

Introduction to Financial Markets

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1. Definition: Financial markets are platforms where individuals and entities trade financial securities, commodities, and other fungible items at prices determined by market forces.

2. Types of Financial Markets: a. **Primary Market:** Where new securities are issued and sold for the first time by companies or governments to raise capital. b. **Secondary Market:** Where existing securities are bought and sold among investors, without involvement from the issuing company or government. c. **Money Market:** Deals with short-term debt securities like treasury bills and commercial paper. d. **Capital Market:** Involves long-term debt and equity instruments like stocks and bonds. e. **Derivatives Market:** Traded financial contracts whose value is derived from an underlying asset.

3. Functions of Financial Markets: a. **Facilitate Capital Formation:** Companies raise funds for growth and expansion through issuing stocks and bonds. b. **Price Discovery:** Market forces determine the prices of securities based on demand and supply. c. **Liquidity and Efficiency:** Investors can buy and sell assets quickly, ensuring smooth market functioning. d. **Risk Management:** Derivatives help in hedging against price fluctuations and managing risk exposure. e. **Transfer of Funds:** Allows the transfer of funds from savers to borrowers efficiently.

4. Participants in Financial Markets: a. **Individual Investors:** Retail investors who buy and sell securities for personal investment. b. **Institutional Investors:** Entities like mutual funds, pension funds, and insurance companies that invest large sums on behalf of others. c. **Brokers:** Facilitate trades between buyers and sellers in exchange for a commission. d. **Regulators:** Ensure fair practices and monitor market activities to protect investors. e. **Issuers:** Companies or governments that issue securities to raise capital.

5. Financial Instruments Traded: a. **Equities:** Ownership shares in a company, representing ownership and potential dividends. b. **Bonds:** Debt securities issued by governments or corporations, promising fixed interest payments. c. **Derivatives:** Contracts whose value is based on an underlying asset, used for speculation or risk management. d. **Commodities:** Raw materials or primary agricultural products traded on exchanges. e. **Currencies:** Foreign exchange markets where different currencies are bought and sold.

6. Importance of Financial Markets: a. **Economic Growth:** Facilitate capital formation, investment, and efficient allocation of resources. b. **Risk Management:** Provide tools for hedging

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against price fluctuations and managing financial risks. c. **Price Discovery:** Market prices reflect all available information, aiding in efficient resource allocation. d. **Investment Opportunities:** Offer a wide range of investment options for individuals and institutions to diversify their portfolios. e. **Global Connectivity:** Link economies worldwide, allowing for international trade and investment flows.

7. Conclusion: Financial markets play a crucial role in the economy by facilitating capital formation, enabling risk management, and providing investment opportunities for a wide range of participants. Understanding the functioning of financial markets is essential for investors, policymakers, and individuals looking to manage their finances effectively.