficient and provide extremely low transactions costs to investors. The transaction costs on auction sites such as eBay tend to be higher (as a percentage of the purchase price) than the existing stock markets. The second reason is investor protection. Stock markets are highly regulated to protect investors, and both Nasdaq and the NYSE devote enormous resources to investor protection. This does not mean, however, that the existing markets will stay the same. The technology of trading has been changing rapidly and will continue to do so.

For more information

There are many good link collections on the web. Here are just a few of the many useful web sites where you can go for more information.

U.S. Stock Markets

American Stock Exchange
www.amex.com

Archipelago Exchange
www.tradearca.com

Arizona Stock Exchange
www.azx.com

Boston Stock Exchange
www.bostonstock.com

Chicago Stock Exchange
www.chicagostockex.com

Cincinnati Stock Exchange
www.cincinnatistock.com

The Nasdaq Stock Market
www.nasdaq.com
www.nasdaqtrader.com

Nasdaq InterMarket
www.intermarket.nasdaqtrader.com

New York Stock Exchange
www.nyse.com

Pacific Exchange
www.pacificex.com

Philadelphia Stock Exchange
www.phlx.com

ATSs, ECNs, and Trading Facilities

Attain
www.attain.com

Bloomberg Tradebook
www.b-trade.com

Brut
www.ebrut.com

GlobeNet
www.globenet.com

Instinet
www.instinet.com

Island
www.island.com

ITG Inc.
www.itginc.com

MarketXT
www.marketxt.com

Nextrade
www.nextrade.org

NYFIX, Inc.
www.nyfix.com

OTC Bulletin Board
www.otcbb.com

Primex Trading
www.primextrading.com

REDIBook
www.redibook.com

Regulatory Agencies

U.S. Securities and Exchange Commission
www.sec.gov

National Association of Securities Dealers
www.nasd.com

NASD Regulation
www.nasdr.com

North American Securities Administrators Association
www.nasaa.org

Settlement Organization

Depository Trust and Clearing Corporation
www.dtcc.com

Industry Organizations

American Association of Individual Investors
www.aaii.com

Securities Industry Association
www.sia.com

Security Traders Association
www.securitytraders.org

Securities Training Corporation
www.stcusa.com

Glossary

account statement
A written summary, provided by a brokerage to its customer, that details all transactions made on behalf of that customer over the preceding month, all interest and dividends received, and the current value of the account.

Advanced Detection System (ADS)
Automated surveillance system used by NASD Regulation's Market Regulation Department; ADS monitors any operational exceptions in member firms' trading and reporting that may have a negative impact on the quality of the market information and processing.

after-hours trading
Trading after the hours a stock market has closed. (For all major U.S. stock markets, after-hours trading is 4:00-6:30 p.m., Eastern Standard Time). After-hours trading often takes place after the release of news that could make the price of a stock rise or fall sharply after the close of trading. Participation in the after-hours market is strictly voluntary and may offer less liquidity and inferior prices.

aftermarket
Trading activity in a security immediately following its initial offering to the public.

alternative trading system (ATS)
Non-traditional, computerized trading systems that compete with or supplement dealer markets and traditional exchanges. These private trading systems; facilitate electronic trading in millions of shares of public issues every day, but do not provide a listing service. ECNs are alternative trading systems; however, not all ATSs are ECNs. (See "electronic communications network.")

American Depository Receipt (ADR)
A negotiable certificate representing shares of a foreign security that have been repackaged for trading on a U.S. stock market. The creation of ADRs makes it easier for U.S. investors to buy shares of foreign-based corporations, because certificates, transfers, and settlement practices for ADRs are identical to those for U.S. securities.

American Depository Shares (ADS)
The actual share issued under an American Depository Receipt agreement. (See "American Depository Receipt.")

American Stock Exchange LLC (Amex)
The American Stock Exchange® is the second largest floor-based securities exchange, as well as the second largest options exchange in the United States, and is the only primary exchange that offers trading across a full range of equities, exchange traded funds (ETFs) including structured products and HOLDRSSM, and options. Amex was acquired by the National Association of Securities Dealers, Inc., in 1998. (See "Curb Exchange.")

appreciation
An increase in the basic value of an asset, such as a stock, bond, commodity, or real estate.

ask price
The price at which an individual is willing to sell a security. Also referred to as "the ask."

ask price (offer price)
The price at which a market maker is willing to sell a security. (See "market maker," "best ask.")

assets
Any possessions that have value in an exchange.

