

Financial Markets

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WHAT'S COVERED

In this lesson, you will learn about the characteristics of different financial markets. Specifically, this lesson will cover:

1. Definition of Financial Markets
2. Classification of Financial Markets
 - 2a. Traditional Financial Markets
 - 2b. Other Financial Markets
3. Financial Market Trends

1. Definition of Financial Markets

A financial market is the aggregate, or collection, of buyers and sellers of financial securities, commodities, and other sellable items, as well as the transactions between them.

Examples of financial markets include:

- Capital markets
- Derivative markets
- Money markets
- Currency markets

Financial markets are important because without financial markets, borrowers would have difficulty finding lenders themselves. Intermediaries like banks can help this process. Banks take deposits from those who have money to save, and individuals that aren't aware that they are lenders are providing capital. However, many do lend money, at least indirectly.

⇒ **EXAMPLE** When people put money in a savings account or contribute to a pension, intermediaries like banks can then lend money from this pool of deposited money in the form of loans to people who seek to borrow.

More complex transactions than a simple bank deposit require markets, where lenders and their agents can meet borrowers and their agents, and where existing borrowing or lending commitments can be sold on to other parties.

➦ **EXAMPLE** One instance of this is a stock exchange.

2. Classification of Financial Markets

There are many different ways to define and classify financial markets. The table below identifies some markets that we will discuss today.

Type of Financial Markets			
Money Markets	Capital Markets		Currency Markets
	Bond Market	Primary Market	
	Stock Market	Secondary Market	

2a. Traditional Financial Markets

For long-term finance, with longer **maturities**, we use the capital markets. For short-term finance, anything up to one year, money markets are used.

	Money Markets	Capital Markets
Purpose	Facilitate short-term lending and borrowing	Long-term investments
Time Horizon	One year or less	Longer term
Risk and Return	Low risk and modest return	Greater risk and return
Examples	Treasury Bonds, Short-term bonds, Certificates of Deposit, Commercial Paper	Stocks, Longer-term bonds, Real Estate Investment Trusts (REITS)

We can take these long-term capital markets and divide them even further into the bond market and the stock market. Companies get financing through the issuing of shares of stock and the issuing of bonds.

Another division between the capital markets is the primary market and the secondary market.

- In the primary market, underwriting firms, like institutional bankers, help companies find the market for their stock or bond issuances. The primary market is where new securities are issued and companies receive the proceeds from the sales of their bonds or stocks.
- The secondary market is where investors like you or me trade, where we buy stocks in the market. The company doesn't get the money that we spend to buy the shares or buy the bonds; they've already gotten their money for that. The person that is holding those bonds or holding those shares at that moment gets the money that we spend.



We trade in the secondary market. The primary market is for issuances for the first time.



Maturity

Date when payment is due.

2b. Other Financial Markets

We've mentioned a lot about capital markets, money markets, and stocks and bonds, but there are other markets as well.

There are derivatives markets. In the financial market for derivatives, the financial instruments are futures contracts or options, which are derived from other assets.

There are also currency markets, like foreign exchange or FOREX. Markets enable currency conversion and determine the relative value of the world currencies.

3. Financial Market Trends

There are several terms that we often hear in the media when we talk about the markets.

We hear the term **bull market**, which is a market that is trending upward. A bull market is associated with increasing investor confidence and increased investing in anticipation of future price increases. A bullish trend in the stock market often begins before an economic downturn shows clear signs of a recovery. The bull market shows up first.

In the other direction is the **bear market**, which is a general decline in the stock market over a period of time. It's a transition from high investor optimism to widespread investor fear and pessimism.

There are also types of trends for the bull and the bear markets. A primary trend is one that has broad support throughout the entire market and lasts for a year or longer. An even longer trend is a secular trend, which can last from 5 years up to 25 years, and is actually a series of primary trends.

⇒ **EXAMPLE** A secular bear market consists of larger bear markets and smaller bull markets. A secular bull market consists of larger bull markets and smaller bear markets. So, over the long term, secular markets follow the pattern associated with that market trend.



HINT

It's often said that the markets are good to everyone, but in the long term.



TERMS TO KNOW

Bull Market

A stock market where a majority of investors are buying ("bulls"), causing overall stock prices to rise.

Bear Market

A stock market where a majority of investors are selling ("bears"), causing overall stock prices to drop.



SUMMARY

In this lesson, you learned about the **definition of financial markets**, which are the aggregate of buyers and sellers of financial securities and commodities, which facilitate the lending and borrowing of money. **Financial markets are classified** as long-term or short-term, bond or stock, and primary or secondary. They are also classified by commodity, such as in the case of the derivatives market or currency markets. Finally, **financial markets include trends** such as the bull markets or bear markets, depending on whether investor confidence and prices are trending upward or downward. These trends are further classified as primary or secular, depending on their duration.

Best of luck in your learning!

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