Derivatives Security.

* generate values by themselves

Securities: stocks, bonds, ETFs
mutual funds, mbs.

* contracts

Derivatives: Futures, Options, Swaps

A promise between 2 parties in which one will deliver payoff, ~~so~~ (in money commodity.

- 1 promiser.
- 2. underlying value.

Over-the-Counter Trading

: private trading

ex. 2 ppl have contract over oil
one of them need money, he sells the contract.

~~the~~
One famous historical example of exchange was Tulipmania. Ppl bet against the quality of tulips (imported from other places). In that time, there was no gov control. So only ppl. betting lost money. But the loss was amplified because the value of the tulip is not that much

ex. South Sea Company crash $\boxed{\text{Britain}}$

Every time some crash happened, new rules were born.

$\boxed{\text{France}}$ John Law - modernized the French banking system.

1900s: First book of options & forwards was created in France.

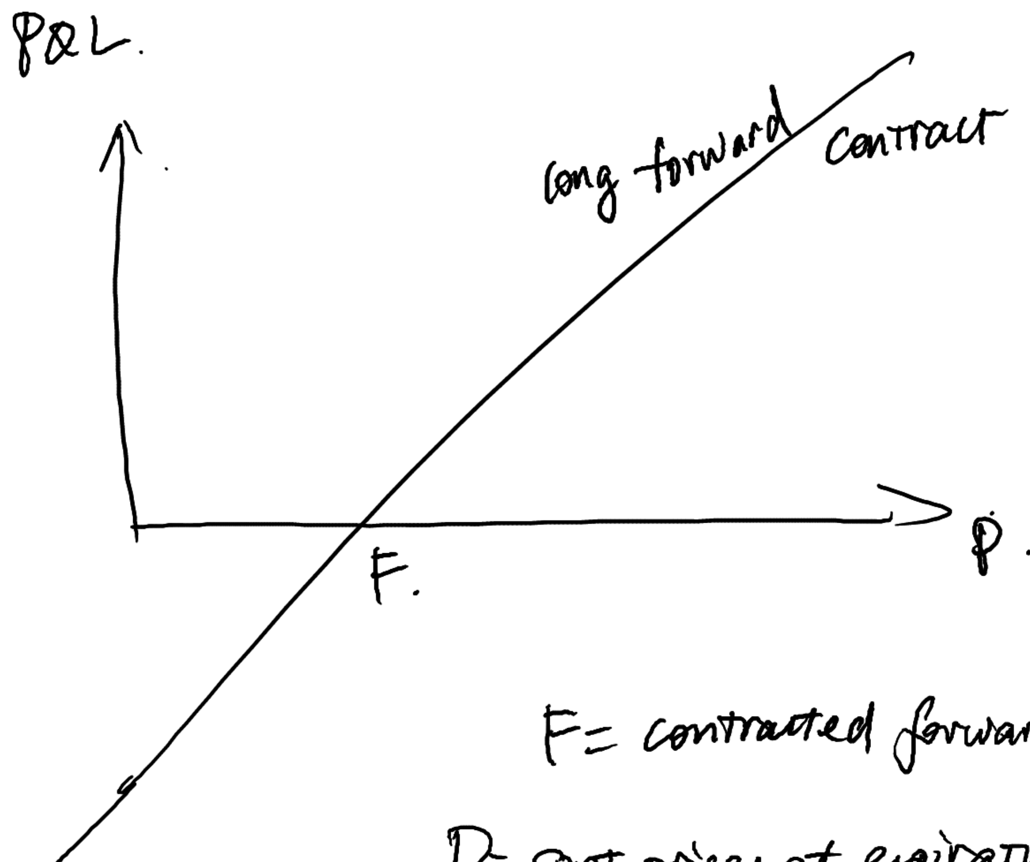
Main Charastiscs of D:

forward transaction & optionality

Forward: Contract specify that $
should take place on one or serveral
future dates.