Association of Publicly Traded Companies (APTC)
This organization, which is not connected with the NASD, provides publicly traded companies with a forum for addressing regulatory and legislative issues that affect them. It was formerly known as the NAOTC.

auction market
A market in which buyers and sellers meet through a single specialist, who, in a centralized location or "floor," matches incoming orders to buy and sell each stock. Specialists use the capital of their firm to represent a stock, but are not allowed to provide research or retail sales support. Stock exchanges, like the New York Stock Exchange and the American Stock Exchange, are auction markets. (See "dealer market," "market maker," "specialist.")

audit
A professional examination of a company's financial and accounting records to verify accuracy.

Automated Confirmation Transaction (ACT) Service℠
An automated Nasdaq service that speeds the post-execution steps of price and volume reporting, comparison, and clearing of pre-negotiated trades completed in Nasdaq and OTCBB securities.

bear and bull markets
A bear market is one in which prices are low or declining; a bull market is one in which prices are high or rising.

best ask
The lowest quoted offer of all competing market makers to sell a particular stock at any given time. (See "market maker," "ask price.")

best bid
The highest quoted bid of all competing market makers to buy a particular stock at any given time. (See "market maker," "bid price.")

best execution requirement
The obligation of market makers, broker/dealers, and others to execute customer orders at the best price available at the time the trade is entered.

bid price (buy price)
The quoted bid at which a market maker is willing to buy a stock. (See "market maker," "best bid.")

Glossary

INTC INTU ITWO IVGN JDSU JNPR KLAC LLTC MCHP MEDI MERQ MLNM MOLX MSFT MXIM NTAP NVDA NVLS

bid-ask spread
The difference between the price at which a market maker is willing to buy a security (bid), and the price at which the firm is willing to sell it (ask). The spread narrows or widens according to the supply and demand for the security being traded. (See "inside spread/quote.")

blue-chip stocks
A term generally applied to stocks of well-established companies that are known for their track records of solid management, and which have excellent records of consistent profits and paying dividends to stockholders. Generally, dividends of blue-chip stocks are relatively moderate in nature.

bond
A long-term promissory note in which the issuer agrees to pay the owner the amount of the face value of the bond on a future date and to pay interest at a specified rate at regular intervals.

broker
An individual or firm who acts as an intermediary between a buyer and seller, usually charging a commission. (See "dealer.")

broker/dealer
NASD member firms that act as securities dealers or brokers, or perform both functions. (See "broker," "dealer.")

bull market
See "bear and bull markets."

capital
The cash or goods used to generate income. Wealth in the form of money or property, used or accumulated in a business by a person, partnership, or corporation.

certificate of deposit (CD)
A debt instrument issued by a bank that usually pays interest. Institutional CDs are issued in denominations of $100,000 or more, and individual CDs start as low as $100. Maturities range from a few weeks to several years. Interest rates are set by competitive forces in the marketplace.

clearance
The conclusion of an exchange of securities. (See "settlement.")

common stock
A class of securities representing ownership and control in a corporation and that may pay dividends as well as appreciate in value. (See "preferred stock.")

Computer Assisted Execution System (CAES℠)
Nasdaq service that automates order routing and execution for securities listed on domestic exchanges in the Intermarket Trading System (ITS). When linked to ITS, market makers can execute trades in exchange-listed securities through CAES with specialists on an exchange floor. (See "Intermarket Trading System," "market maker," "specialist.")

Consolidated Quotation System (CQS)
An electronic service that provides quotations on issues listed on the New York and American Stock Exchanges, regional stock exchanges, and issues traded by market makers in the Nasdaq InterMarket. Nasdaq processes this data and provides it to its subscribers as the Composite Quotation Service. The initials may be used either for the exchange system or Nasdaq service. (See "Nasdaq InterMarket.")

