Trading The Markets

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Contents

The main objective of this course is to better understand the various types of financial markets, as well as their main trading tools and vocabulary.

1 Financial Markets

Essentially there are four main components of what are reffered to as the Financial Markets:

1. Equities
   - Generally we split up equities into two main categories:
     - Corporations (or Stocks), which are the most popular and widespread.
     - Special Equities such as REIT's, MLP's, BDC's etc.
       * Real Estate Investment Trusts (REIT's)
         · A REIT is a company that owns, operates, or finances income-producing properties. A reason REIT's are potentially a good investment opportunity is because they tend to provide a steady income stream foir investors, given that they are designed as: give us money we buy property with it and set appropriate rent prices so that you see a return on your investment. The drawback of this equity is that they offer little in way of capital appreciation. Stocks can double in a day, property only falls that fast, it takes time for it property to appreciate.
         · Most REIT's are publicly traded like stocks, making them highly liquid as apposed to real estate investments (such as buying and owning property directly) which are not easily bought or sold (ie low liquid).
         · REIT's invest in a wide variety of property types, such as apartment buildings, cell towers, data centers, hotels, medical facilities and hospitals, office buildings, retail centers, and warehouses.
         · REITS's allow you to gain exposure to a portfolio of real estate properties in a specific region/sector.
         · By law they are required to pay 90% of their income as distribution (you can think of this as an equivalent to dividends with stocks). By doing this REIT's avoid paying corporate taxes.
         · Here are a couple links for more information on REIT's:
         (a) `https://en.wikipedia.org/wiki/Real_estate_investment_trust`
         (b) `https://www.investopedia.com/terms/r/reit.asp`
       * Master Limited Partnerships (MLP's)
         · An MLP is a business venture in the form of a publicly traded limited partnership. It combines the tax benefits of a private partnership with the piquidity of a publicly traded company.
         · Instead of focusing on the profit generated by Real Estate ownership, MLP's focus on generating profit based on the production, processing, storage, and transportation of natural resources.
         · MLP's trade on national exchanges, generally experience cash flow stability and are required by partnership agreement to distribute a set amount of cash to investors. MLP's are structured in a way that is intended to reduce the cost of cpital-intensive businesses (the energy sector for example).
         · Here are a couple links for more information on MLP's:
         (a) `https://www.investopedia.com/terms/m/mlp.asp`
         (b) `https://en.wikipedia.org/wiki/Master_limited_partnership`
       * Business Development Companies (BDC's)
         · A BDC is an organization that invests in small and medium-sized companies as well as distressed companies. The idea behind BDC's is an intention to help small or medium-sized firms to grow in the intitial stages of their development. In the case of distressed businesses, BDC's aim to help companies regain their financial footing in the market.
         · BDC's allow you to gain exposure to a protfolio of investments in non-public small and mid-sized businesses. This is analogous to a private equity gain, but the difference is that you are buying stocks in a company that invests in companies instead of directly investing your money in these start-ups or distressed companies through a private equity gain.
         · Many BDC's are public companies whose shares trade on major stock sxchanges such as AMEX, Nasdaq, etc.
         · Due to their nature of helping start-ups and distressed companies, these equities are considered high risk, high reward.
         · Similar to REIT's and MLP's, BDC's avoid corporate tax by distributing 90% of their income as to their investors.

  - · Here are a couple links for more information on BDC's:
    (a) `https://en.wikipedia.org/wiki/Business_Development_Company`
    (b) `https://www.investopedia.com/terms/b/bdc.asp`
- Equities are widley owned and widely covered. This means that it is very easy to access data, some of which is already covered by analysts who conduct their own market research and issue buy or sell recommendations based on that research. Moreover, there is also an extensive community of stock owners implying that it is easier to communicate and understand the companies movements and intentions.
- This area of investment is enormous in size and holds for than 70 trillion dollars of value.
- Sometimes these equities, such as stocks, will pay a dididend. This can increase overall returns.
- We can use all four main schools of analysis (fundamental, technical, event-driven, and volatility) to analyze equites. This is a major benefit as you can gain extensive analysis from different viewpoints of the equity using these different analytical methods.

