



Chapter no. 2: Financial markets

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Financial market

- = a market in which people and institutions trade financial securities, commodities, and other items of value
- = the set price is a result of **supply** and **demand**
- Does not have physical existence

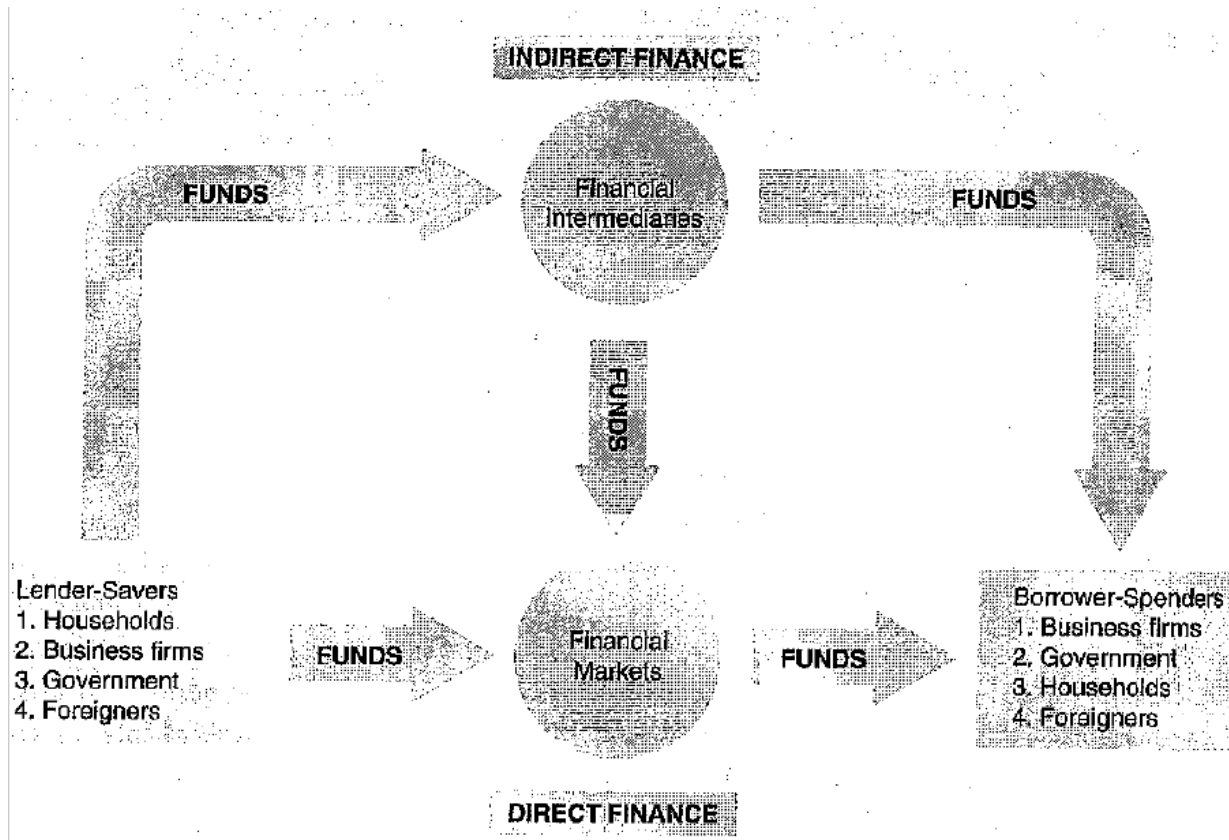
Primary and secondary market

- Primary market
 - a financial market in which new issues of a security, such as a bond or a stock, are sold to initial buyers
 - Investments banks usually help with the first/initial process of selling
 - IPO = Initial Public Offering (flotation)
- Secondary market
 - A financial market in which securities that have been previously issued can be resold

Direct vs. Indirect finance

- Direct finance
 - Without any middlemen
 - For some types of trades such connection is not possible
- Indirect finance
 - The communication between a buyer and a seller is administered by an intermediary (middleman)
 - *Higher transaction costs – why?*

Direct and Indirect finance



Functions of financial market

- Transfer of resources
 - Money is transferred from surplus do deficit units, using different types of tools
- Price determination
 - The price is set due to the demand and supply on the market
- Productive usage
- Enhancing income
 - The financial market enables surplus units to enhance their financial sources
- Information
 - Various types of information are available on the market

Magic triangle

- ***Can you reach all of the points at the same time?***



Money market

- = short-time investments
- Products:
 - Cheque
 - Banking products (e.g.: savings account)
 - Assets with due date in shorter period than one year
- What is the main advantage?

Bond market

- = a debt investment in which an investor loans money to an entity (typically corporate or governmental) which borrows the funds for a defined period of time at a variable or fixed interest rate
- Less risky than shares but more risky than products of money market
- Various types of bonds -

Stock market

- Share/stock = a claim on the company's assets and earnings
- Different types of shares: ordinary, preferred shares, common stocks
- Different forms of shares
- Rights related to shares holding:
 - A part of the decision-making process
 - Right to payment of the liquidation value
 - Right to be paid dividends
- More risky but more profitable (comparing to bonds/debentures or products traded on the money market)

Asymmetric information: Adverse Selection + Moral Hazard

- Adverse Selection
 - Originally used in insurance
 - situation where sellers have information that buyers do not, or vice versa, about some aspect of product quality
- Moral Hazard
 - the risk that a party to a transaction has not entered into the contract in good faith, has provided misleading information about its assets, liabilities or credit capacity, or has an incentive to take unusual risks in a desperate attempt to earn a profit before the contract settles

Market bubbles

- **Market bubble**
 - speculative bubble, a market bubble, a price bubble, a financial bubble, a speculative mania or a balloon
 - Based on wrong assumption of society behaviour
 - People tend to believe in the value of something which is actually worthless or has very low value
- **Various bubbles which happened in the past**
 - Tulip mania (around 1637)
 - Dot-com bubble (1991-2001)
 - Railway mania (1840)
 - Housing bubble (2007-2008)

Up-to-date trends on the financial market

- Globalization
- Internationalization
- International trade
- Dematerialization

- Financial literacy
- Behavioural finance

Terms to be familiar with

- IPO (flotation)
 - Initial Public Offering
 - The very first offer of a company's shares
- Transaction costs
 - The time and money spent in carrying out financial transactions
- OTC market
- Bonds/shares/stocks/stakes
- Financial derivatives – different types
- Bond coupon
- Principal

Questions for revision

- What is the difference between stocks and bonds?
- What is the main disadvantage of stocks/shares from the point of an investor?
- What is the difference between direct and indirect finance?
- What are main functions of financial market?
- What are financial derivatives?
- Which types of financial derivatives do you know?
- Describe the intuition of moral hazard.
- What are main attributes of shares/stocks in comparison with bonds and products of money market?



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Thank you for your attention

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