Curb Exchange, Curb Market
Historical forebear of the American Stock Exchange. The loose association of curbside merchants and auctioneers that operated in New York was organized in 1908 as the New York Curb Agency. The Association moved indoors in 1921 and was renamed The New York Curb Market Association, and in 1953 was renamed the American Stock Exchange, which is still sometimes referred to in financial circles as "the Curb." (See "American Stock Exchange LLC.")

dealer market
A market in which many competing dealers, called market makers, use their own capital, research, retail, and/or systems resources to represent a stock. Many market makers can represent the same stock; thus, they compete with each other to buy and sell that stock. Nasdaq is a competing dealer market, as opposed to an auction market. (See "auction market," "Market Maker.")

decimalization
The process that converted stock prices from fractional pricing to pricing in decimals; that is, in increments from eighths or sixteenths of dollars to nickels or pennies. Decimalization and the reduction of tick sizes are not the same and are not necessarily dependent on each other.

depository bank
When a company decides to issue American Depository Receipts, it appoints an authorized depository, normally part of a large U.S. banking institution or trust company. (See "American Depository Receipts.")

Depository Trust and Clearing Corporation (DTCC)
The DTCC, established in September 1999, is a holding company that oversees two principal subsidiaries – The Depository Trust Company (DTC) and the National Securities Clearing Corporation (NSCC). These two firms provide the primary infrastructure for the clearance, settlement and custody of the vast majority of equity, corporate debt, and municipal bond transactions in the U.S. The DTCC is owned by its principal users – major banks, broker/dealers, and other companies within the financial services industry, including the NASD and the NYSE.

dividend
Distribution of earnings to shareholders, prorated by the class of security and paid in the form of money, stock, scrip, or, rarely, company products or property. The amount is decided by a board of directors and is usually paid quarterly. Mutual fund dividends are paid out of income, usually on a quarterly basis from the fund's investments.

Dow Jones Industrial Average (DJIA)
A price-weighted average of 30 actively traded blue chip stocks, including such companies as Microsoft, Intel, IBM, General Electric, and General Motors. Prepared and published by Dow Jones & Co., it is the oldest and most quoted of all the market indicators. Often referred to as "the Dow," it is calculated by adding the closing prices of the component stocks and using a divisor that is adjusted for splits and stock dividends equal to 10 percent or more of the market value of an issue, as well as substitutions and mergers. The average is quoted in points, not dollars.

earnings per share (EPS)
The portion of a company's profit allocated to each outstanding share of common stock.

electronic communication network (ECN)
An electronic facility that matches customer buy and sell orders directly through a computer. ECNs act on behalf of customers and do not buy and sell from their own account. ECNs are alternative trading systems.

equity
The ownership interest of stockholders in a company. Also, the excess of the market value of securities over debit balances in a margin account. (See "margin.")

exchange
An organized marketplace in which stocks, common stock equivalents, and bonds are traded by members of the exchange, acting both as brokers and dealers/traders. Such exchanges have a location (either physical or virtual) where brokers and dealers meet to execute orders from institutional and individual investors and to buy and sell securities. Also known as "stock exchange."

Exchange Traded Fund (ETF)
Shares of ownership in either fund, unit investment trusts, or depository receipts that hold portfolios of common stocks which closely track the performance and dividend yield of specific indexes, either broad market, sector, or international. An entire portfolio of stocks in a single security can be bought or sold as easily as buying or selling a share of stock. While similar to an index mutual fund, ETFs differ in that they are priced, and can be bought and sold, throughout the trading day. Furthermore, ETFs can be sold short and bought on margin. Examples include DIAMONDS Trust Series I (DIA), Nasdaq-100 Index Tracking Stock (QQQ), and SPDR Trust Series I (SPY).

fiscal year
A 12-month period for which a business operates and reports its income-earning activities. This period may or may not coincide with the calendar year.

floor
The space where trading on a traditional stock exchange takes place. Electronic markets, like Nasdaq, trade through vast computer networks, rather than by meeting in a physical location.

