

Introduction to Financial Markets

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Key concepts, functions, and types of markets

1. What Is a Financial Market?

Aspect	Description
Definition	A platform (physical or electronic) where buyers and sellers trade financial assets such as stocks, bonds, currencies, and derivatives.
Primary Goal	Allocate capital efficiently – channel funds from savers/investors to borrowers/entrepreneurs.
Core Functions	1. Price Discovery – market forces determine asset values. 2. Liquidity – assets can be bought/sold quickly with minimal price impact. 3. Risk Transfer – participants can hedge or assume risk via various instruments. 4. Information Aggregation – prices reflect collective expectations about future events.

2. Main Types of Financial Markets

Market Type	Primary Instruments	Typical Participants	Example Exchanges
Capital (Securities) Markets	Stocks, corporate bonds, government bonds	Corporations, institutional investors, retail investors	NYSE, NASDAQ, London Stock Exchange
Money Markets	Treasury bills, commercial paper, certificates of deposit (short-term <1 year)	Banks, corporations, governments, money market funds	Eurocurrency markets, Federal Reserve's Fedwire
Foreign Exchange (Forex) Markets	Currency pairs (e.g., EUR/USD)	Banks, multinational firms, hedge funds, central banks	Interbank network, CME FX
Derivatives Markets	Futures, options, swaps, forwards	Hedgers, speculators, arbitrageurs	CME Group, ICE, Eurex

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Market Type	Primary Instruments	Typical Participants	Example Exchanges
Commodity Markets	Physical commodities (oil, gold, agricultural products) and related derivatives	Producers, consumers, traders, investors	Chicago Mercantile Exchange (CME), London Metal Exchange (LME)
Alternative/Private Markets	Private equity, venture capital, real estate, hedge funds	Accredited investors, institutional funds	Private placement platforms, venture? capital firms

3. Market Structure & Participants

1. **Primary Market** – New securities are issued directly to investors (e.g., IPOs, bond issuances).

- *Key players:* Issuers, underwriters, regulators.

2. **Secondary Market** – Existing securities are bought and sold among investors.

- *Key players:* Stock exchanges, broker?dealers, electronic communication networks (ECNs).

3. **Intermediaries**

- **Broker?Dealers** – Execute trades on behalf of clients or for their own account.
- **Market Makers** – Provide continuous bid/ask quotes, ensuring liquidity.
- **Clearinghouses** – Act as counter?party to all trades, manage settlement and collateral.

4. **Regulators** – Enforce rules, protect investors, maintain market integrity.

- Examples: SEC (U.S.), FCA (U.K.), ESMA (EU), MAS (Singapore).
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4. How Prices Are Determined

Mechanism

Description

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Order-Driven (Limit Order Book)	Prices emerge from matching buy and sell limit orders (e.g., most equity exchanges).
Quote-Driven (Dealer Market)	Market makers post bid/ask quotes; trades occur at those prices (common in OTC markets).
Hybrid Systems	Combine order-driven and quote-driven features (e.g., NYSE's Designated Market Makers).
Arbitrage	Exploits price