INTRODUCTION TO THE WORLD OF THE STOCK MARKET

A guide to everything you need to know before Investing or Trading

ALEX SMITH

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ISBN 978-1-7378709-0-6

Book Design: Najdan Mancic

CONTENTS

Introduction to the Stock Market 1

CHAPTER 1: The History of the U.S. Stock Market 5

The Meaning and History of Trading 6

The American Stock Market 13

CHAPTER 2: How the Stock Market Works 22

The Functions and Roles of the Stock market 29

Stock Market Players 32

Types of Stock Market Investors 35

The Types of Markets 37

CHAPTER 3: Indexes 42

Popular Market Indexes 44

Dow Jones Industrial Average 44

Nasdaq Composite 52

Standard & Poor's 500 Index 56

Bloomberg Barclays Aggregate Bond Index 59

Other Indexes 61

Wilshire 5000 Total Market Index 61

Russell 3000 Index 62

NYSE Composite Index 63

Barron's 400 Index 63

Investing in Market Indexes 65

CHAPTER 4: Stocks and Stockbrokers 66
Understanding the Different Classifications and Categories of Stocks.... 67
Large-Cap Stocks 68
Mid-Cap Stocks 69
Small-Cap Stocks 70
Domestic Stocks and Foreign Stocks 70
Cyclical and Non-Cyclical Stocks 71
Growth Stocks 75
Value Stocks 77
Dividend Stocks 77
Blue Chip Stocks 78
Penny Stocks 80
Sectoral Stocks 81
Understanding Stockbrokers and Major Brokerage Companies 86
The History of Stock Brokering 86
Types of Brokers 90
Major Brokerage Companies 94
Choosing a Stock Broker 99

CHAPTER 5: Funds 103
Types of Information to Look Out for When Considering a Fund 104
Prospectus 104
Statement Of Additional Information (SAI) 105
Shareholder Reports 105
Other Reports 106
Stock Funds 107
Type of Stock Funds 107
Bond Funds 114
Types of Bond Funds 115

Money Market Funds 118
Types of Money Market Funds 119
Mutual Funds Vs. Exchange-Traded Funds (ETFs) 120
History of Mutual Funds 121
History of ETFs 122
Mutual Funds 123
Exchange-Traded Funds (ETFs) 126
CHAPTER 6: Trading vs. Investing 130
Understanding What Investing Is All About 131
Types of Investing 132
Major Categories of Investors 133
Pros and Cons of Investing 135
Understanding What Trading is All About 137
Types of Trading 138
Major Categories of Traders 140
Pros and Cons of Trading 142
CHAPTER 7: Welcome to the Modern World of Trading 146
Stock Ticker 147
Stock Symbol 147
Shares Traded and Price Traded 150
Change Direction and Change Amount 150
Candlestick Chart System 151
Candlestick Patterns 153
Chart Patterns 162
Support and Resistance Levels 168
How to Draw Support and Resistance levels 170
How to Trade Support and Resistance Levels 173

Technical Indicators 174
Moving Average 174
Moving Average Convergence and Divergence (MACD) 178
Relative Strength Index (RSI) 182
Volume 184
Other Trading Tools 185
Stock Simulators 185
Stock Screeners 187

CHAPTER 8: Welcome to the Modern World of Investing 190
Value Investing 190
How to Identify Value Stocks 195
The Bottom Line on Identifying Value Stocks 208
Income Investing 208
How to Build an Income-Based Portfolio 210
The Bottom Line on Building an Income-Based Portfolio 215
Index Investing 217
How to Identify Good Index Funds 217
The Bottom Line on Index Investing 220
Growth Investing 221
How to Identify Growth Stocks 222
The Bottom Line on Growth Investing 225

CHAPTER 9: Things You Need to Understand Before You Start Trading or Investing 227
The Stock Market is not a Get-Rich-Quick Scheme 228
Educate Yourself Continuously 229
Practice Makes Perfect 231
Diversification is Important 233
Trading Stocks with Leverage is Risky 235

Planning is Important 237
Record Keeping is Important 240
Traits You Need to Possess as an Investor or Trader 243
Discipline 243
Patience 244
Adaptability 244
Mental Resilience 245
Independence 247
Forward thinking 247
Bottom line on Traits You Need as an Investor or Trader 248
Conclusion 250

INTRODUCTION

My foray into the stock market all started five years ago when inflation was silently eating up my savings. Simultaneously, I also realized that my savings would not get me the cushy retirement egg nest I wanted or increase my wealth as quickly as I desired. I needed to make my savings work for me instead of just leaving them to gather up dust in my savings account and lose value because of inflation. Hence, I researched the best ways to make my money work for me, and my search led me to the stock market.