Generally Accepted Accounting Principles (GAAP)
Rules, conventions, standards, and procedures that are widely accepted among financial accountants. Since 1973, GAAP doctrine has been established by the Financial Accounting Standards Board (FASB), an independent, self-regulating organization.

goodwill
The going-concern value of a company in excess of its asset value; goodwill is considered an intangible asset. Generally, it is the value of the business' good name, its customer relations, high employee morale, and other factors that might translate into earning power. Nasdaq's calculation of net tangible asset value excludes goodwill.

holder
Owner of a security.

index
A market indicator, such as the Nasdaq Composite Index or the Dow Jones Industrial Average, which represents a measure of the relative value of a combined group of stocks.

index fund
A passively managed mutual fund that tries to match the performance of a specific index by purchasing the same securities that are held by that index.

initial public offering (IPO)
A company's first sale of stock to the public. Companies making an IPO are seeking outside equity capital and a public market for their stock. (See "public company," "underwriter.")

inside spread (inside quote)
The difference between the best bid and best ask being quoted among all of the market makers competing in a security. Since the inside spread is the aggregate of individual market maker spreads, it is narrower than an individual dealer spread or quote. (See "market maker.")

interest
1) The return made on an investment, usually expressed as an annual percentage; 2) The fee lenders charge borrowers for the use of loaned funds; 3) An individual's share, right, or title in a company or property.

Intermarket Trading System (ITS)
A computer system that interconnects competing exchange markets for the purpose of choosing the best market. ITS is operated by the Securities Industry Automation Corporation (SIAC). (See "Computer Assisted Execution System.")

investor
A person who buys or sells securities for his or her own account or the account of others.

issuer
A corporation that has distributed to the public securities that are registered with the U.S. Securities and Exchange Commission (SEC).

Glossary

limit order
An order to buy or sell a security at a customer-specified price; a customer order to buy or sell a specified number of shares of a security at a specific price. (See "market order," "stop-loss order.")

listing requirements
The minimum qualification standards a market requires for a company to list stock on that market.

liquidity
The ease with which the market can absorb volume buying or selling in a stock, without dramatic fluctuation in price.

margin
An account in which a customer purchases securities on credit extended by a broker/dealer. Rules of the Federal Reserve Board and NASD govern margin accounts.

market maker
A firm that maintains a firm bid and offer price in a given security by standing ready to buy or sell at publicly quoted prices. The Nasdaq Stock Market is a decentralized network of competitive market makers (or dealers). Market makers process orders for their own customers and for other NASD broker/dealers; all Nasdaq securities are traded through market maker firms. There are four primary types of market-making firms: retail, wholesale, institutional, and regional.

market order
An order to buy or sell a stated amount of a security at the best possible price at the time the order is received in the marketplace.

market price
The last reported price at which a security was sold on an exchange or market.

material news
News released by a public company that might reasonably be expected to affect the value of a company's securities or influence investors' decisions. Material news includes information regarding corporate events of an unusual and non-recurring nature, news of tender offers, unusually good or bad earnings reports, and a stock split or stock dividend. (See "trading halt.")

mutual fund
Fund operated by an investment company that raises money from shareholders and invests it in stocks, bonds, options, commodities, or money market securities on the shareholders' behalf.

Nasdaq-100 Index®
The Nasdaq-100 Index includes 100 of the largest non-financial domestic companies listed on the Nasdaq National Market tier of The Nasdaq Stock Market. Launched in January 1985, each security in the Index is proportionately represented by its market capitalization in relation to the total market value of the Index.

Nasdaq InterMarket℠ (formerly, Third Market)
The Nasdaq InterMarket consists of Nasdaq market makers and electronic communications networks, which quote and trade NYSE and Amex® exchange-listed securities using their proprietary systems, Nasdaq technology, and the Intermarket Trading System (ITS). Through Nasdaq's Computer Assisted Execution System (CAESSM), participants are linked with each other and with ITS, enabling them to enter and execute trades in all exchange-listed securities via the Nasdaq systems or an application programming interface (API). (See "Computer Assisted Execution System," "Intermarket Trading System.")

National Association of Securities Dealers, Inc. (NASD®)
The largest securities-industry, self-regulatory organization in the United States. Through its subsidiaries, NASD Regulation, Inc, NASD Dispute Resolution, Inc., and the American Stock Exchange, the NASD develops rules and regulations, conducts regulatory reviews of members' business activities, disciplines violators, provides arbitration and mediation services, and regulates securities markets for the benefit and protection of the investor. In 2000, NASD members voted to spin off a controlling interest in The Nasdaq Stock Market, Inc.