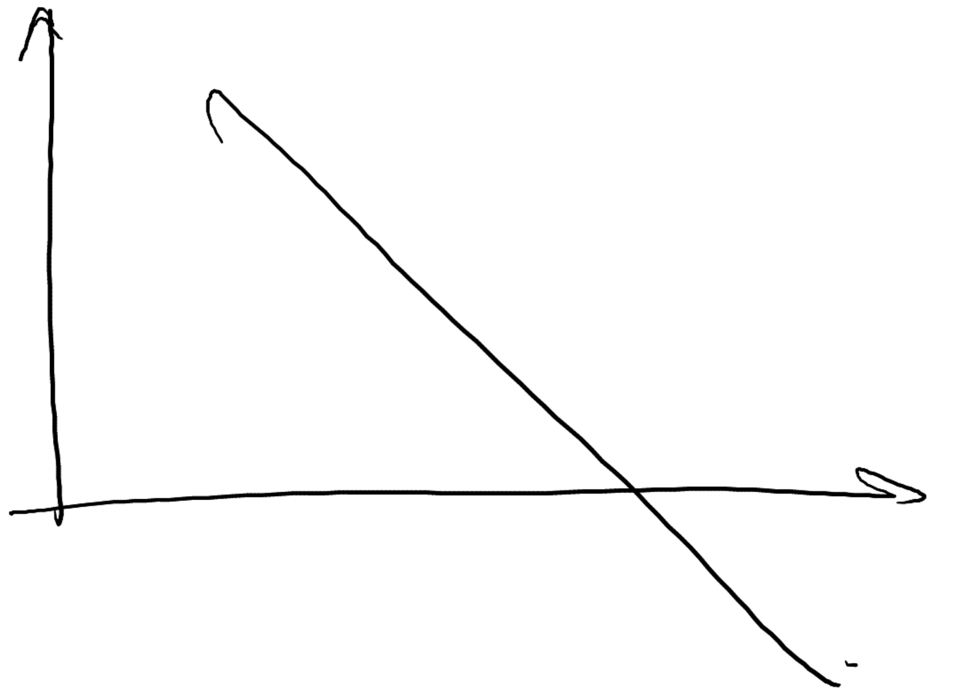
Optionality: Some contracts may specify
that cash-flow/delivery/payment
may or may not take place.
depending on future event (price
level/entity/event).

