ASX

Schools Sharemarket Game

PLAY THE GAME!

THE ECONOMY & THE SHAREMARKET

Supplementary lesson 3

Includes: Student lessons . Teacher notes & answers

The economy and the sharemarket

Introduction:

In this lesson students will take a look at influences on the performance of the sharemarket, individual companies or sectors. This lesson is more advanced than other lessons as it addresses economic issues in greater depth.

You might like to develop simpler lessons based on the content provided.

Lesson Design:

Online lesson

Expected Learning Outcomes:

Students will:

1) Understand the impact interest rates and exchange rates might have on companies and the sharemarket.
2) Understand how government decisions / actions might influence the sharemarket.
3) Have a better understanding of the types of corporate actions companies can undertake.
4) Gain an understanding of the influence of the global economy on the Australian sharemarket.
5) Learn more about commodities and their impact on the sharemarket.

Overview of Student Lesson:

1) Introduce the topic 'The economy and the sharemarket.'
2) Split students into groups: Give each group a topic to research – students will need access to the internet. (The exchange rate topic is best suited to more advanced students.)

   The aim of this lesson is for students to research the topic themselves. We have provided a few questions on each topic to help get them started. If they are struggling to find information there are additional web links in the teacher notes (pg T.2 – T.6) for each topic.

   The teacher notes also include a guide as to the answers students might give.
3) Students can present back to the class on what they have discovered. (You might choose to give them guidelines as to how you want this presented. For example, Power Points, poster, A4 page – similar to the example on pg S.4.)

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Teacher Notes: THE ECONOMY & THE SHAREMARKET

These notes include a guide to the answers students may give to the questions in the student section plus web links you may give to students to help them further.

Group 1: Interest rates

What are they? Interest rates are a fee charged by a lender of money to the borrower. They are usually charged as a percentage.

How do rising interest rates affect lenders/borrowers? Rising interest rates reward lenders as they make more money due to increased payments given to them and disadvantage borrowers as they have to pay more interest.

Can they have an impact on company profits? A company that has a high level of borrowing will have to pay higher interest charges so this can have an impact on the company profits.

How might rising or falling interest rates have an impact on the share price or the sharemarket as a whole?

Interest rates can encourage or discourage investment.

- Generally **low interest rates** are good for the sharemarket because it becomes cheaper to borrow money and there are less interest costs which means more profits for companies. It is easier for companies to borrow in order to fund new projects, buy new equipment, etc.
- News of **higher interest rates** tends to cause the sharemarket to fall as costs will rise. Higher interest rates may affect companies differently depending on their debt levels.
- This next point is probably only something to discuss with senior or more advanced students and it relates to interest rates and demand for Australian currency. Following the global financial crisis many countries had extremely low interest rates in an attempt to encourage more growth. Australia had higher interest rates. This meant that capital was attracted to Australia to earn a higher rate. This increased demand for Aussie dollars which caused the Aussie dollar to remain high despite weakening commodity prices.

HELPFUL ARTICLES

- The RBA's cut to interest rates will boost house prices, but that's not the only effect.
- What's The Likely Impact of Further Interest Rate Cuts on Australian House Prices?
- Higher interest rates would hurt economy Higher interest rates would hurt economy.

Group 2: Government policies / actions

List the types of actions: Actions might include: government spending, subsidies, taxes, change in policy, an election, etc.

Consider how each action might affect the sharemarket or companies listed on the sharemarket.

- **Government monetary policy** can have an impact on the sharemarket, particularly around budget time.

  The government can influence interest rates and this can have a major influence on both the economy and the sharemarket.

  Government policies can also affect the sharemarket generally by affecting the level of money in the economy and whether its policies encourage growth and confidence or the reverse.
- **Changes to how companies are taxed** may have an impact on the profitability of a company, and therefore may affect share prices. The nature of those taxes may encourage some sectors and discourage others.
- **Major infrastructure projects** will benefit construction companies and the companies that supply them. (Continued over)

- **Government subsidies** can encourage particular industries such as subsidies for purchasing solar panels and the removal of subsidies can adversely affect industries, for example automotive manufacturing. In addition, grants for research can assist companies.
- **Trade agreements** can significantly affect whether it is possible to import or export certain goods. For example, free trade agreements with Japan, Korea and China will benefit some industries where as other less competitive industries may be disadvantaged. The "other side of the coin" is easier access to our markets for overseas companies.

HELPFUL ARTICLES

- How Federal elections impact the sharemarket
- Federal election: impact on investment markets
- Understanding & managing political risk
- Impact of policy & politics on share prices

Group 3: Commodity prices

What is a commodity? A commodity is a product or good that has come out of the earth such as gold, oil, coffee etc.

