

Guideline on Financial contracts

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Abstract

This paper gives an overview on different types of online trading.

Keywords

Online Trading, Forex, Binary Options, Cryptocurrency, Futures.

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Introduction

Nowadays, there are many methods to trade online. In this paper, we give a brief overview of each *market*.

1. Forex

The Forex is the foreign exchange market also known as the currency market. It is a global decentralized or over-the-counter market, which means it is done directly between two parties without any supervisions. This certainly implies lower fees in opening an account, but at the same time the default from one party may come up because there are not predisposed institutions in regulation. However, forex is the most liquid market and always open. Therefore, it requires to analyse the market several hours per day, and in case of hedge the risk with a differentiated portfolio (which is always a good idea). In addition, many economists such as Milton Friedman argues that while investment in traditional financial instruments like bonds, stocks, futures and options (regulated) often is considered to contribute positively to economic growth by providing capital, currency speculation does not.

1.1 Cryptocurrency

A cryptocurrency is a digital asset which employs strong secret key to secure the financial transaction. It is certainly one of the most sensational inventions of the last decade with the most famous bitcoin. In principle, everyone can generate their coin (for instance bitcoin) by mining. To make the story short, the mining consists of finding a new secret key, the drawback is the energy cost. However, it is possible to trade cryptocurrencies in certain regulated forex markets (there are also futures contracts associated with the bitcoin). Normally, the cryptocurrency prices are very fluctuating (volatile) and therefore, it is needed regulation in order to avoid a possible default. This is one of the reasons why many countries, exchange limit the trading. Because, the volatility and the lack of historical data in some cases, it also requires a high education level.

CONS:

1. Cryptocurrencies are very volatile;
2. there are many scams on crypto and forex;
3. many scams on crypto and forex;
4. it requires a remarkable time by analysing indicators.

PROS:

1. Easy to access;
2. easy for low budget;
3. large community and bibliography.

2. Stocks

A stock (share) is essentially fractional ownership of the associated corporation. The owner of the stocks has the ownership of the corporation according to the percentage of the held shares. In addition, stocks can be bought and sold privately or on stock exchanges. In the latter the biggest companies list their stocks, therefore stock exchanges are rather liquid. Nowadays, all the banks have the option to trade in stocks, and in some cases, they have an ad-hoc portfolio according to your education level. Normally, trading in stocks is worth in the long term or in case of large investment capitals.

CONS:

1. It is for persistent persons;
2. managed portfolios imply very low returns (1% annual);
3. it requires large budget.

PROS:

1. Easy to access;
2. large bibliography.

3. Options

An option is a financial contract which gives the owner the right (but not the obligation) to buy or sell an underlying asset at a specified price. Therefore, the owner has not the obligation to buy or sell. However, contrary to other financial contracts, the owner has the obligation to pay in advance, and therefore this corresponds to the maximum risk the holder can face. There are two types of options: call (buy an option) and put (sell an option). The options are often used to hedge the risk, for instances, import/export companies typically employ options on currencies, airline companies use options to circumvent the high variability of oil and kerosene. Therefore, the option is certainly one of the most traded contracts. To trade options is certainly needed an adequate education level and practice.

Furthermore, during the last decade, among low-skilled traders the *binary options* have become very popular. Essentially, in a binary option, you have only two choices: you can bet if the price grows or drops. In total agreement with the most recognized financial institution, we would like to warn you and bear in mind that *binary options* are prone to fraud and it is comparable as a form of gambling. In essence, many binary options are an unfair game, as the roulette, and like an unfair coin, therefore before opening an account on binary options do not forget to check whether the broker is trustworthy. If you are interested in trading options, we recommend checking the Securities and Exchange Commission (for USA market) which gives a list of approved exchanges.

CONS:

1. It is for persistent persons;
2. it requires a remarkable educational effort.

PROS:

1. It is possible to hedge the risk;
2. it is good for small budget holders (3000 \$);
3. average monthly return is about 8%-10%;
4. large bibliography.

4. Futures

The futures is one of the oldest financial contracts. In summary, it is a legal agreement which gives to the owner the right to buy or sell the underlying asset. Essentially this is a standardized contract where the underlying assets can be traded in the exchanges (for instance CME, LIFFE, EUREX, etc), in addition in these ecosystems, there are entities which ensure the contract terms are honored. This is because they prevent a possible default from one party. The details of this contract are known in advance, and the main ones can be summarized as follows:

1. price (normally in USD per volume unit);
2. delivery time (year and month);
3. size (total volume);
4. margin (normally in USD).

Together with stocks, options and bonds, the futures contract is one of the most rewarding types of trading. Contrary to options, to buy (or sell) a futures contract does not require to pay in advance, but the broker requires a minimum balance which is correlated to the margin (it is proportional to the risk). Clearly, it is risky to trade futures without a guide, however, there are many methods to hedge the risk: spreads and trading seasonal contracts. There are many publications and courses in this field, in addition, if you want to get an idea you can check our free course on futures trading. Together with adequate practice, you will be able to trade futures in 4/6 months.

CONS:

1. It is for persistent persons.

PROS:

1. The daily trading requires low effort (maximum 30 min daily);
2. it is possible to hedge the risk with seasonal trends;
3. it is good for small budget holders (3000 \$);
4. average monthly return is about 4%-6%;
5. large bibliography;
6. free course, and support on Tradology.

Conclusion

In this report, we have given an overview of the most popular methods to trade. Whether you decide to trade forex, options, stocks or futures bear in mind to do it with the right approach and with an adequate educational level, otherwise, the default is around the corner. Finally, we have proposed a free course on futures trading, where you will have the needed information and will be assisted as soon as you are independent, just register on Tradology.