Profit Diagram

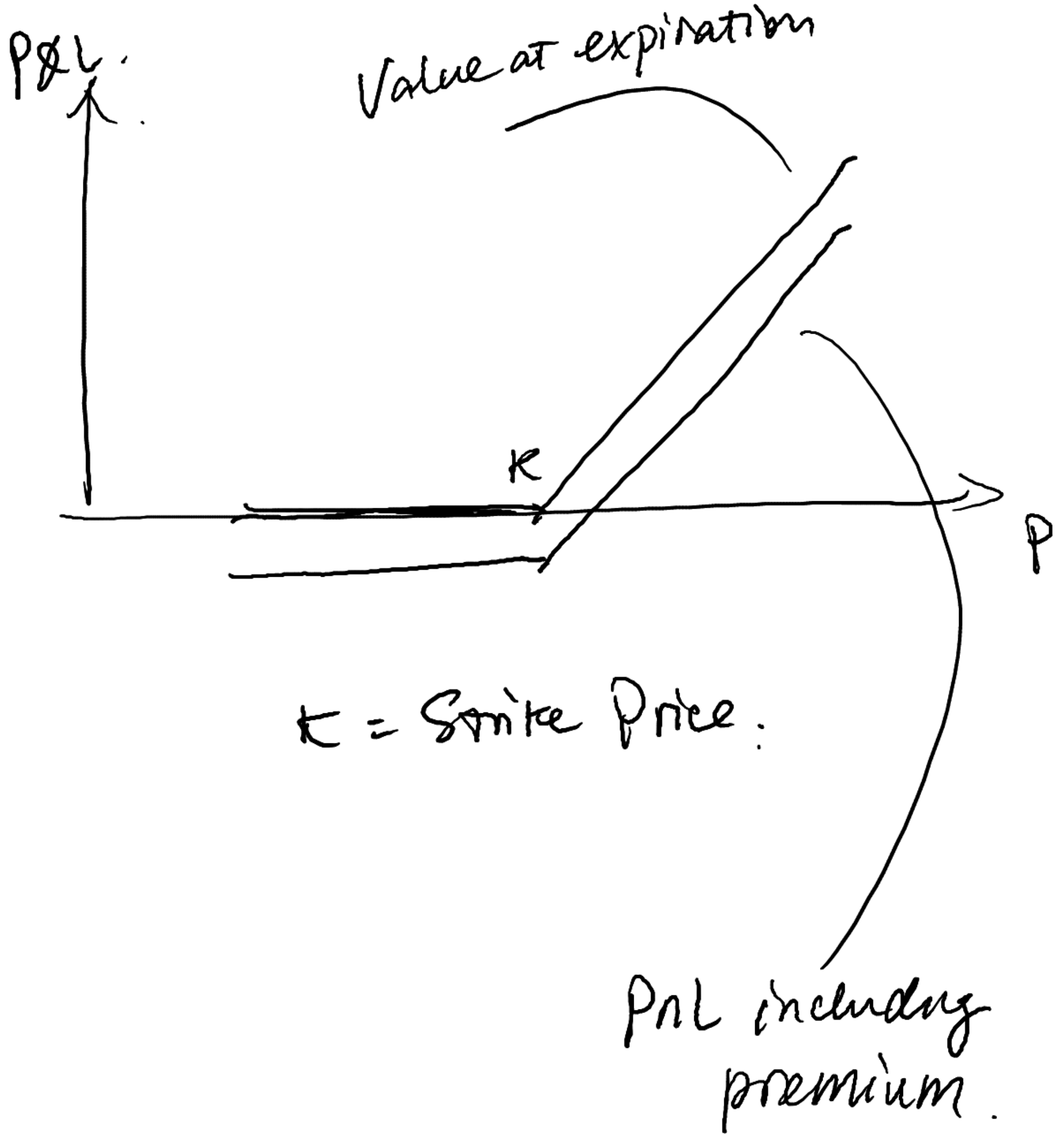


F = contracted forward px

P = spot prices at expiration

