Supply and Demand: The Basics

Tom Mullooly: In episode 62, we're going to cover supply and demand.

Welcome to the Mullooly Asset Show. I'm your host, Tom Mullooly, and this is episode number 62.

Everybody asks us, "Where do you get these great questions from?" We get them from you. It shouldn't be a surprise. We get them from our clients. We get them from our viewers of the video. We get people who listen to our podcast and chime in with additional questions.

Don't be shy. If you've got a question that's just burning a hole in your brain and you need to know the answer, get in touch with us. You may wind up seeing it on a video or hear it on a podcast.

Tim, what are we going to be talking about today?

Tim Mullooly: **Why do stock prices go up and down based on certain news?**

Tom Mullooly: OK, so we're going to try and answer why stock prices move, sometimes violently, when there's news. If there's good news, the stock usually goes up. If there's bad news, not so much. What it really comes down to is supply and demand.

For the first part of this answer, let's imagine that we already own a stock. Say you and I are partners on an investment account, and we own shares of Netflix. Pretty good stock. It seems to move around a lot. It's always in the news.

Suppose Netflix announces earnings that are fantastic, and they announce it after the stock market closes. What normally happens the next morning? The stock may close at this level, but it opens again at that level. Why? Why does that happen? Primarily, because you and I, the existing shareholders, have no desire to sell our shares. Why are we going to sell it if it's a good, long-term investment? But other people that want to buy it, they can't find sellers.

When there are no sellers, when there's more demand for something, the price can only go in one direction. It can only go higher. When there's a lot of demand, the prices will rise. Let's look at the flip side.

Suppose there's bad news, and people want to get out. If everybody's trying to stampede out of an investment at the same time, what happens to the price? You know this. The price has to fall.

If a lot of people are trying to do the same thing together, the price is going to change. If people are looking to buy, and a lot of buyers show up all at once, the price has to go up. That's ‘Economics 101’.

If too many people are trying to get out of an investment, real estate in 2008, 2009 ... We'll think of some other examples, but you get the idea. When people are trying to stampede out of stocks, the prices just fall all at once. They fall immediately, and there's not enough time to call your broker.

Understanding that supply and demand is at the root level of what happens in the stock market is so important. It sounds really dumb or glib to say, clients used to call me all the time, and they'd be like, 'Why did the market go up today?' Or 'Why did the market go down today?' Or ‘Why do you think this happened, or that happened in the market or with this sector?’ Unfortunately the flip answer is, more sellers than buyers. Why did the market go down today? There were more sellers than buyers. That's the long and short of it.

Why does the stock go up? There are more buyers than sellers, than people who want to sell the stock. Supply and demand is something that you really need to get a grasp on. That's a great question. We don't cover some of these really basic things, but understand that when stock prices move, it's because there's an imbalance between buyers and sellers.

If there's too many buyers, price has to rise. There's demand. If there's too many sellers, everybody's trying to get out at the same time, price has to fall. They will fall until they reach their equilibrium point. They will rise until buyers and sellers match. Pretty simple, but important to understand.

Thanks for watching episode 62. We look forward to catching up with you on the next one.