

DERIVATIVE MARKET



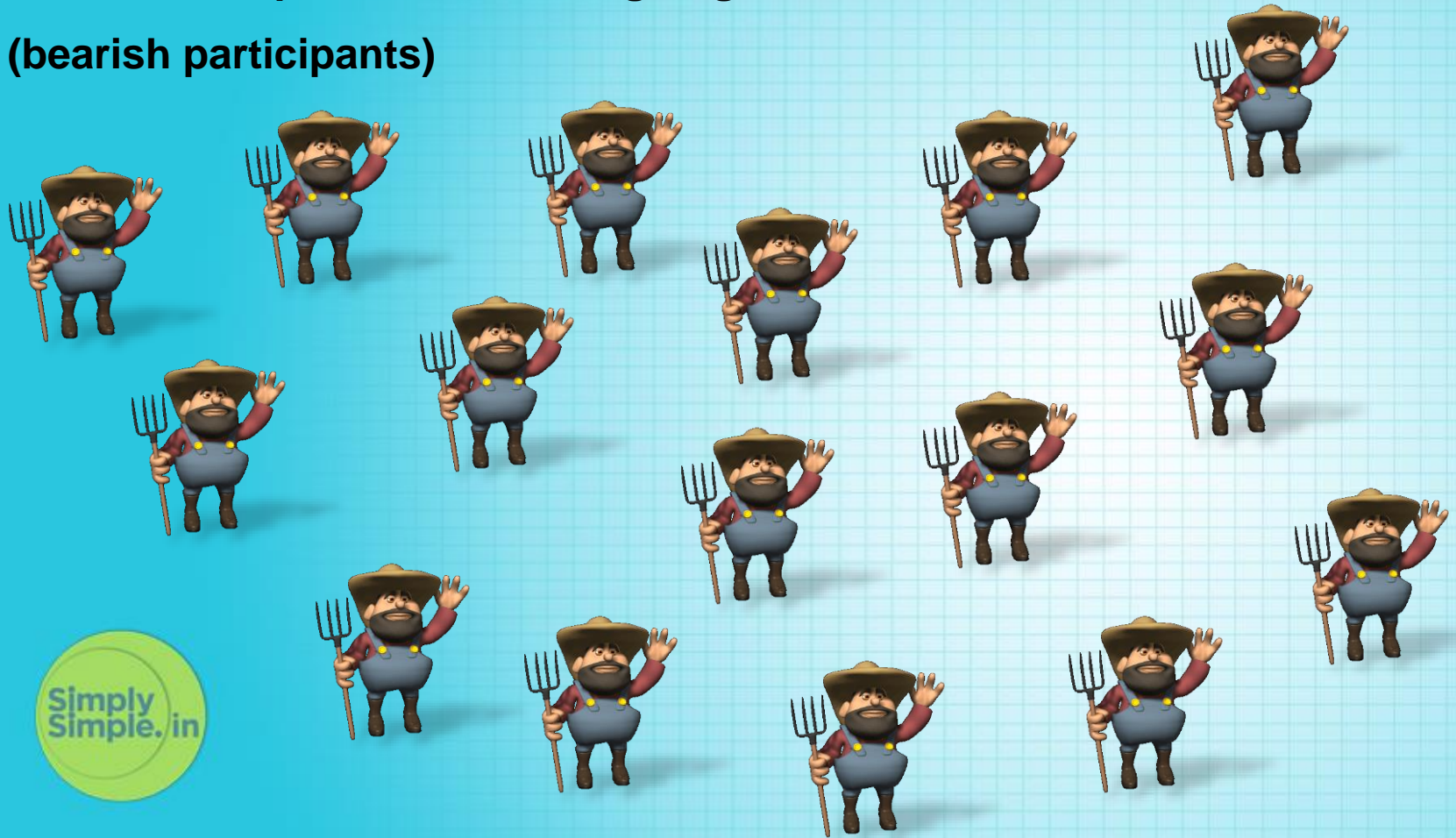
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**Simplifying how derivative
products operate
in the stock market
– By Prof. *Simply Simple*™**



