

Research
Based
Curricula



You've Got to Speculate to Accumulate: Financial Markets and Portfolio Investments

Key Stage 5 Business
Resource 6

2019



Resource Six Overview



Topic	Trading
A-Level Modules	Price determination, market mechanism
Objectives	<p>After completing this resource you should be able to understand:</p> <ul style="list-style-type: none">✓ Long and short positions in the market.✓ What forward and futures contracts are.✓ Market indexes and the role they play in financial markets.
Instructions	<ol style="list-style-type: none">1. Read the data source2. Complete the activities3. Explore the further reading
Context	<p>Trading is an active style of participating in the financial markets, which seeks to outperform traditional buy-and-hold investing. Instead of waiting to profit from long-term uptrends in the markets, traders seek short-term price moves in order to profit during both rising and falling markets. As a trader, you can be your own boss, work from home, set your own schedule and have the opportunity to achieve unlimited income potential. These factors, combined with the ease with which someone can enter the field, help make trading attractive.</p>



Resource Six

Data Source



Section A

Going long or short?

Short-selling the stock consists in borrowing the stock from someone who owns it and selling it. The short-seller hopes that the price of the stock will drop. When that happens, she will buy the stock at that lower price and return it to the original owner. The investor that owes the stock has a **short position** in the stock. The act of buying back the stock and returning it to the original owner is called **covering the short position**.

Section B

Futures and forwards

Futures and forwards are contracts by which:

- one party agrees to buy the underlying asset (this party takes a long position in the contract) at a future, predetermined date (maturity) at a predetermined price (futures price or forward price), and
- the other party agrees to deliver the underlying (this party takes a short position in the contract) at the predetermined date for the agreed price

There is no exchange of money today for this obligation to buy/sell at the forward/futures price.

The difference between the futures and forwards is the way the payments are made from one party to the other:

- In the case of a forward contract, the exchange of money and assets is made only at the final date
- For futures the exchange is more complex, occurring in stages - futures are marked to market which entails less bookkeeping. It is for this reason that futures are traded on exchanges

Resource Six

Data Source



Section C

Reasons for trading futures



An investor may want to use futures for:

1. Speculation: bet on the direction of the price of the underlying
2. Leverage:
 - a) trading futures provides a way of borrowing assets; futures provide embedded leverage
 - b) trading in futures requires less initial investment than buying the commodity immediately at the spot price
3. Hedging (risks of other positions or business moves): A farmer who will harvest corn in four months and is afraid that an unexpected drop in the price of corn might run him out of business can take a short position in a futures contract on corn with maturity at the date of the harvest to eliminate uncertainty about the price

Section D

Organisation of financial markets

Some securities and financial contracts can be purchased, or entered into, in markets with a physical location. Those markets are called exchanges.

- ✓ New York Stock Exchange (NYSE) – trades stocks of most of the largest companies
- ✓ American Exchange (Amex) – trades stocks of smaller companies
- ✓ Chicago Board of Options Exchange (CBOE)
- ✓ Chicago Board of Trade (CBOT), Chicago Mercantile Exchange (CME) – trade futures contracts
- ✓ Corporate bonds are typically traded on exchanges

Resource Six

Data Source



Some securities and contracts are sold through sources without a physical location. They are traded over the counter or on an OTC market.

- ✓ The National Association of Security Dealers Automated Quotation (Nasdaq)
- ✓ American Exchange or Amex (trades stocks of smaller companies)
- ✓ Treasury bonds, issued by the U.S. Treasury, are traded OTC
- ✓ Exotic options trade only OTC

In the United States there are two federal agencies that oversee the proper functioning of financial markets:

1. The Securities and Exchange Commission (SEC) oversees the securities markets, stocks, and options
2. The Commodities and Futures Trading Commission (CFTC) in charge of the futures markets

Section E

Organisation of financial markets

An index tries to express through a single number a summary of the level of the markets or a subset of markets.

1. Standard & Poor's 500 (S&P 500) Weighted average (by market capitalization value) of the prices of 500 of the largest stocks listed on the NYSE or Nasdaq
2. Dow Jones Industrial Average (DJIA) Weighted average of 30 of the most important companies (highly correlated with the S&P 500)
3. Nasdaq index Weighted average (by market capitalization value) of all the securities listed on Nasdaq (indicator of the performance of the technology sector)
4. Russell 3000, Russel 2000, Wilshire 6000

Resource Six Activities



- Activities**
1. Can agents buy a negative amount of a financial asset in practice?
 2. What are the price expectations of an investor who takes a long position?
 3. Explain the process of short-selling, particularly, how investors expect the stock price to behave when they are taking a short position?
 4. What is the main difference between futures and forwards?
 5. Explain what hedging is, particularly, what can it be compared to and why investors want to hedge their portfolios.

Resource Six

Further Reading



Explore



1. Try some trading games for you to understand how it works:
 - <https://www.wallstreetsurvivor.com/>
 - <https://www.howthemarketworks.com/>
2. Book: "Liar's Poker" by Michael Lewis
3. Movie: "Big Short"



www.researchbasedcurricula.com



www.access-ed.ngo



[@_AccessEd](https://twitter.com/_AccessEd)



hello@access-ed.ngo



100 Black Prince Road
London, SE1 7SJ



AccessEd is a non-profit company
registered in England (#10383890)