19BAE710-FINANCIAL DERIVATIVES

Currencies:

1. **Definition:**

    - Currencies, also known as foreign exchange (forex or FX), refer to the monetary units of different countries. The foreign exchange market is where currencies are traded.

2. **Major Currencies:**

    - Major currencies include the U.S. Dollar (USD), Euro (EUR), Japanese Yen (JPY), British Pound (GBP), Swiss Franc (CHF), Canadian Dollar (CAD), Australian Dollar (AUD), and others.

3. **Currency Pairs:**

    - Currencies are traded in pairs. The exchange rate represents the value of one currency against another. For example, in the EUR/USD pair, the value of the Euro is expressed in terms of U.S. Dollars.

4. **Exchange Rate Quotations:**

    - Exchange rates can be quoted as direct or indirect. A direct quote expresses the home currency's value in terms of the foreign currency, while an indirect quote expresses the foreign currency's value in terms of the home currency.

5. **Bid and Ask Prices:**

    - The bid price is the price at which traders can sell a currency pair, while the ask price is the price at which they can buy. The difference between the bid and ask prices is known as the spread.

6. **Currency Market Participants:**

    - Participants in the currency market include banks, financial institutions, corporations, governments, and individual traders.

7. **Factors Influencing Currency Values:**

    - Currency values are influenced by various factors such as interest rates, economic indicators, political stability, trade balances, and market sentiment.

8. **Leverage and Margin:**
    - Forex trading often involves the use of leverage, allowing traders to control larger positions with a smaller amount of capital. However, this also increases the risk, and traders may need to use margin.

Futures:

1. **Definition:**
    - Futures are standardized financial contracts that obligate the buyer to purchase, or the seller to sell, a specific quantity of an asset (such as commodities, currencies, or financial instruments) at a predetermined price on a specified future date.
2. **Underlying Assets:**
    - Futures contracts can be based on various underlying assets, including commodities (like gold, oil, or agricultural products), financial instruments (like stock indices or interest rates), or currencies.
3. **Contract Specifications:**
    - Each futures contract has standardized specifications, including the contract size, expiration date, and tick size. The contract size represents the quantity of the underlying asset.
4. **Long and Short Positions:**
    - The buyer of a futures contract (going long) agrees to buy the underlying asset at a future date, while the seller (going short) agrees to sell. Profits and losses depend on the price movement of the underlying asset.
5. **Margin Requirements:**
    - Futures trading involves the use of margin, where traders are required to deposit a percentage of the contract value as collateral. This allows for leveraged trading but also entails risk.
6. **Mark-to-Market:**
    - Futures contracts are marked-to-market daily, meaning that gains or losses are settled daily. This helps ensure that both parties have sufficient margin to cover potential losses.
7. **Hedging:**
    - Futures contracts are commonly used for hedging against price fluctuations. For example, a commodity producer may use futures contracts to lock in prices and mitigate the risk of adverse market movements.

8. **Expiration and Rollover:**

    - Futures contracts have a predetermined expiration date. Traders can choose to close out their positions before expiration or roll them over to a future contract if they wish to maintain exposure.

9. **Futures Exchanges:**

    - Futures contracts are traded on organized exchanges such as the Chicago Mercantile Exchange (CME) or Eurex. These exchanges provide a centralized marketplace and ensure the integrity of the contracts.

Understanding both currencies and futures is important for investors and traders involved in global financial markets. Each has its unique characteristics, and their use depends on the investor's objectives, risk tolerance, and market outlook.