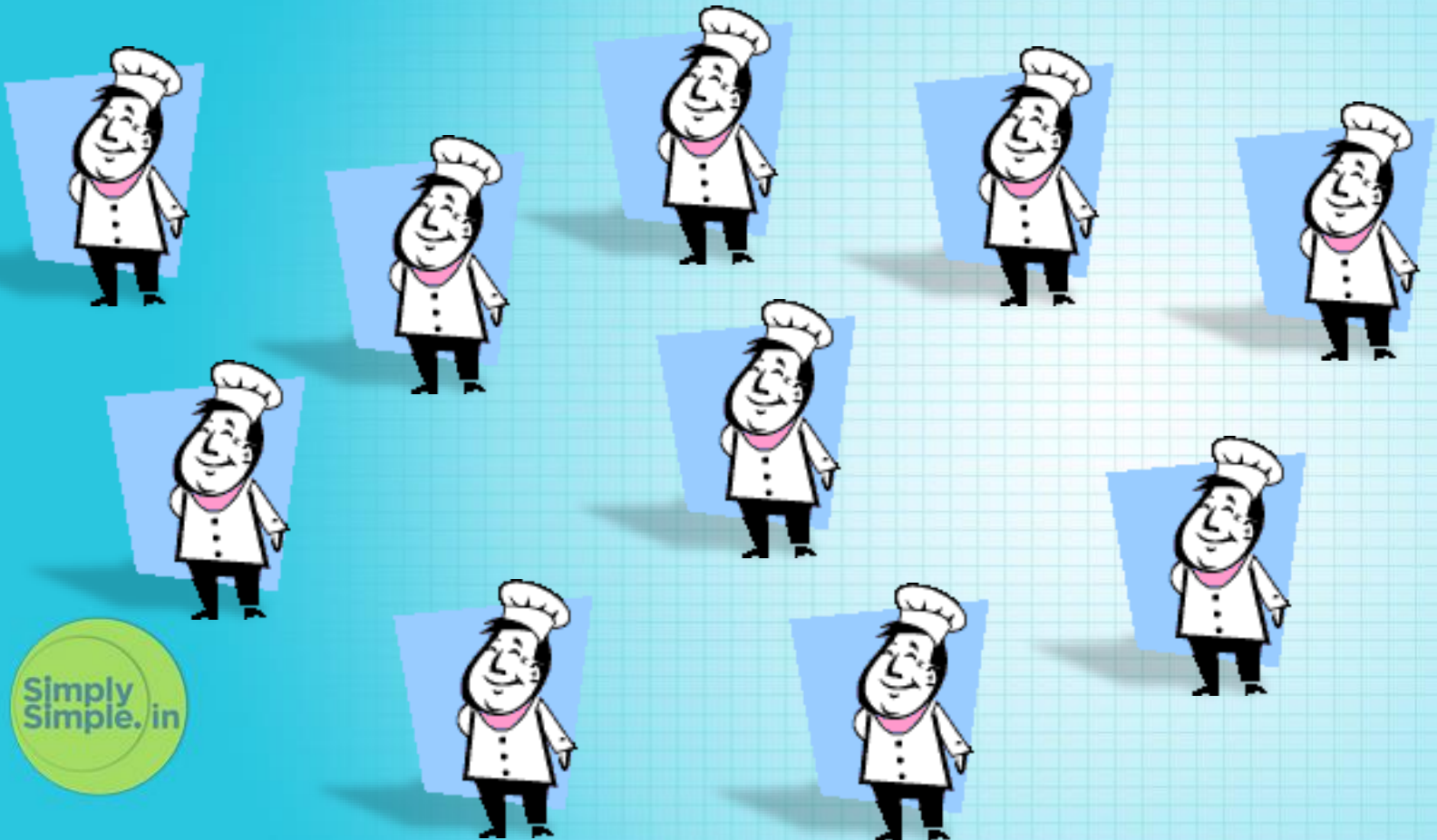
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Imagine there are several farmers in a market. Some have a view that the price of Wheat is going to fall in the near future (bearish participants)



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Also some bakers have a view that the price of wheat is going to rise in the near future (bullish participants)



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The market place has free flow of information. It provides a platform to both bullish & bearish participants to execute their trades without even knowing each other or hunting for counterparties.



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- ❑ So the expected future price (price of wheat) is known to every farmer and bread manufacturer.
- ❑ Any farmer trying to extract a higher price will not be able to do so because for the bread manufacturer there are several other farmers to buy from and vice versa.



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- ❑ Since the price is universally known and there are several farmers and bread manufacturers, there is no need to get into individual contracts.
- ❑ There is no need to know who the options/futures buyer is and who the options/futures seller is for it does not make any difference for either party.



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- ❑ The markets also make it possible for either party to deal with several counter parties at the same time.
- ❑ The market thus makes it possible to keep identities of parties to remain confidential with respect to the respective counter parties.
- ❑ If one were to replace the farmer and bread manufacturer by normal people who have opposite views about the future prices of stocks, what we have is a typical Derivatives Market.



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So in a nutshell...

- ❑ The market provides a platform for several parties and counter parties to come together to trade over stocks about which information is free flowing)
- ❑ This leads to a single future price for all participants, thereby rendering irrelevant the need to know who the buyer for the seller and vice versa
- ❑ Despite all of the above, the market system independently has all the necessary information about the market participants.



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I hope you understood the derivative market dynamics and why there is no need to know the names of counter parties.



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