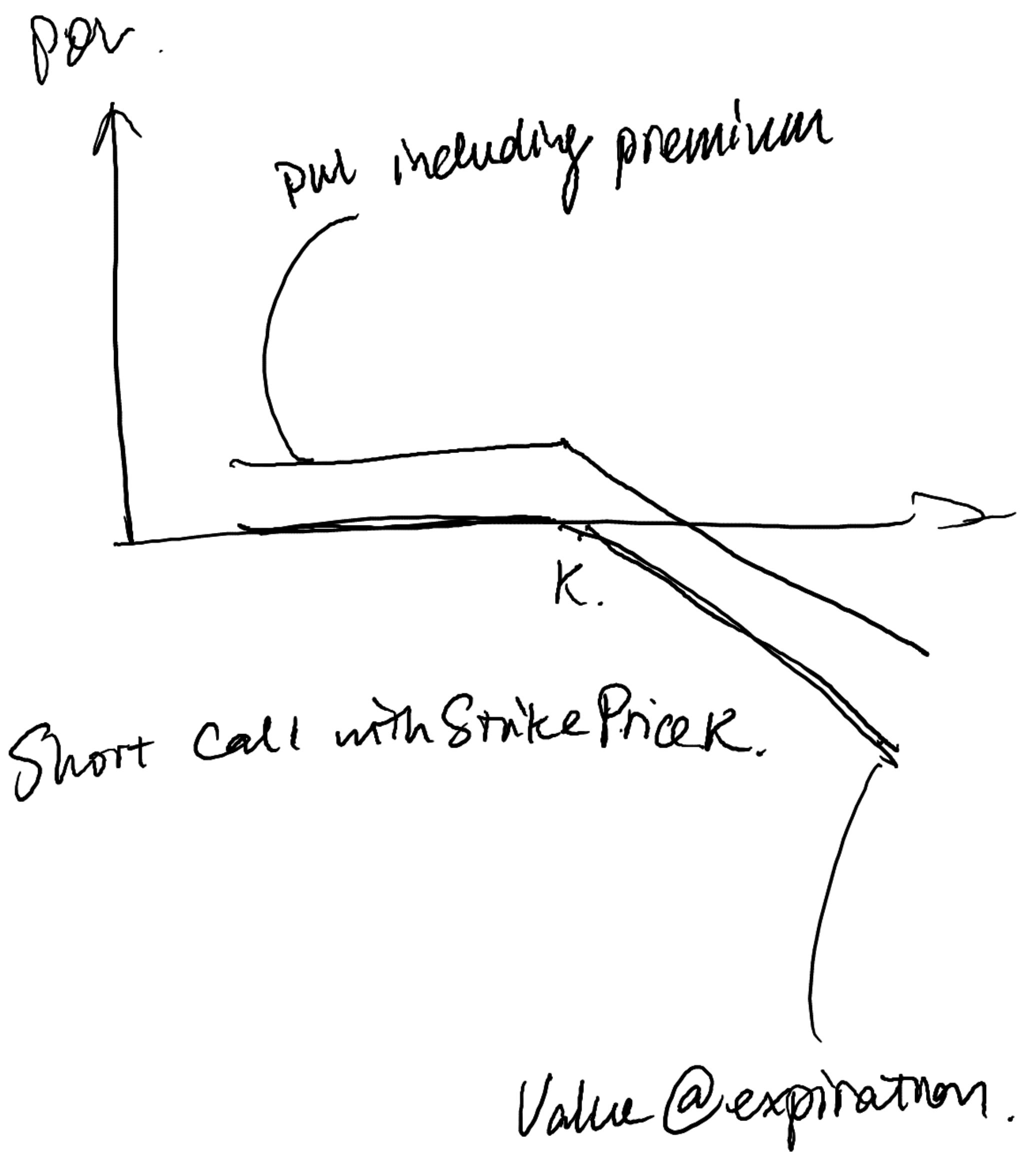


Profit Diagram: Long Call Option

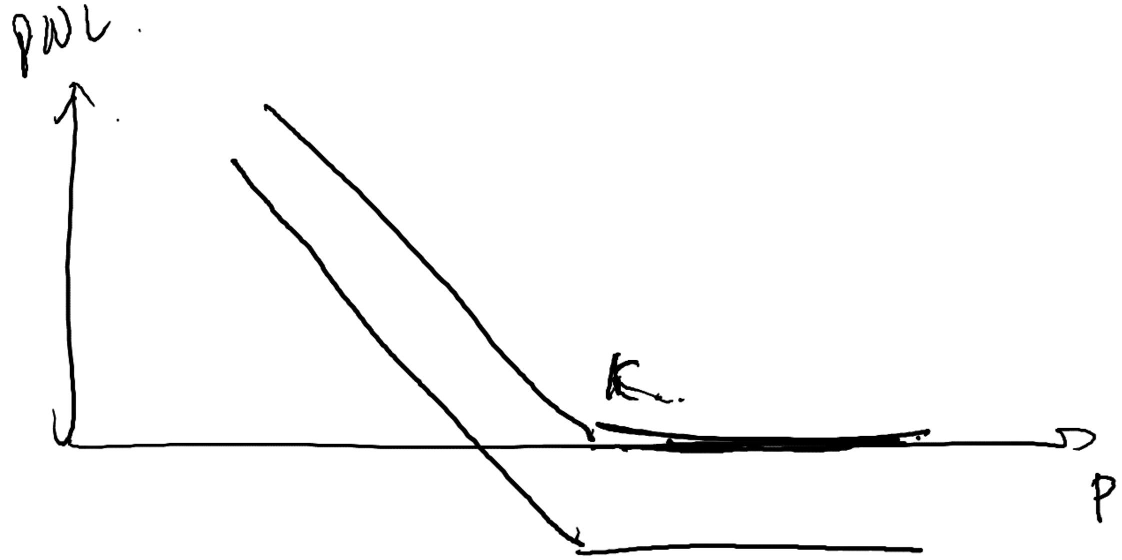


K = Strike Price.