New York Stock Exchange (NYSE)
The oldest stock exchange and the largest floor-based exchange in the United States, the NYSE is an auction market, where buy and sell orders for each listed security meet directly on the trading floor in assigned locations. (See "auction market," "floor," "specialist.")

NYSE Composite Index (NYSE)
A market-value-weighted index that relates all NYSE stocks to an aggregate market value as of December 31, 1965, adjusted for capitalization changes.

offer price
See "ask price (offer price)."

order book
Compiled list of orders received that are away from the current best price in the market.

OTC Bulletin Board® (OTCBB) Service
A regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter (OTC) equity securities. OTCBB is a quotation medium for subscribing members, not an issuer listing service, and should not be confused with The Nasdaq Stock Market.

over-the-counter (OTC) securities
Securities that are not listed and traded on an organized exchange or market and are generally not subject to the same requirements.

preferred stock
A security that usually pays a fixed dividend and that gives the holder a claim on corporate earnings and assets that is superior to that of holders of common stock. (See "common stock.")

price/earnings ratio (price-to-earnings or P/E ratio)
The price of a share of a stock divided by earnings per share (EPS), usually calculated using the latest year's earnings. The P/E ratio is also called the "multiple."

primary market
The market in which a company initially sells newly issued shares to investors, such as through an initial public offering. The primary market provides promising companies with the capital they need to invest in growing their businesses.

publicly traded
Term used to describe a company which has issued securities through an offering and that are traded on an open market, such as a stock market. By issuing public shares, the company is relinquishing exclusive control of the company's future to its shareholders.

risk
The measurable possibility an investment will lose or not gain value.

secondary market
Markets where securities are bought and sold subsequent to original issuance. Stock markets serve as secondary markets for shares of publicly owned companies.

securities
A broad range of investment instruments, including stocks, bonds, and mutual funds.

Securities Act of 1933
The first act passed by Congress to regulate the securities markets. The disclosure statute requires companies to register stock offerings to the public and disclose important facts through a prospectus and additional information filed with the SEC. (See "Securities and Exchange Commission.")

Securities Acts Amendments of 1975
Considered the most significant securities legislation since the 1934 Act, this act ended fixed commission rates, initiated action toward development of a national market system, and granted the SEC final say in the adoption of rules by any of the SROs. (See "Securities and Exchange Commission," "self-regulatory organizations.")

Securities and Exchange Commission, U.S. (SEC)
The federal agency created by the Securities Exchange Act of 1934 to administer that act and the Securities Act of 1933. The statutes administered by the SEC are designed to promote full public disclosure and protect the investing public against fraudulent and manipulative practices in the securities markets. Generally, most issues of securities offered in interstate commerce or through the mail must be registered with the SEC.

Securities Exchange Act of 1934
This law created the Securities and Exchange Commission to regulate the securities industry. The law outlawed manipulative and abusive practices in the issuance of securities; it required registration of stock exchanges, brokers and dealers, and registration of exchange-listed securities; it also required disclosure of certain financial information and insider activity. The law gave the SEC surveillance authority over exchanges and brokers, and the authority to regulate margin requirements. The law also authorized the SEC to enforce the Securities Act of 1934 to allow regulation of over-the-counter markets through national associations registered with the SEC. The NASD is the only association ever to register under the act.

Securities Industry Association (SIA)
The principal trade association and lobbying arm of the securities industry.

Securities Industry Automation Corporation (SIAC)
A facility owned by the New York and American Stock Exchanges, which operates automated communication systems to support trading, surveillance and market data for these exchanges.

Securities Investor Protection Corporation (SIPC)
A nonprofit corporation that insures investors against the failure of brokerage houses. Coverage is limited to a maximum of $500,000 per account, but only up to $100,000 in cash. SIPC does not insure against market risk.

self-regulatory organization (SRO)
An entity responsible for regulating its members through the adoption and enforcement of rules and regulations governing the business conduct of its members.

settlement
The conclusion of a securities transaction — a broker/dealer buying securities pays for them, and a selling broker delivers the securities to the buyer's broker.

settlement date (T+3, T+1)
The date specified for delivery of securities from one securities firm to another, often specified as T+x, where x equals the period of time in business days and T equals the trade date. Currently, the settlement date is three business days after the date of order execution (T+3).

share
A single unit of ownership in a corporation (also called a "stock").

specialist
A member of a stock exchange through which all trades in a given security pass.

