

Finance (Basic)

Ludek Benada
Department of Finance
Office 533
75970@mail.muni.cz

Financial markets

... system of institutions (instruments) that ensures the movement of money and capital from SSU to DSU. The movement is based on supply and demand. (Channels for allocation of savings to investment).


Functions of FM

- Borrowing and Lending
- Price determination
- Information Aggregation and Coordination
- Risk Sharing
- Liquidity
- Efficiency

Interest rate

Type of interest:

Simple interest x Compound interest

Inflation  Nominal x Real IR

Major components of FM

- ❑ Money market (T-Bills,)
short-term up to one year
- ❑ Capital market (Stocks, Bonds...)
more than one year

Practical examples

The client saved to the bank from 08/03/2011 to 05/05/2011 an amount of 15,000.00 to an annual interest rate of 8%. How much was the interest during this period?

The client saved for two years 10,000.00 to the bank. The interest rate was 6% per annum. The inflation was in this period 2%. How much got the client from the bank in two years? What was his real gain?

Subtypes of FMs

- ❑ Capital Markets (Stocks, Bonds)
- ❑ Foreign Exchange Markets (FOREX)
- ❑ Insurance Markets
- ❑ Futures Markets (standardized derivative)
- ❑ Derivative Markets (Options, Swaps, Forwards)
- ❑ Commodity Markets
- ❑ Money Markets

Capital markets

- ❑ Primary markets – IPO (matching of quantity)
- ❑ Secondary markets – trading with issued securities (matching of price, quantity is already given)

Secondary market

- ❑ Spot market (Closing the transaction and the delivery of goods take place simultaneously or within a few days)
- ❑ Forward market (Transaction closed in present, settlement and delivery in the future)

The major players in FMs

- Brokers
- Dealers
- Investment Banks
- Financial Intermediaries

Financial market structures

- ❑ Over-The-Counter (The largest market structure, includes FOREX as well).
- ❑ Centralized Exchanges (Stock Exchange, e.g. NYSE).
- ❑ Electronic Communication networks (buyers and sellers can directly interact with each other, then costs are minimalized).

Index

... barometer for investors, a statistical measure for economy or financial markets. Stock Exchange Index – portfolio value of traded stock on the market (PSE, DAX, DJIA, S&P 500, NIKKEI 225).

□ **Types of indices:**

- Global (MSCI World)
- National (FTSE 100, PSE,...)
- Specialized (Morgan Standley Biotech Index)

Efficient-market hypothesis

FMs are informationally efficient.

- ❑ Three version of the hypothesis:
 - ❑ Weak
 - ❑ Semi-strong
 - ❑ Strong

Asymmetric Information in FMs

... difference or asymmetry in
information available to buyers and
sellers.

Two types of AI

Adverse selection *is a problem that arises for a buyer of goods, services, or assets when the buyer has difficulty assessing the quality of these items in advance of purchase. (Loan Markets)*

Moral Hazard *exists in a market if, after the signing of a purchase agreement between the buyer and seller (of asset) the seller changes his behavior in such a way that the probabilities (risk) used by the buyer to determine the terms of the purchase agreement are no longer accurate.*

Thank you for your attention