Now, I have heard about the stock market all my life and how regular people were building their wealth through it. But I always felt that the process would be too stressful or too complicated to get into. Therefore, I ignored and tuned out anything that concerns the stock market. A big mistake—and my loss—because the stock market was the top result that kept popping up on my search for the best way to build my wealth by making my money work for me. I discovered that the stock market is a terrific place to beat inflation and grow my wealth. I also realized that I had only to take the time to learn about how to participate in

the market profitably. And so, without further ado, I learned all I could about the stock market, and the rest, they say, is history.

As of 2020, 55% of Americans or over 180 million Americans were participating in the stock market. Why? Because there is money to be made from the market! Because more than half of the American population has discovered the secret to wealth building. Because six out of every ten Americans have learned that saving their money in the bank was not taking them anywhere; instead, they were steadily losing a portion of their savings to inflation. And do you know why the remaining 45% of Americans are not participating in the stock market? Because 53% do not have enough money to invest in the stock market. Because 21% say they do not trust stockbrokers or financial advisors. And the remaining 26% are not participating in the stock market because they are simply indifferent to it like I was!

You may have discovered that saving your money in the bank is not the best or fastest way to grow your wealth. You may also, like me, be looking for the best ways to make your money work for you so you can build your wealth. You may have heard about the stock market repeatedly, but like me, you may have written off the stock market as too complex for you to bother yourself with. But after years of passing over the stock market and watching average Joes make money from that same market, you may have resolved to learn how to use the stock market as a tool to grow your wealth. But now, the problem is, where do you start?

This book is an excellent place to start. The complexity of the stock market is why I wrote this book to guide people like you to learn about the stock market in the simplest way possible. Unlike

other books, this book does not overload you with too much information. Instead, this book adopts an introductory approach that gently introduces you to the world of stocks. After reading this book, you will not only have a broad idea of how the stock market operates, but you can also participate in the market.

In this book, you will learn about how the stock market works by learning about the major components that make up the stock market. You will learn about the two main ways you can participate in the stock market, just as you will learn about multiple strategies you can adopt in participating in the market. You will learn how to use the stock market as a wealth-growing tool so you do not have to worry about inflation eating up your savings. This book will provide you with a broad knowledge of the stock market and how you can grow your wealth through it.

I have been participating in the stock market for over five years. During this period, I have participated both as a trader and an investor. The first year was tough because I was a greenhorn and still learning all I could about the market. But, in the four years after that, I have experienced such massive success trading and investing in the stock market I have been able to build my wealth to a point where I can comfortably retire anytime I choose to.

However, in all my trading and investing years, I have always been intrigued as to why more people were not participating in the stock market—especially those with stable paying jobs. Conversations with friends, family, and coworkers made me realize that most people do not just know where to start. And so, I took it upon myself to create this introductory book to the stock market to help regular people like myself learn the basics about

the complex world of participating in the stock market. The information in this book will help you learn how to trade or invest in the stock market. It will also provide you with an intermediate level of knowledge that will take you from a stock market amateur to a semi-professional quickly.

The first step in ripping off your greenhorn tag is to learn about the history of the stock market and how it all began. And that is what I will be discussing in the first chapter. I hope you enjoy reading the book!

CHAPTER 1

INTRODUCTION TO THE STOCK MARKET

Welcome to the Modern World of the Stock Market: The History of the U.S. Stock Market

The stock market has helped thousands of companies and corporations to raise funds to grow their business. It is also a platform where millions of people have made significant returns on their investments. The stock market has, without a doubt, made many people happy over the years, yet only a handful of people know how it all began. What is the origin of the stock market? How did it develop over the centuries? How did it become what it is today?

To answer these questions, we need to go back to the beginning of things—and no, I do not mean back to when the world was created. To be more precise, we need to go back to the one thing that inevitably led to the creation of the stock market. The one thing that has existed as long as humans have existed. The one thing that has, contributed to the prosperity the world now enjoys. The one thing that has served as a fuel that keeps the engine of the world in operation. That thing is nothing other than trade.