2. ETF's (Exchange Traded Funds)

   - Exchange Traded Funds are a type of pooled investment fund (security) that is also an exchange-traded product, in other words, they are traded on stock exchanges. Typically, ETF's track or seek to outperform a particular index, sector, commodoty, or other asset. These differ from mutual funds in that orders are executed throughout a trading day, whereas mutual fund orders can only be executed after market hours. ETF's can own assets such as stocks, bonds, currencies, debts, future contracts, commodities, etc. You can think of ETF's as a fund, either passive or managed, that allows access to a wide array of positions such as:
     – Stock indexes such as S&P 500, Nasdaq, Russell 2000 (Us small-cap stocks), Nikkei (Japan), DAX (Germany), etc.
     – Stock sectors such as Energy Industry, Cannabis, Tech, etc.
     – Commodoties such as oil, copper, Natural Gas, etc.
     – Currencies such as USD, EUR, JPY, etc.
     – Strategies such as short funds, insider sentiment,
   - ETF's are also widely owned and widely covered, i.e. it is very easy to access data, and they have a decent liquidity.
   - ETF's are an excellent diversification and hedging tool. Buying just one share will gain you access to an entire sector of the market.
   - This sector has seen an immense boom in recent years, and is one of the fastest growing investment products.
   - Some ETF's will even pay a dividend, increasing overall returns. However, one drawback is that they charge expenses fees.
   - ETF's can also be studied using the four schools of financial analysis: Fundamental, Technical, Event-Driven, and Volatility.

3. Commodities

   - Commodities are basic goods interchangable between producers, such as grains, gold, currencies, beef, oil and natural gas to name a few. As an asset class they are highly speculative and are especially sensitive to economic shifts.
   - Commodities allow you to invest in non-corparate markets. Unlike with stocks, you are investing in the price of a particular item or items (commodity).
   - These are pure product plays, meaning the focus is solely on one type of product or service. They are straight-forward bets on the price of a product, avoiding all of the possible "distractions" of company variables, i.e. there are no earnings reports, accounting issues, management scandals, branding aspects, etc. to worry about with commoditiy investments. In fact some hedge funds, such as Garda Capital and Caxton Associates, employ only this global macro investment strategy (take bets on the macroeconomics of a situation).
   - When it comes to analyzing these investments, you look at things such as weather patterns, supply and demands, geo-politics, things that will effect the supply and demand of the commoditiy itself.
   - Commodities don't necessarily correlate with the performance of the stock market, which makes them an interesting alternative investment space.
   - Similar to Equities and ETF's, Commodities can be analyzed from the four main schools of analysis: Fundamental, Technical, Event-Driven, and Volatility.

4. Bonds

   - Bonds will be discussed in greater detail in L3.

2 Bulls & Bears

- **Bulls**
  - Bulls are optomists. They belive that the price of a stock (or any other security) is going up.
  - "Bullish strategy", "Bullish market", "the bulls have taken control".
- **Bears**
  - Bears are the pessimists. They believe that the price of a stock (or any other security) is going down.
  - "Bearish strategy", "Bearish market", "the bears are starting to press".
- Oftentimes people will confuse Bull and Bear with going long and going short and while this is true most of the time it is not true all of the time, meaning this is not an if and only if relationship.
- **Long**
  - Going long simply means buying the security, whether it be a stock, ETF, commodity, etc, to open or add to a position.
    - Buy to open
    - Close to sell
  - You expect "XYZ" to go up in value, so you buy the stock (buy to open). After the price has gone up, and you've made money, you sell it (close to sell).
- **Short**
  - Shorting (or going short) means that you are selling a security (stock, ETF, commodity, etc.) without actually owning the shares, with the expectation that they will drop in value. When the price drops you will be able to "buy back" those shares, return them to their owner, and pocket the difference.
    - Sell to open
    - Buy to close
  - Be careful when shorting as there can be interest payments and poor risk/reward. The risk/reward method tends to not be in the analysts favor as there is a limit to how low a stock price can fall (this limit being zero because you cannot have a negative stock, ETF, commodity price) whereas there is no limit to how high a price can rise.