List some of the main commodities Australia exports. Coal, iron ore, liquid natural gas, wool, wheat, live sheep and dairy products.

What things influence commodity prices? Students might list natural disasters, extreme weather conditions, over or under supply of a commodity, the Australian dollar or economic growth.

- Increased economic growth overseas, particularly in China increased the demand for coking coal and iron ore. Slower economic growth since then plus increased supply has caused prices to fall.
- If there is an oversupply of a commodity, prices will tend to decrease whereas if a commodity is scarce the prices will tend to increase.
- The value of the Australian dollar will make our commodities more /less expensive for overseas buyers which will affect demand.

Does the rise and fall of commodities impact the sharemarket or particular sectors? The price of certain commodities (e.g. gold, oil, wool, grain, sugar, and iron ore, copper) on the world market may affect share prices. For example, a company engaged in gold mining is unlikely to achieve exceptional profit results if the price of gold is low.

Approximately 30 percent of listed companies on the ASX are in the resource sector, so energy and metal prices can have a dramatic effect on the sharemarket. Of course not all companies on the ASX are mining companies but a booming mining sector can spill over and encourage higher prices in other areas of the market.

Sectors often affected – resources and consumer staples.

HELPFUL ARTICLES

- Australia Trade: These Are The Top Commodity Imports & Exports
- Falling commodity prices 2018
- Commodities prices and the Australian stock market

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Group 4: Exchange rates

What are exchange rates? An exchange rate is the rate at which one currency may be converted into another. If you go to America you must buy U.S. dollars. The exchange rate determines how many Australian dollars you will pay to buy U.S. dollars.

Which companies listed on the Australian sharemarket are worse off if the Australian dollar is worth less compared to other currencies – importers or exporters? Why?

Exchange rates go up and down for various reasons. When they do, this can affect people who are buying goods from overseas (importers) and people who are selling goods to people overseas (exporters). Companies listed on the ASX will be affected differently as exchange rates go up and down.

- **High Aussie dollar:** A rising Aussie dollar benefits importers as it costs less to bring goods to Australia from overseas. Students might list retailers such as Harvey Norman, JB Hi-Fi and Myer as these companies can do well when the Aussie dollar is high as imports cost less. (Of course a high Aussie dollar has also encouraged online buying of overseas goods.) Manufacturing companies may find it more difficult as they have to compete with companies that are importing.
- **Low Aussie dollar:** A falling Aussie dollar will benefit exporters. If the dollar is weaker, mining companies and other exporters such as agricultural companies will benefit because they can sell their products at a cheaper rate making them more competitive.

Are there some sectors that are affected more by a rise in the Australian dollar (AUD)? The consumer discretionary sector, which includes retailers such as Harvey Norman and companies involved in tourism, such as Flight Centre and Qantas.

The materials sector where many of the companies that export may be disadvantaged due to the increase in the Aussie dollar. See also the earlier discussion on how interest rates can have an impact on the exchange rate.

HELPFUL ARTICLES

- Exchange Rates and the Australian Economy
- What Role Does the Australian Dollar Play in Our Economy?
- How the Australian dollar affects the results of companies
- The Aussie dollar rollercoaster

Group 5: Other financial markets and economies

Which overseas sharemarket has historically had the greatest impact on the Australian sharemarket? Movements in overseas sharemarkets can influence the Australian sharemarket. If we wake to hear news that the Dow Jones Index in New York has dropped a significant number of points overnight, there may be a reaction to this when the Australian sharemarket opens.

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The effect may in part be psychological as some investors begin to worry that share prices on the Australian sharemarket may fall and as a result, sell their shares to avoid any further losses. Also, large investors that have money invested all around the world might decide to sell shares on the Australian market after big falls overseas.

Australia's economy is also highly dependent on our exports to overseas countries. Therefore, a downturn in other economies may affect the willingness of companies overseas to buy our products, affecting profitability and therefore share prices.

What is happening in the global economy at present?

Is the Australian Sharemarket being impacted by this?

Answers to the above questions will vary depending on what is happening in the economy at the time.

HELPFUL ARTICLES

- How the overseas markets affect Australian stocks
- Spillovers to Australia from the Chinese Economy
- Figures show how much Australia's economy relies on China

Group 6: Corporate actions

What are corporate actions? A corporate action is an event or decision made by the company that gives an entitlement to the shareholders or creates a change in the company; examples of corporate actions include a dividend, a stock split, a merger, a takeover or an acquisition. Understanding corporate actions can give a clearer picture as to what is happening with a company financially and may help with decisions of whether one should be buying, selling or holding.

Dividends: Can you explain what a dividend is – who pays it and who receives it?

