FINANCIAL/SECURITIES MARKETS NOTES

FOR SEBI GRADE A & RBI GRADE B
The Financial Market is an integral part of the Financial System of any country which is again an important topic in the General Awareness section of Banking and Government Exams especially RBI Grade B, RBI Assistant, SEBI, NABARD, SIDBI etc. Let us understand the basics of Financial Markets here in this e-book.

What are Financial Markets?

Financial markets is a broad term describing any marketplace where buyers and sellers engage in the trade of assets such as equities, bonds, currencies, derivatives, precious metals etc.

The term market is used exclusively for exchanges or organizations that facilitate the trade in financial securities for e.g. A Stock Exchange or Commodity Exchange. This may be a physical location like the New York Stock Exchange (NYSE), Bombay Stock Exchange (BSE), London Stock Exchange (LSE), Tokyo Stock Exchange (TYO) Johannesburg Stock Exchange (JSE) or an Electronic System like NASDAQ.

Types of Financial Markets

1. Capital Markets

A capital market is a financial market in which long-term securities (more than a year) or equity-backed securities are bought and sold.

Public sector organizations as well as private sector often sell securities in the capital markets to raise funds.

Government and corporations require capital to finance its operations and to engage in its own long-term investments.

To do this, a company raises money through the sale of securities – stocks and bonds in the company’s name. These are bought and sold in the capital markets.
Capital Market is composed of both the Primary and Secondary markets.

1.1. Primary Market:

When a company issues stock or bonds for the first time and sells those securities directly to investors, that transaction occurs on the primary market.

Some of the most common and well-publicized primary market transactions are IPOs (initial public offerings).

Here securities are sold to investors via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (municipal corporations, local or national) and business enterprises.

Governments issue only bonds, whereas companies often issue both equity and bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf.

1.2. Secondary market:

Here existing securities are bought and sold among investors usually on an exchange or over the counter. In secondary markets, investors exchange with each other rather than with the issuing entity.

Another Classification of Financial Markets

Stock Market:

Stock markets allow investors to buy and sell shares in publicly traded companies. They are one of the most vital areas of a market economy as they provide companies with access to capital and investors with a slice of ownership in the company and the potential of gains based on the company’s future performance.

Bond Markets:

A bond is a debt instrument in which an investor loans away his money to a corporate or government entity, which borrows the funds for a defined period at a fixed interest rate. Bonds are used by companies, municipalities, states and national governments to finance a variety of projects and activities. Bonds can be bought and sold by investors in Bond markets.

2. Money Markets

The money market is a segment of the financial market in which financial instruments of high liquidity and short-term maturities are traded.
Money market is used as a means for lending and borrowing in the short term ranging from a few day to a year.

Participants include banks, mutual funds, investment institutions and Central Banks.

There are five major segments of money market which are Certificate of Deposits, Commercial Paper, Swaps, Repo and Government treasury securities.

2.1. Instruments in Money Market

2.1.1. Call/Notice Money
These are money market Instruments in which money is raised for a very short term. When the term ranges from 1 day to 14 days it is called as notice money and when it exceeds 14 days it is termed as call money.

2.1.2. Commercial Bills
A commercial bill is a negotiable, self-liquidating financial instrument. If a company buys goods on credit, these bills improve the liability to make payment at the specified date.

2.1.3. Treasury Bills
These are short term negotiable financial assets issued by the central bank on behalf of the government for overcoming liquidity shortfalls.

2.1.4. Commercial Paper
These are unsecured promissory notes issued by large and creditworthy companies at a discount on its face value and redeemable at its face value.

2.1.5. Certificate of Deposit
It is an unsecured, negotiable financial instrument which a bank and financial institution issues to individuals, corporation, trust, funds etc. at a discount on its face value and its maturity vary from 15 days to one year.
3. Cash Market or Spot Market

Cash or spot market is a type of financial market in which goods are sold for cash and are delivered immediately.

Contracts bought and sold in the spot market become immediately effective. Prices for the goods are settled in cash on the spot at current market prices.

This is notably different from other markets, in which trades are determined at forward prices as opposed to cash market where trades are determined at the current market prices.

There are opportunities for both big losses and big gains in spot markets.

4. Derivatives Markets

The derivatives market is a financial market for derivatives instruments like forwards, futures, options, swaps etc whose value is derived from its underlying asset or assets.

A derivative is a contract, but in this case the contract price is determined by the market price of the core asset. The derivatives market can be divided into two categories that is exchange-traded derivatives and that for over-the-counter derivatives.

5. Foreign Exchange Market and the Inter-Bank Market

The foreign exchange market or currency market is a type of financial market that is an over the counter (OTC) market for the trading of currencies.

The Forex market is the largest, most liquid market in the world. This market determines the foreign exchange rate.

It includes all aspects of buying, selling and exchanging currencies at current or determined prices.

The main participants in this market are the large international banks.

Since currencies are always traded in pairs, the foreign exchange market does not set a currency’s absolute value but rather determines its relative value by setting the market price of one currency if paid for with another.

Most foreign exchange dealers are banks, so this behind-the-scenes market is sometimes called the inter-bank market.

The inter-bank market is the financial system and trading of currencies among banks and financial institutions, excluding retail investors and smaller trading parties.

While some inter-bank trading is performed by banks on behalf of large customers, most inter-bank trading takes place from the banks’ own accounts.
6. The OTC Market

The over the counter (OTC) market is a type of secondary market also referred to as a dealer market. The term “over-the-counter” refers to stocks that are not trading on a stock exchange.

Bullish & Bearish Markets

You must have definitely heard about the terms Bullish & Bearish Markets here and there in the Finance related news or read it the newspaper. Let us understand the meanings of these terms here.

What is a Bull Market?

i. The term “bull” or “bullish” comes from the bull, who strikes upwards with its horns, & thus pushing prices higher.

ii. Characterized by Rising Share Prices.

iii. A Financial Market (whether its currencies, metals or commodities) where prices are rising or are expected to rise.


v. A bull market is when an asset’s price is rising—called an uptrend—typically over a sustained time period, such as months or years.

vi. A bull market refers to a market that is on the rise. It is typified by a sustained increase in market share prices. In such times, investors often have faith that the uptrend will continue over the long term. Typically, in this scenario, the country’s economy is strong and employment levels are high.

vii. Example: We are Bullish on the company’s future.

What is a Bear Market?

i. The term “bear” or “bearish” comes from the bear, who strikes downward with its paws, & thus pushing prices down.

ii. Characterised by Falling Share Prices.

iii. The Bear Market is characterised by falling prices and typically shrouded in pessimism.

iv. A time when the price of a share is falling, and a lot of people are selling them.
v. A bear market is when an asset’s price is falling—called a downtrend—typically over a sustained period of time such as months or years.

vi. A bear market is one that is in continuous decline. Share prices are continuously dropping, resulting in a downward trend that investors believe will continue, which, in turn, perpetuates the downward spiral. During a bear market, the economy will typically slow down and unemployment will rise as companies begin laying off workers.

vii. Example: The overall oil price outlook is expected to remain Bearish.

Securities Markets Basic Terms

1. Stockbroker

Stockbrokers are registered trading members of stock exchanges. They sell new issuance of securities to investors. They put through the buy and sell transactions of investors on stock exchanges. All secondary market transactions on stock exchanges have to be conducted through registered brokers. (source – NISM.ac.in)

2. Asset Management Company

It is a company which handles the day to day operations and investment decision of unit trust. Asset management companies are permitted to offer securities (called units) that represent participation in a pool of money, which is used to create the portfolio. The company charges the investor a fee for rendering their services. (source – NISM.ac.in)

3. Portfolio Managers

They are investment specialists who offer their services in selecting and managing a portfolio of securities. Portfolio managers do not offer any security and are not permitted to pool the money collected from investors. Like the Asset management company, the Portfolio managers too charge the investor a fee for the services provided. (source – NISM.ac.in)

4. Merchant Brokers/Investment Bankers

Investment Bankers help an issuer access the security market with an issuance of securities. They evaluate the capital needs, structure an appropriate instrument, get involved in pricing the instrument, and manage the entire issue process until the securities are issued and listed on a stock exchange. They engage other intermediaries such as registrars, brokers, bankers, underwriters and credit rating agencies in managing the issue process. (source – NISM.ac.in)
5. Underwriters

Underwriters are primary market specialists who promise to pick up that portion of an offer of securities which may not be bought by investors. They serve an important function in the primary market, providing the issuer with the comfort that if the securities being offered do not elicit the desired demand, the underwriters will step in and buy the securities. (source – NISM.ac.in)

6. Issuers

Issuers are organizations that raise money by issuing securities. They may have short-term and long-term need for capital, and they issue securities based on their need, their ability to service the securities. Some of the common issuers in the Indian Securities Markets are Private Companies, Central, State and Local Governments, Banks, Public Sector companies, Mutual funds, etc. (source – NISM.ac.in)

7. Credit Rating Agencies in the Securities Markets

Credit rating agencies evaluate a debt security to provide a professional opinion about the ability of the issuer to meet the obligations for payment of interest and return of principal as indicated in the security. They use rating symbols to rank debt issues, which enable investors to assess the default risk in a security. (source – NISM.ac.in)

8. Investment Adviser

Investment adviser work with investors to help them make a choice of securities that they can buy, based on an assessment of their needs, time horizon return expectation and ability to bear the risk. They may also be involved in creating financial plans for investors, where they define the goals for which investors need to save money and propose appropriate investment strategies to meet the defined goals. (source – NISM.ac.in)

9. Time Value of Money

A rupee in hand today is more valuable than a rupee obtained in future. For example, let us compare receiving Rs.1000 today, and receiving it after 2 years. If today’s Rs.1000 is placed in a 2-year bank deposit earning simple interest of 8%, then it will be worth Rs.1080 (principal 1000 + interest 80) at the end of 2 years. This makes today’s Rs.1000 more valuable than the future Rs.1000. The value of currently available funds over funds received in the future is due to the return that can be earned by investing current funds. (source – NISM.ac.in)
10. Risk and Return

**Risk** - In the Securities Markets, Risk means the probability of Losing the part/entire investment or receiving unfavourable or no returns on an investment over a period of time due to the poor performance of the particular investment (Shares) in the market.

**Return** - Return refers to the benefit the investor will receive from investing in the security. The return will be in the form of interest, paid periodically to the investor, at a rate and frequency specified in the security. (source – NISM.ac.in)