THE MEANING AND HISTORY OF TRADING

Trade is the exchange of goods and services from one person to another in exchange for money. But back in the good old days, there was no universally accepted form of money. People resorted to exchanging goods and services for other goods and services in a process known as bartering. Bartering was the prehistoric era's trading system, which involved people exchanging what they had for what they needed. Bartering was a complicated trade system for a difficult period in human history.

It did not take too long before people grew tired of the complexity that came with the bartering system. This led them to seek other ways to trade their goods and services. Around the Stone Age, people settled on obsidian and flint for money and exchanged goods with them. And so, the Stone Age saw traders trading with obsidian within the Mediterranean region. Their trading activities within this region covered distances up to 900 kilometers.

In the 3rd millennium BCE, longer trading routes appeared when the Sumerians from Mesopotamia traded with the Harappans from the Indus Valley. Shortly after that, the Phoenicians traveled across the Mediterranean Sea to as far as Britain in search of tin to manufacture bronze. The long distance led them to establish trade colonies along their trade routes which they called emporia.

Traders imported spices from India and China to Europe in the 2nd century. Europe's spice importation was a valuable inter-continental trade that lasted till the fall of the Roman Empire in the 5th century. The Roman transition from kingdom to republic helped produce a stable and secure transportation network that enabled the continental shipment of goods. This transportation network facilitated the movement of spices from the far East down

to Europe. But then, the fall of the Roman empire—and the subsequent Dark Ages—brought instability to Western Europe, which stopped the importation of spice to Europe and almost led to the collapse of trading networks in the western world. However, this instability was contained in the western world as trade continued to thrive and flourish in the Middle East, India, China, Southeast Asia, and the Kingdoms of Africa.

In 1500 BC, the Austronesian people of Southeast Asia created the first actual maritime trade network on the Indian Ocean. They established trade routes with Sri Lanka and Southern India during this period, exchanging material culture between the nations. The trade network stretched to the far reaches of Africa and the Arabian Peninsula. It was known as the Austronesian trade network for a long time before later becoming the Maritime Silk Road.

Commerce developed in Europe during the Middle Ages via the trading of luxury goods at trade fairs. Banking systems also developed during the Middle Ages; their development made wealth convertible to movable wealth as it became possible to transfer money across nations. The Middle Ages also saw the development of hand-to-hand markets in the Western World, which town authorities regulated as they became a permanent feature of town life. Western Europe also developed its trade network during the Middle Ages—albeit a more complex and extensive one. Bristol—the English port city—traded with people from modern-day Iceland, the western coast of France, and modern-day Spain. The Middle Ages witnessed Central Asia being the world's economic center as the Sogdians dominated the East-West trade route known as the Silk Road.

The Vikings and Varangians entered the global trading mix in the 8th century and participated until the 11th century. They sailed to and from Scandinavia—with the Vikings sailing down to Western Europe and the Varangians sailing down to Russia. In the 13th century, an alliance of trading cities created the Hanseatic League. The league helped the alliance maintain a trading monopoly over the Baltic and most parts of Northern Europe.

The Kingdoms of West Africa became significant members of global trade as early as 1070 due to the gold and other resources sent out by Muslim traders on the Trans-Saharan trading network. Later, West Africa exported spices, gold, textile, and slaves to different European traders, such as the Dutch, English, and Portuguese. Their exports were often in exchange for iron, textiles, or cowries—which they used as local currency.

The Bengal Sultanate, founded in 1352, was a major trading nation and was often referred to by the Europeans as the wealthiest country. A few decades later, Vasco da Gama restarted the spice trade when he reached Calicut after sailing around the Cape of Good Hope in 1498. Before Vasco da Gama sailed, the flow of spice from India into Europe had been under the control of Islamic powers—especially Egypt. But Europe got spices directly from India after the successful European expedition led by Vasco da Gama. The trade of spices was economically important and helped stimulate the Age of Discovery in Europe.

Vasco da Gama

In the 16th century, the Seventeen Provinces became the center of free trade after they scrapped exchange controls and encouraged the free movement of goods. The 16th century also saw Portugal dominating trade in the East Indies before monopoly shifted to the Dutch Republic in the 17th century and the British in the 18th century.

In 1799, the Dutch East India Company—formerly the world's largest company—became bankrupt partly due to the upsurge of competitive free trade, which led to high skepticism about the concept of free trade among several countries. Yet, James Mill, Robert Torrens, and David Ricardo demonstrated that free trade would be beneficial to the industrially-weak countries as well as industrially-strong countries via the theory of comparative advantage. Their demonstration doused the fire of skepticism around the concept of free trade and helped it gain prominence across the world in the 19th century.

