



Ticker's Tales

"A Stock Market Mystery"

Lots of things make stock prices jump up and down from day to day. But over time the most important reason is how much a company earns. Rising earnings usually bring a higher stock price, and lower earnings bring a lower one.

It was good news, then, when J.C. Penney recently reported a huge increase in its earnings — about double that of the same period last year. But the company's stock price barely budged compared with the overall stock market. Why not?

We can solve the mystery by remembering the importance of expectations. Expectations are what we think will happen in the future. For example, don't you buy clothes you expect will be in style and will make you look cool in the coming weeks and months? Your willingness to buy them today depends on how much use and enjoyment you expect to get out of them in the future.

When you shop for clothes, you're behaving like investors shopping for stocks. Their willingness to buy a particular stock also depends on the future benefit they expect from owning it. A stockholder benefits by getting a share of any profit the company earns in the future. So if investors suddenly expect a company to earn more money in the future, they become more eager to buy its stock today. As they try to buy more shares, they push up the price of its stock.

So why didn't Penney's stock soar relative to the market in general? While the company's sales and earnings had grown rapidly in recent months, that was news about the past, not the future. You don't buy clothes because they were in style last year. You want clothes you expect to be in style when you wear them next week or next month.

Investors also look ahead, not behind, and they didn't expect the rapid growth of Penney's sales and earnings to continue in coming months. What's more, the company lowered a sales forecast after a sudden snowstorm on the East coast had chilled sales. So despite the good news about Penney's past earnings, investors weren't shopping more eagerly for the company's stock. And that was no mystery.

Write Now

J.C. Penney competes against other stores, such as Wal-Mart (WMT) and Federated Department Stores (FD). Use a newspaper's stock tables to find the listing of all three stocks. How do the current prices of the stocks compare with the 52-week highs and lows? Would your willingness to own any of these stocks depend on your expectations? Explain.