A dividend is a cash payment from the company's profits or earnings, usually expressed in cents per share which is paid to shareholders. A company is not required to pay a dividend from earnings and some choose to reinvest earnings back into the business. Many ASX listed companies pay dividends twice each year as an 'interim' dividend and a 'final' dividend.

Ex-dividend date: The Ex-dividend date refers to the day shares are traded, "ex" or without their dividend. Suppose XYZ company is paying a dividend but the shares go "ex" on 20 October. If you buy shares in XYZ company on 20 October you would not receive the dividend. You would however receive a dividend if you bought and held shares in this company on 19 October.

What usually happens to a share price after a share goes "ex-dividend"? One may think that it is worth jumping in and buying the stock just before the ex-dividend date, get the dividend and then sell the shares. This will not generally work as the dividend has been factored into the price of the share and on the ex-date the price falls, often by the amount of the dividend. For example, if the dividend is $1.00 you would expect the share price to drop by $1.00 when the shares start trading "ex-dividend".

What is a takeover? A takeover is when one company puts forward a proposal to buy out another company.

Takeovers: Strong growth in a company can often lead to **a takeover** or merger. It may be that a younger company has new / fresh ideas. Larger companies often look to expand and one of the ways of doing this is to take over a smaller company that can fit in well with their business. Other companies look to take over similar businesses as their own because they think they can run a larger, combined business more efficiently and hopefully more profitably.

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A weak Australian dollar can often encourage overseas companies to look further afield for expansion because they can buy Australian companies more cheaply than before. Conversely when the Australian dollar is strong, Aussie companies are more likely to look at takeover targets overseas.

What usually happens to the share price of a company if another company makes a takeover offer for it?

Will this action have a positive or negative impact on a company?

A takeover can affect the value of company shares whether it is the company that is making the takeover offer or the company that is the target.

In the case of the company making the takeover offer, the share price may go down or up depending on whether the market thinks the purchase will be a good one and whether the price they are going to pay is good value.

HELPFUL ARTICLES

- Pinpoint Takeovers First
- What happens to your shares in a takeover?
- How do Corporate Actions affect the Share Market

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Student Lesson: THE ECONOMY & THE SHAREMARKET

The economy and the sharemarket

Many things can have an impact on the sharemarket as a whole or on individual companies. These include interest rates, government policies, commodity prices, exchange rates, other financial markets and economies as well as corporate actions.

In this lesson, you will be researching one of these topics.

Under each topic there are some questions to help get you started. If you discover extra information that you think might be helpful; add this to your answers.

Provide feedback to your class on what you found.

GROUP 1: INTEREST RATES

- What are they?
- How do rising interest rates affect lenders/ borrowers?
- Can they have an impact on company profits?
- How might rising or falling interest rates have an impact on the share price or the sharemarket as a whole?
- See if you find some news articles on this topic

GROUP 2: GOVERNMENT POLICIES / ACTIONS

- List the types of government actions that might effect the sharemarket.

  Think about things that governments do, for example, how they make money, spend money, the decisions they might make etc.
- Consider how each of these actions might affect the sharemarket or companies listed on the sharemarket.
- Find a recent example of a news article of a government initiative that has had an effect on the sharemarket, particular companies or industries?

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GROUP 3: COMMODITY PRICES

- What is a commodity?
- List some of the main commodities that Australia exports.
- What things influence commodity prices?
  (Consider things that might happen in Australia or overseas. Think about natural events, government policies and foreign exchange markets.)
- Does the rise and fall of commodities impact the market/particular sectors?
- Can you give an example – a news article?

GROUP 4: EXCHANGE RATES

- What are exchange rates?
- Find out the current Australian dollar (AUD)/ US dollar (USD) exchange rate?
- Which companies listed on the Australian sharemarket are more likely to be worse off if the Australian dollar is worth less compared to other currencies – importers or exporters? Why?
- Are there some sectors that are affected more by a rise in the Australian dollar?

GROUP 5: OTHER FINANCIAL MARKETS AND ECONOMIES

- Which overseas sharemarket has historically had the greatest impact on the Australian sharemarket?
- What is happening in the global economy at present?
- Is the Australian sharemarket being impacted by this? How?
- See if you can find a news article on the impact of overseas markets on the Australian sharemarket.

GROUP 6: CORPORATE ACTIONS

- What are corporate actions?
- Can you explain what a dividend is – who pays it and who receives it?
- What usually happens to a share price after a share goes "ex-dividend"?
- What is a takeover?
- What usually happens to the share price of a company if another company makes a takeover offer for it?
- Can you find any other types of corporate actions?

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Our Topic:

What we discovered:

Definition:

How it affects the sharemarket:

How it affects a company or sector:

Other information we found:

Examples: