FE535 Week 1 Notes

Market risk – the general risk you take as the market moves up and down.

Credit Risk – the risk that someone getting lent money will not be able to buy it back.

**Asset Classes**

* Equities
  + G7 markets – Canada, US, Italy, Germany, Britain, France, Japan
* Fixed Income
  + G7
  + Bonds are under this
  + Specifically, government bonds under G7 countries.
    - No credit risk (not technically true, but generally assumed)
    - Interest rate risk. Rate could go up, but you’re still tied up in the worse rate.
* Emerging Markets
  + Very large.
  + Equities, fixed income, etc are all under here.
  + From US perspective, has volatility and credit, political, and/or foreign exchange risk.
* Commodities
  + Gold, oil, etc. Real goods.
  + Seasonality risk. For heating, oil is worth more in the winter. Etc.
  + Volatility risk.
* Foreign Exchange
  + Two interest rates (currency from, and currency to)
  + Political risk.
  + Manipulation risk.
    - Central banks can manipulate currencies. Governments run central banks. Thus they can manipulate currency values and exchange values.
    - Japan, if their currency gets too strong, will sell Yen and flood the market with Yen to decrease its value. Helps exports.
* Mortgage Backed Security
  + Banks will sell off mortgage contracts. A group gets 10000 mortgages together, has a $10 million fixed income security. They take on the risk of mortgage default, get a good rate.
  + Pay principal and interest on top. End of duration, principal and interest are both paid back. Amortizes.
    - Amortization risk exists.
  + Pre-payment. Prepay the loan ahead of the time, if you’re moving out early. “Credit event.”
* Credit
  + US Corporate Bonds.

**Product Types**

Exist for each asset type.

* *Cash*
  + Pay cash today, get the instrument relatively quickly. Stocks, bonds, etc.
* *Future*
  + An agreement to spend money in the future. If you agree to buy you have to buy, if you agree to sell you have to sell.
  + *Swaps*
    - Series of Futures.
* *Options*
  + *Derivatives* and *Structured Products –* **Big focus in QF. This class too.**
  + You pay to have the option to buy or sell something. Call, put.