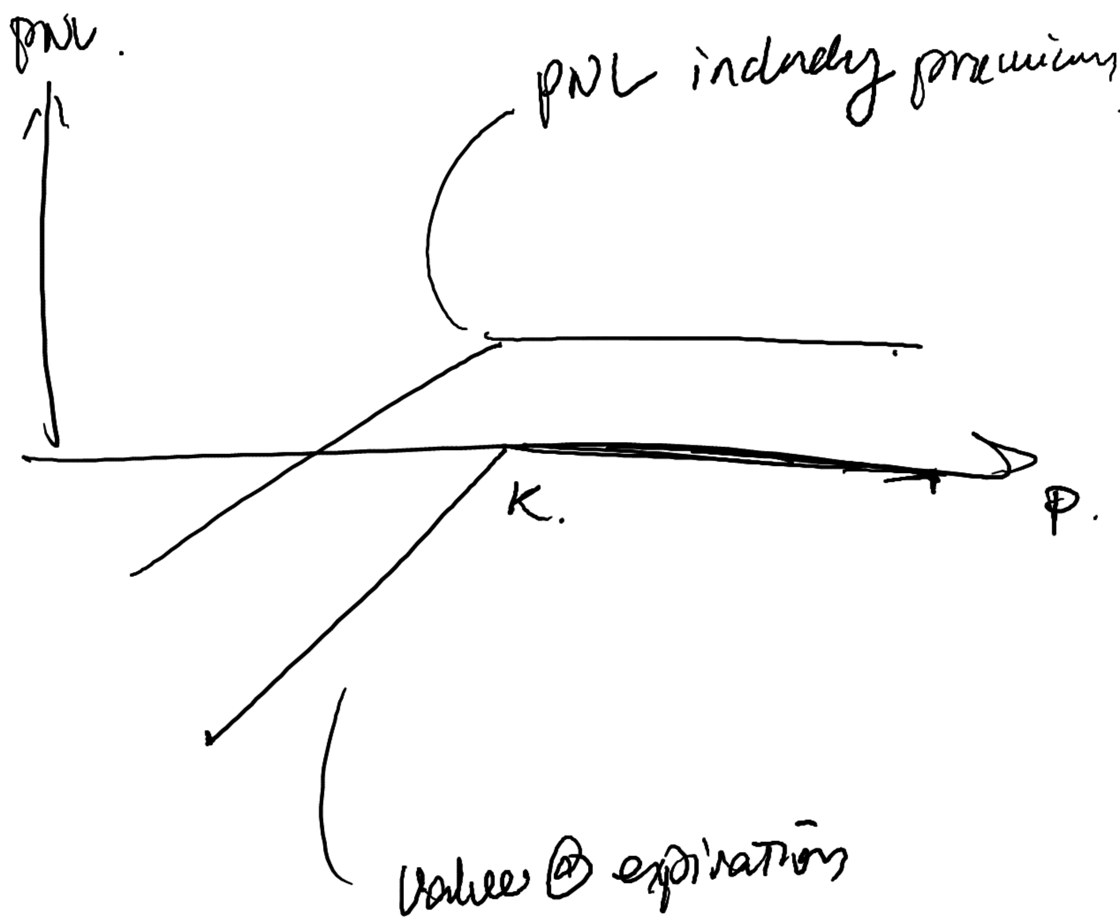
Short Call Option.



Long Put Option.



