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Impact of stock market

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Abstract
This Study aims to find out the impact of Stock Market. Stock Market is a place for buying and selling of Securities. This article helps to understand the impact of stock Market.

Keywords: Stock Market, Impact, Primary Market, Secondary Market

Introduction

Movements in the stock market can have a profound economic impact on the economy and everyday people. A collapse in share prices has the potential to cause widespread economic disruption. Most famously, the stock market crash of 1929 was a key factor in causing the great depression of the 1930s. Yet, daily movements in the stock market can also have less impact on the economy than we might imagine.
Stock markets have predicted 10 out of the last 3 recessions.
For example, the stock market crash of 1987, didn't cause any lasting economic damage. (Though it did influence monetary policy. The UK cut interest rates in fear the stock market crash would cause a recession. Instead, low interest rates caused a boom.

Economic effects of the stock market

1. Wealth effect

The first impact is that people with shares will see a fall in their wealth. If the fall is significant it will affect their financial outlook. If they are losing money on shares they will be more hesitant to spend money; this can contribute to a fall in consumer spending. However, the effect should not be given too much importance. Often people who buy shares are prepared to lose money; their spending patterns are usually independent of share prices, especially for short term losses. The wealth effect is more prominent in the housing market. In Dec 2014, the value of the UK stock market was US $6.06 trillion so it has a big impact on wealth.

2. Effect on pensions

Anybody with a private pension or investment trust will be affected by the stock market, at least indirectly. Pension funds invest a significant part of their funds on the stock market. Therefore, if there is a serious fall in share prices, it reduces the value of pension funds. This means that future pension payouts will be lower. If share prices fall too much, pension funds can struggle to meet their promises. The important thing is the long term movements in the share prices. If share prices fall for a long time then it will definitely affect pension funds and future payouts.

3. Confidence

Often share price movements are reflections of what is happening in the economy. E.g. a fear of a recession and global slowdown could cause share prices to fall. The stock market itself can affect consumer confidence. Bad headlines of falling share prices are another factor which discourage people from spending. On its own it may not have much effect, but combined with falling house prices, share prices can be a discouraging factor. However, there are times when the stock market can appear out of step with the rest of the economy. In the depth of a recession, share prices may rise as investors look forward to a recovery two years in the future.

4. Investment
Falling share prices can hamper firms ability to raise finance on the stock market. Firms who are expanding and wish to borrow often do so by issuing more shares – it provides a low cost way of borrowing more money. However, with falling share prices it becomes much more difficult.

5. Bond market
A fall in the stock market makes other investments more attractive. People may move out of shares and into government bonds or gold. These investments offer a better return in times of uncertainty. Though sometimes the stock market could be falling over concerns in government bond markets (e.g. Euro fiscal crisis)

Stock market effect ordinary people
Most people, who do not own shares, will be largely unaffected by short term movements in the stock market. However, ordinary workers are not completely unaffected by the stock market.

1. Pension funds: Many private pension funds will invest in the stock market. A substantial and prolonged fall in the stock market could lead to a fall in the value of their pension fund, and it could lead to lower pension payouts when they retire. Similarly, if the stock market does well, the value of pension funds could increase. Even if people don't own shares, it is quite likely people with a private pension will have some connection to the stock market.

2. Business investment: The stock market could be a source of business investment, e.g. firms offering new shares to finance investment. This could lead to more jobs and growth. The stock market can be a source of private finance when bank finance is limited. However, the stock market is not usually the first source of finance. Most investment is usually financed through bank loans rather than share options. The stock market only plays a limited role in determining investment and jobs.

3. Short-termism: It could be argued workers and consumers can be adversely affected by the short-termism that the stock market encourages. Shareholders usually want bigger dividends. Therefore, firms listed on the stock market can feel under pressure to increase short-term profits. This can lead to cost cutting which affects workers (e.g. zero contract hours) or the firm may be more tempted to engage in collusive practises which push up prices for consumers. It has been argued that UK firms are more prone to short-termism because the stock market plays a bigger role in financing firms. In Germany, firms are more likely to be financed by long-term loans from banks. Typically, banks are more interested in the long-term success of firms and are willing to encourage more investment, rather than short-term profit maximisation.

Interest Rates and the Stock Market
So now we see how those ripples can rock the stock market. If a company is seen as cutting back on its growth spending or is making less profit – either through higher debt expenses or less revenue – then the estimated amount of future cash flows will drop. All else being equal, this will lower the price of the company's stock. (A key way to value a company is to take the sum of all the expected future cash flows from that company discounted back to the present. To arrive at a stock's price, take the sum of the future discounted cash flow and divide it by the number of shares available.)
If enough companies experience declines in their stock prices, the whole market, or the key indexes (like the Dow Jones Industrial Average or the S&P 500) that many people equate with the market, will go down. With a lowered expectation in the growth and future cash flows of the company, investors will not get as much growth from stock price appreciation, making stock ownership less desirable. Furthermore, investing in equities can be viewed as too risky compared to other investments.
However, some sectors do benefit from interest rate hikes. One sector that tends to benefit the most the financial industry. Banks, brokerages, mortgage companies and insurance companies' earnings often increase as interest rates move higher, because they can charge more for lending.

Impact of Interest Rates on Stocks
And by the way, nothing has to actually happen to consumers or companies for the stock market to react to interest-rate changes. Rising or falling interest rates also affect investors' psychology – and the markets are nothing if not psychological. When the Fed announces a hike, both businesses and consumers will cut back on spending; this will cause earnings to fall and stock prices to drop, everyone thinks – and the market tumbles in anticipation. On the other hand, when the Fed announces a cut, the assumption is that consumers and businesses will increase spending and investment, causing stock prices to rise – and the market jumps for joy.
However, if expectations differ significantly from the Fed's actions, these generalized, conventional reactions may not apply. For example, let's say the word on the street is that the Fed is going to cut interest rates by 50 basis points at its next meeting, but the Fed announces a drop of only 25 basis points. The news may actually cause stocks to decline – because assumptions of a 50 basis point cut had already been priced into the market.
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Conclusion
Although the relationship between interest rates and the stock market is fairly indirect, the two tend to move in opposite directions: as a general rule of thumb, when the Fed cuts interest rates, it causes the stock market to go up; when the Fed raises interest rates, it causes the stock market as a whole to go down. But there can be no guarantee about how the market will react to any given interest rate change the Fed chooses to make. For example, in 2013, in defiance of conventional wisdom, both interest rates and the S&P 500 rose significantly. Economists are still trying to figure that one out.

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