In the 20th century, a major economic crisis in the Great Depression occurred between 1929 to the late 1930s. During this period, the stock market saw a tremendous drop in trading activities. The Great Depression caused inflation and stagnation, and the lack of free trade among the affected countries was the principal cause of the economic crisis. The causes and some other chain of events led 44 countries to sign the Bretton Woods Agreement in 1944 to prevent any future depressions. Then in 1947, 23 countries agreed to the General Agreement on Tariffs and Trade (GATT) to further promote free trade. This ascendency of free trade led the European Union to become the largest exporter of manufactured goods and services in the world—servicing around 80 countries.

The concept of free trade advanced further in the late 20th century when the European Union lifted barriers to internal trade in goods and labor in 1992. On the 1st of January 1994, the North American Free Trade Agreement (NAFTA) took effect. It was followed by the GATT Marrakech Agreement, which specified the formation of the World Trade Organization. Then on the 1st of January 1995, the World Trade Organization was created to facilitate free trade among all signatories. A few years later, the European Union created the Economic and Monetary Union (EMU) in 2002. Then the EMU introduced the Euro, and the creation resulted in a single market between 13 member states in the European Union. Finally, in 2005, several countries, including the Dominican Republic and the United States, signed the Central American Free Trade Agreement.

Today, in the 21st century, trade has dramatically evolved from its original complex barter system. It has transcended beyond

mere goods and services to trade equities, bonds, currencies, and even virtual currencies. And this leads us to examine the advent of the stock market—whose emergence results from the evolution of trade.

THE AMERICAN STOCK MARKET

While the United States of America has the reputation of leading most breakthroughs and developments globally, this was not the case with the stock market. The stock market's history began in Antwerp—modern-day Belgium—in the late 1400s. Back then, in Antwerp, merchants bought goods in anticipation that the price might rise so they could make profits by reselling them at a higher price. Besides the anticipatory trading activities of the merchants, brokers and moneylenders in Antwerp met to trade promissory notes and bonds, but there was no trading of real stocks back then.

That changed when the first modern stock trading system was created in Amsterdam in 1611. Before creating the Amsterdam Exchange, East Indian companies—which received charters from the British, French, and Dutch governments—issued shares that paid dividends based on the proceeds from the voyages the companies undertook in the 1600s. These companies were the first modern joint-stock companies, and they issued their shares on paper. Investors could sell these papers to other investors, but unfortunately, there was no stock exchange as of then. Hence, investors who wanted to sell their shares would have to track down a broker who would have to look for someone who wanted to buy the shares.

However, the creation of the Amsterdam Exchange in 1611 led to the Dutch East India Company listing their stock on the exchange, becoming the first publicly-traded company. This meant that investors could trade their shares via the exchange instead of tracking down brokers. For many years, the Dutch East India Company was the only company with trading activity on the exchange. But a few decades later, the Amsterdam Exchange expanded to include trading in various derivatives, such as options trading.

Seeing the success of the East India companies—most notably the Dutch East India Company and the British East India Company—and wanting a piece of the action, other countries created similar companies. In 1711, the South Sea Company was formed. It was officially known as "The Governor and Company of the Merchants of Great Britain." The company was created as a private-public partnership to reduce the national debt. The company intended to trade with the "South Seas" and America. The company immediately sold shares even before the first ship left the harbor, using the fortune it derived from investors to open plush offices in the best parts of London. The perceived success of the South Sea Company—especially when they realized that the company had not done a thing besides issuing shares—led other so-called businessmen to rush in and offer shares in their respective ventures.

Despite the ludicrous nature of some of the ventures—such as one company promising investors shares in a vastly significant undertaking that they could not reveal and another company stating that their mission was to reclaim sunshine from vegetables—a lot of wannabe investors bought up the shares. Buying

shares from companies became all the rage for investors. The excitement blinded most investors and led them to buy any shares without investigating the company, resulting in a financial bubble. The bubble burst when the South Sea Company failed to pay any dividend on the meager profits they realized from their voyage. Investors became fearful and tried to sell their shares hurriedly. However, no one was buying, and this led to the market crashing in 1720. Then the crash led the British government to outlaw issuing shares—and the ban was held until 1825.