Short · Put Option

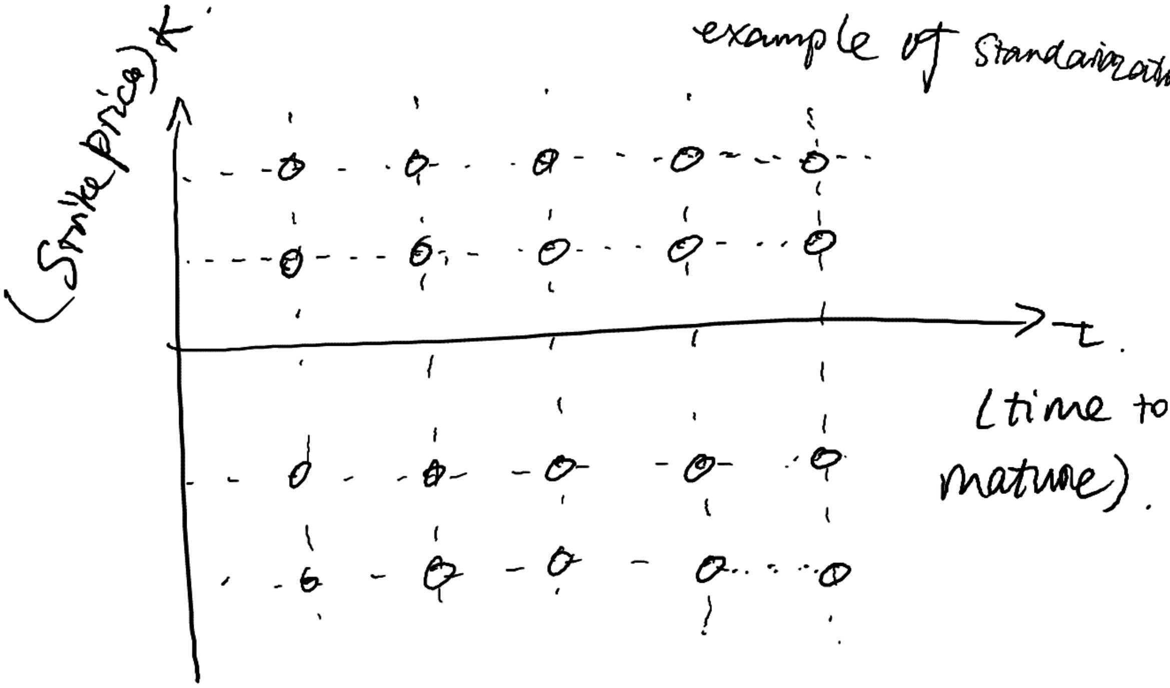


US. Market.

1848 Chicago Board of Trade
Creation of the "To-Arrive" contract for grains.