S & P 500
A capitalization-weighted index (shares outstanding multiplied by stock price) of 500 stocks that are traded on the New York Stock Exchange, American Stock Exchange, and Nasdaq National Market. (See "index," "Standard and Poor's Corporation.")

Standard & Poor's Corporation
A company well known for its rating of stocks and bonds according to investment risk (the Standard & Poor's Rating) and for compiling the Standard & Poor's Index, commonly called the S&P 500, that tracks 400 industrial stocks, 20 transportation stocks, 40 financial stocks, and 40 public utilities as a measurement indicative of broad changes in the market.

stock
An instrument that signifies an ownership position in a corporation. (See "common stock," "preferred stock," "share.")

stock dividend
Payment of a corporate dividend in the form of stock rather than cash. The stock dividend may be additional shares in the company, or it may be shares in a subsidiary being spun off to shareholders. Stock dividends are often used to conserve cash needed to operate the business. Unlike a cash dividend, stock dividends are not taxed until sold.

stop-loss order
A customer order to a broker that sets the sell price of a stock below the current market price, therefore protecting profits that have already been made or preventing further losses if the stock drops. (See "limit order," "market order.")

street name
Term given to securities held in the name of a broker on behalf of a customer. This arrangement allows shares to be transferred easily. If the stock were registered in the customer's name rather than the broker's name, physical certificates would need to be transferred.

SuperMontage
The next-generation electronic trading system in both order display and execution for Nasdaq securities, launched by The Nasdaq Stock Market in mid-2002. The new trading system provides a fully integrated order display and execution platform, aggregating quotes and orders to provide access to more possible trades. SuperMontage will be capable of handling an expanded universe of orders and, in its final state, will provide a completely rebuilt market platform that can seamlessly accommodate future enhancements and upgrades. Via its enhanced depth and transparency and multiple options for execution, SuperMontage provides a natural center of liquidity, allowing users to take advantage of technological efficiencies.

SuperSoes℠
The primary order routing and automatic execution system for Nasdaq National Market securities. A result of the integration of Nasdaq's Small Order Execution System℠ (SOES℠) and SelectNet® automated trade execution systems, the system is designed to expand significantly the earlier systems' order capacity capabilities. The modifications to Nasdaq's execution services were developed to reduce dual liability and message traffic, re-establish SelectNet as a non-liability system for purposes of order delivery and negotiation, allow market makers to use the automatic execution system on a proprietary basis for transactions, enable system interaction with a market maker's reserve size, increase efficiency of trading, and deliver executions as opposed to orders.

The Nasdaq Stock Market®
The Nasdaq Stock Market® is a major national and international stock market that uses computers and telecommunications for the trading and surveillance of thousands of securities. As the world's largest electronic stock market, Nasdaq® is not limited to one central trading location. Rather, trading is executed through Nasdaq's sophisticated computer and telecommunications network of competing market maker firms that list specific prices for the sale or purchase of securities. This network transmits real-time quote and trade data to more than 1.3 million users in 83 countries. Without size limitations or geographical boundaries, Nasdaq's "open architecture" market structure allows a virtually unlimited number of participants to trade in a company's stock.

ticker symbol
The standard abbreviation used to identify a stock.

trading floor
Main area of an exchange where orders and active trading are executed. Also just called "the floor."

trading halt
The temporary suspension of trading in a security while material news from the issuer is being disseminated. A trading halt generally lasts approximately 30 minutes after complete news coverage and gives all investors equal opportunity to evaluate news and make buy, sell, or hold decisions on that basis. A trading halt may also be imposed for regulatory reasons, or to stop a rapidly declining market. (See "material news.")

QQQ
Ticker symbol for the Nasdaq-100 Index Tracking Stock. (See "Exchange Traded Fund.")

underwriter
An investment banker that assumes the risk of bringing a new securities issue to market. The underwriter will buy the issue from the issuer and guarantee sale of a certain number of shares to investors, which is called firm-commitment underwriting. To spread the risk of purchasing the issue, the underwriter often will form a syndicate (underwriting group, purchase group) among other investment firms.

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