Although the stock market's history started in 1611, the United States did not get into the game until the late 1700s. The history of the American Stock exchange began in 1791 when a small group of merchants met under a tree in Buttonwood to buy and sell stocks and bonds. After doing this for over a year, these security traders –24 in number—officially banded together and created the Buttonwood Agreement on the 17th of May 1792.

Two main reasons that helped to form the agreement were to discourage any form of intervention from the government and prevent outsiders from joining the coalition willy-nilly. Because of the agreement, any non-member that wanted to buy a stock had to do that through an approved broker. After forming the Buttonwood Agreement, the signees moved their operations to offices at the Tontine Coffee House, on the corner of Wall Street and Water Street, where they operated until they moved into the Merchants' Exchange building at 55 Wall Street, in 1802.

While the Buttonwood traders would become the creators of the largest stock exchange in America, the creation of the

Philadelphia Stock Exchange in 1970 made it America's first stock exchange. Originally named the Board of Brokers of Philadelphia, it changed its name to the Philadelphia Stock Exchange in 1875. The exchange had a profound impact on the city's place in the global economy. It helped spur the development of the United States' financial sector and its expansion to the west.

On the 8th of March, 1817, the Buttonwood traders visited the Philadelphia Merchants Exchange to observe and study their mode of operation. They then used their observations to create their version of a stock exchange which they named the New York Stock and Exchange Board. They created a constitution for their exchange and elected Anthony Stockholm as president. He oversaw operations and announced the stock being traded every morning. The New York Stock and Exchange had a dress code that mandated its members to wear suits with top hats and dress coats. Before a person could gain a seat on the exchange, they had to be voted in by members and be willing to pay a fee of $25. This fee rose to $100 by 1834, and by 1848, it was $400.

Unfortunately, on the 16th of December 1835, a fire—subsequently referred to as the Great Fire of 1935—tragically wiped out 700 buildings in lower Manhattan and led to a significant property loss for Wall Street, which was calculated at a whopping $40 million in damages. Fortunately, Samuel Morse opened a telegraph demonstration office on Wall Street two years later, which the brokers embraced as it allowed them to communicate remotely. Thirty years after the Great Fire, Edward Calahan created the stock ticker, which featured wheels of narrow paper strips detailing stock transactions. Clerks dispensed these paper

strips to typists via a pneumatic tube, and the typist sent the information to brokers through the telegraph.

The history of the American Stock Market will not be complete without mentioning the efforts of women in contributing to the American Stock Market. On the 5th of February 1879, Cornelius Vanderbilt funded the Ohio-born sisters, Victoria Woodhull and Tennessee Claflin, to open the first women-owned Wall Street stock brokerage. Women had a tough time being allowed to trade directly in the New York Stock Exchange. In the 1940s, women were allowed out of the "back rooms" to work on the trading floor. Yet, not until 1967 did Muriel Siebert become the first woman to own a New York Stock Exchange seat, marking a historic turn in the American Stock Market.

In 1882, the world's first electricity plant was launched on Pearl Street by Thomas Edison. This electricity plant powered a whopping 7,200 lamps on Wall Street and was the second major technological innovation to grace Wall Street after the invention of the stock ticker in 1867. Seven years after the electric plant was launched, the Dow Jones & Company debuted the Wall Street Journal. The journal sold for two-cent per cover, and its most popular feature was the Dow Jones Industrial Average, an index that charted the performance of a group of stocks.

In 1863—28 years after the Great Fire of 1835—the New York Stock and Exchange Board changed its name for the last time to the New York Stock Exchange. A few decades later, after undergoing two years of construction, a modern New York Stock Exchange building was opened at 18 Broad Street in 1903. Designed by architect George Post, the building was the earliest to feature air

conditioning in America. The building also contained hundreds of underground vaults where stock certificates were kept.

Again, the American Stock Market's history will not be complete without discussing the major competitor the New York Stock Market had during its formative years. Although the New York Stock Exchange had competition in New York and other areas, its major competitor was a group of individuals known as the Curbstone brokers. These brokers also dealt with securities, but their comparative advantage over the New York Stock Exchange was that they would handle small transactions that did not meet the New York Stock Exchange requirements—commonly called the "big board" back then. While the big board required at least 100 shares per transaction, the Curbstone brokers would accept as little as one share per transaction. And so, the Curbstone brokers attracted traders that could not afford to or did not want to buy or sell 100 shares per transaction.