1865 Standardization of forward contracts.

example of standardization



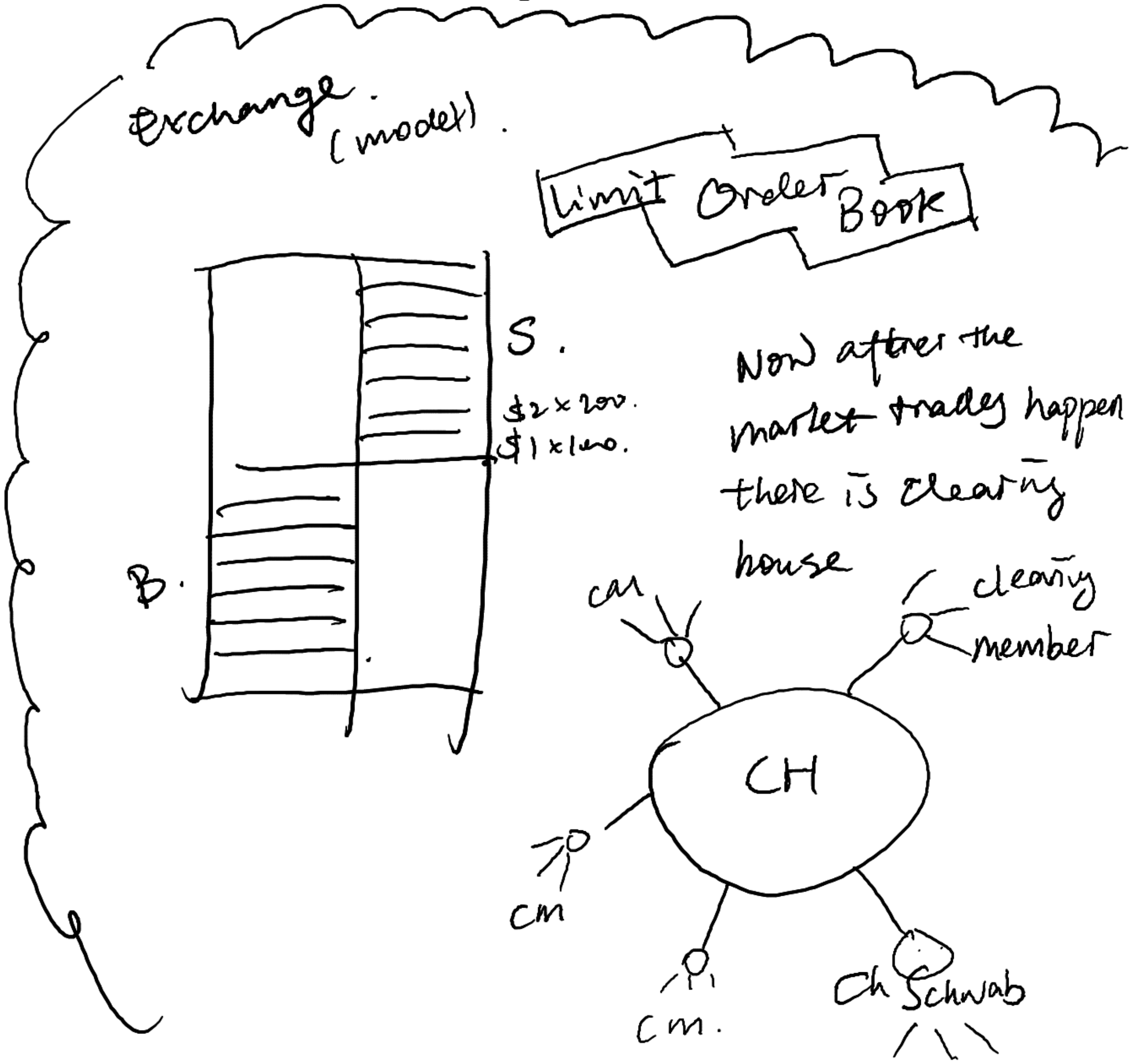
o option/future. contracts.

