



Stock talk

Jack and the Beans Talk

by Bill Dickneider

There's no proof that the following events actually took place, but the lesson they hold is as real as pepperoni pizza. Jack Stockwell could tell you that.

Beta Beans

Jack who? Jack Stockwell is a devoted player of The Stock Market Game. One day while researching Papa John's pizza on the web, he stumbled across an unusual term called beta. "What in the world is *that*?" he said to himself.

Suddenly, odd creatures appeared on his computer screen. "You called?" asked one of the critters.

Jack jumped. The creatures had huge oval heads that looked like beans. "What do you mean?" blurted a bewildered Jack. "Who — or what — are you?"

"Relax! Relax! We thought you called us. We're the Beta Beans. We can tell you anything and everything about beta."

"Well, I *am* puzzled," admitted Jack, who had settled down after his surprise. "I was checking Papa John's pizza to see if it would be a good investment. But there

among all the statistics on the web page was a number called beta. It said Papa John's beta was 0.41. I have no idea what that means."

Sensitive Stocks

"It's time for a Beta Bean to teach a human being," said the legumes. "When the stock market moves up and down, individual stocks tend to move with it. Beta measures how sensitive a stock is to these changes in the overall market. Stocks that exactly match the ups and downs of the market have a beta equal to one. But some stocks are less sensitive to market changes. They swing up and down less than the overall market. Their betas are less than one."

"I get it," said Jack. "Papa John's has a beta of 0.41, which obviously is less than one. So when the stock market rises and falls, Papa John's stock probably changes more slowly."



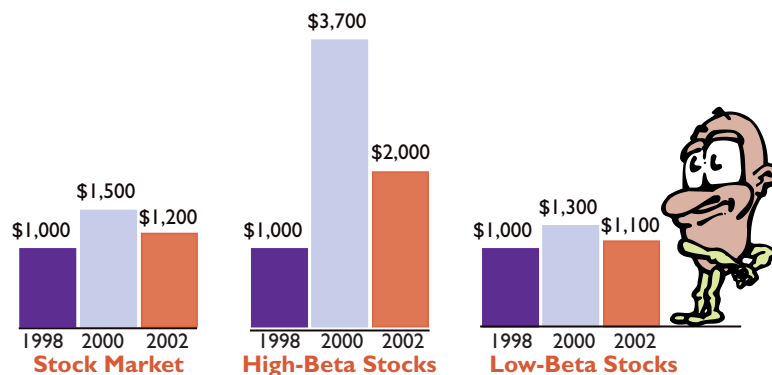
Beta measures how sensitive a stock is to changes in the overall stock market. Papa John's beta is 0.41. What does this number mean?

"That's using your bean," said the little veggies. "Ah, but what if a stock's beta is *greater* than one?"

"The stock would probably rise or fall faster than the market," answered Jack. "It would be *more* sensitive to changes in the market."

"Okay, bean brain," said the brainy beans. "Take a look at this (see table below). Tell us which stocks in the table are likely to bounce around more than the market whenever the market rises and falls."

"That's easy," answered Jack. "Cisco, Dell, Intel, and Microsoft all have betas greater than one. The prices of these stocks are very sensitive to market changes. They would change much more than the general market."



In January 1998 you make three investments of \$1,000 each. One is in stocks that move along with the stock market. Another is in the four high-beta stocks shown by the table at the left. The third investment is in the four low-beta stocks.

The stock market soars from 1998 to 2000 and then sinks thereafter. The columns above show what happens to each investment by January 2000 and then by January 2002. Does the high-beta investment vary more or less than the stock market? What about the investment in low-beta stocks? Can beta help you pick stocks more likely to grow in step with the stock market?

Some Betas for Your Bean

High-Beta Stocks

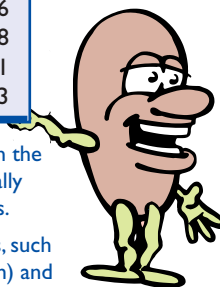
Cisco Systems (CSCO)	1.96
Dell (DELL)	1.87
Intel (INTC)	2.04
Microsoft (MSFT)	1.46

Low-Beta Stocks

ExxonMobil (EOM)	0.26
McDonald's (MCD)	0.38
Papa John's International (PZZA)	0.41
Procter & Gamble (PG)	0.23

Beta measures a stock's response to changes in the overall stock market. The stock market is usually measured by the S&P 500 index of stock prices.

You can find a stock's beta at various web sites, such as The Nasdaq Stock Market (www.nasdaq.com) and The New York Stock Exchange (www.nyse.com).



"Right," agreed the beans. "By January 2002, your \$1,500 investment would have dropped to \$1,100. But suppose back in January 1998 you had also invested \$1,000 in the four high-beta stocks and \$1,000 in the four low-beta stocks."

The beans then presented the chart above and asked Jack to explain how these other two investments fared when compared with the \$1,000 invested in the general stock market.

"That's easy," said Jack. "The investment in high-beta stocks rose much more than the stock market from 1998 to 2000. But when the market dropped after that, the high-beta investment dropped much more."

"What about the low-beta stocks?" asked the beans.

"They were just the opposite," answered Jack. "The investment in these stock went up less than the market from 1998 to 2000. It also dropped less than the market when the stock market sank after that."

Suddenly, the beans disappeared. Jack smiled as he thought about their lesson. He hoped his computer would soon again be full of beans.

"What about the other four stocks?" asked the beans.

"Their betas are much less than one," explained Jack. "So these stocks aren't very sensitive to market changes. They would change less than the stock market."

"Not bad! Not bad!" applauded the beans. "Now let's apply the lesson to the stock market over the last five years. Suppose you had invested \$1,000 in the stock market back in January 1998. Between January 1998 and December 2000, the stock market soared. If your investment had grown along with the market, it would have been worth \$1,500 in January 2000.

"Well, the market sure sank after that," exclaimed Jack.

Write Now

Pick one of the following and write a paragraph to explain your answer.

Jack invested in the four high-beta stocks in January 2000. Jill invested the same amount in January 1998 but put the money in the four low-beta stocks. How did their investments compare in January 2002?

Would you prefer to invest in a low-beta company or a high-beta company? Why?