The Curbstone brokers' mode of operation was to wait to see what the price of securities was set at for the day by the big board before conducting their auctions in the evening. Interestingly, they conducted business outside regardless of the weather. Rain or shine, they were always outside running their business. After operating their business this way for over 100 years, they moved their operation indoors. And so, they purchased a lot on Wall Street and built a building to house their operations. In 1928, they named themselves the New York Curb Exchange, and in 1953, they changed their name to the American Stock Exchange.

On the 16th of September 1920—85 years after the Great Fire of 1835—a devastating explosion believed to be targeted at J.P

Morgan's bank. The explosion occurred when a wagon parked in front of the Assay Office exploded. The explosion was so powerful that it sent a car flying into the 34th floor of the Equitable Building before crashing down to the ground. The explosion claimed thirty lives while hundreds of people sustained varying degrees of injuries. Several buildings were also destroyed, and scores of horses lost their lives as well. Because many of the explosion victims worked at J.P Morgan's bank, investigators concluded that the bank was the target of the bomb. The blast stopped all trading activities on the street for quite some time while a three-year investigation by the Bureau of Investigation yielded no arrests.

On the 24th of October 1929—nine years after the explosion at J.P Morgan—the U.S. Stock Market surged as high as 50 percent despite indications that the U.S. economy was declining. People kept pumping money into the stock market despite the indications of a waning economy and amid predictions that the stock market would soon collapse. It all ended when the stock market dropped by 11 percent, wiping out investors who bought at the top in what is now called Black Thursday. But that was not the end of it all. By the 28th of October—later called Black Tuesday—a panic ensued amongst investors and resulted in a frenzied selling of 16 million shares. And by the following day, the U.S. Stock Market had lost nothing less than $30 billion! While there was an immediate recovery, the damage had been done, and the stock market continued to slide until 1932, when it reached its lowest level ever. It took the U.S. Stock Market all of the 1930s to recover. This period was tagged as the Great Depression and was characterized by mass unemployment and poverty.

In 1971, the National Association of Securities Dealers founded a new stock exchange naming it the National Association of Securities Dealers Automated Quotations or NASDAQ in short. The NASDAQ Stock Market began its operations as the world's first electronic stock market. In 1992, NASDAQ joined forces with the London Stock Exchange to form the first intercontinental securities market. Six years later, it became the first stock market to conduct online trading in America. Unlike the New York Stock Exchange, which is a physical stock exchange that provides in-person trading, NASDAQ allows investors to buy and sell stocks on a network of computers.

Unfortunately, the 1929 stock market crash was not the last crash to the American Stock Market. On the 19th of October 1987, the U.S. Stock Market experienced one of its largest single-day crashes, resulting in the market losing $500 billion as markets nosedived worldwide. The U.S. Stock Market crash was exacerbated because computers on Wall Street were programmed to sell stocks when they crossed specific price thresholds. Subsequently, a domino effect was set in motion when computers started selling off thousands of stocks, with the clerks unable to stop the transactions. To add salt to injury, the automated programs also prevented buying, which wiped away any bids. After this unfortunate incident occurred, special rules were created and implemented to allow overrun automated protocols to prevent future disasters.

Everything was proceeding as it should in the U.S. Stock Market until terror attacks targeted at the financial district occurred on the 11th of September 2001. These attacks resulted

in over 6,000 injuries, 2,996 deaths, and the destruction of the twin towers of the World Trade Center. The wanton destruction damaged communication networks, and the debris from the destruction limited access to the financial offices, resulting in the stock market being closed for seven days. Heavy development around the areas affected by the terror attacks followed the disaster. It led to a substantial number of building projects—with the singular World Trade Center being the most notable of those projects.

In 2008, America's Stock Market witnessed yet another crash. This crash was one of the worst since the Great Depression, and in a few short words, it was caused mainly by the mishandling of subprime mortgages. The crisis resulted in the government taking over Freddie Mac and Fannie Mae while Lehman Brothers filed for bankruptcy. Many banks were expected to file for bankruptcy, so the government stepped in to offer a federal bailout to the banks—which amounted to trillions of dollars. Housing prices crashed, and there were massive foreclosures and seizures of homes across the country. 2008 also saw the New York Stock Exchange acquiring the American Stock Exchange to become an even larger organization.

To sum it all up, the American Stock Market began when a group of merchants created what later became the largest and most valuable stock exchange in the world—the New York Stock Exchange. The 1972 Buttonwood Agreement in New York formally created the American stock exchange, which inevitably led the city to become the epicenter of the stock market in the United States.