WTI - some oil.

1874. Creation of Chicago Produce Exchge

1919: CPE becomes the Chicago Mercantile Exchange.

1XXX. First clearing house.



OTC — clearing house. since 2008

2000's: credit derivative

insurance against defaults.

get premium when company go bankrupt.

Credit Crunch.

↓ cause.

Dodd-Frank Act of 2010.

& central trading derivatives.

& no private trading.

In 2008, a lot of swaps were already standardized because ~~of~~ of ISDA.

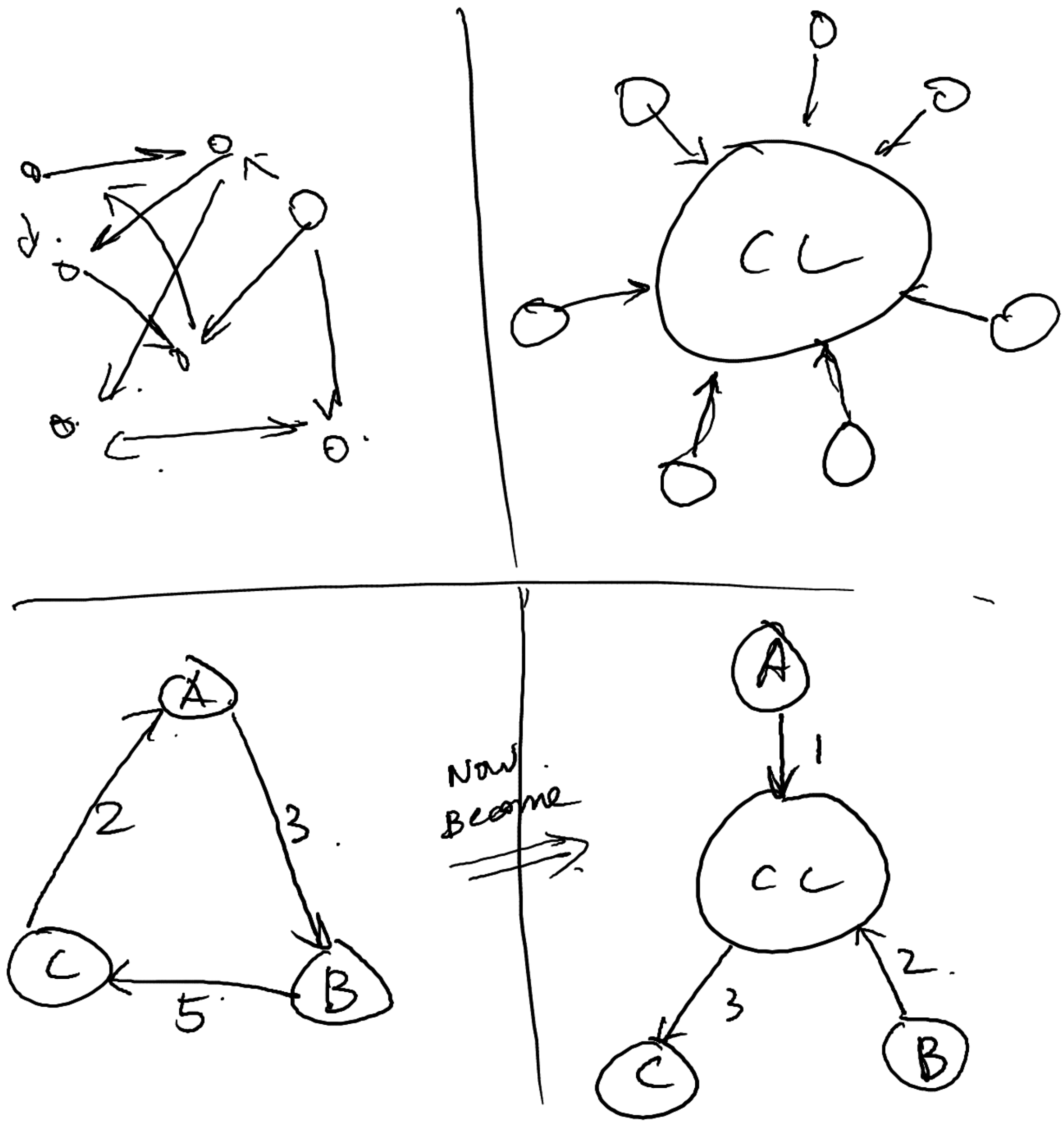
but Central Clearing House was missing.

IS. central clearing house a good thing or bad thing?

winner.	Loser.
Central Bank.	dealers. (now pass the cost of clearing to end users).
public.	end users.
Society	

Ex. One sells. a Argentina-defaut derivaties. to another. They then both go to CCH. to each have CCH as the counter party.

Bilateral arrangements vs. Central Clearing



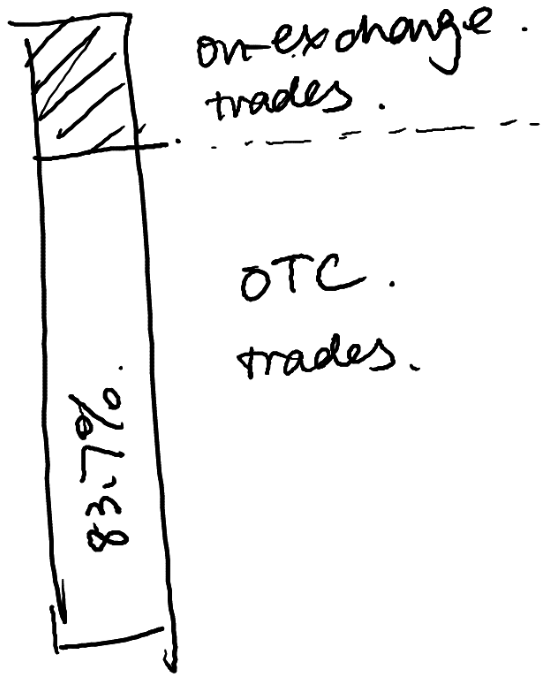
CCH does.

① reduce risk.

eg. easy to probe/monitor.

② shrink/simplify the market

@ 2007 derivatives trades



CLH caused the market notional.
amount declined.