

Different Financial Instruments

Key Terms

- **Commodity:** A material which can be bought or sold, typically traded in the form of Futures Contracts.
- **IAS:** The International Accounting Standards (IAS) ensure that companies use a standardized financial reporting framework.

Understanding Diversification Through Different Assets

Diversification works as a strategy to reduce risk, but how “diverse” can your portfolio really be? Below are some of the myriad assets to invest in, some more complicated than others, to grow your money in new ways.

Cash Instruments: Cash instruments include securities and loans. Securities are traded on the stock market and represent ownership of a company. Loans are assets made available to people through a contractual agreement.

Derivative Instruments: Derivative instruments “derive” their value from underlying assets. There are a few types of derivative investments, including:

Futures: This is a contract that determines the sale of shares on a predetermined date at a specific price.

Options: This is a contract that provides an investor the right to buy (call) or sell (put) an asset at a certain price on a specified date. However, the investor is not obligated to exercise those call or put options. Options also present a way to hedge risk and because they require less financial commitment than traditional equities can be perceived as less risky.

Rate Swaps: This is a contract between two parties that facilitates those involved to pay different interest rates on their loans.

Forex: Foreign Exchange Instruments: Forex instruments are mostly made up of derivatives and currency agreements.

Spot: This is a currency agreement that occurs under a limited timeframe. It guarantees that the actual exchange occurs within two business days.

Outright Forwards: This is a currency agreement that allows parties to exchange currency in advance of the actual exchange date. This is used in cases with volatile exchange rates.

Currency Swap: A currency swap involves buying and selling currencies simultaneously.

The Bottom Line

There are many types of financial instruments that populate different sides of the market. Make sure to practice with basic securities investing before getting heavily involved with derivatives instruments or forex, so as not to make avoidable mistakes.