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Financial Securities

Financial securities are tradable and interchangeable financial instruments, like stocks. bonds, or exchange-traded funds (ETFS). that represent a specific financial value. To qualify as a security, it must be possible to buy, sell, or trade it on the market, ensuring liquidity and negotiability.

1. What is a security?

Securities are tradable financial instruments employed to procure capital within public and private markets. Primarily categorised into equity, debt, and hybrid instruments, they offer distinct investment avenues. Equity securities represent ownership stakes, while debt securities constitute loans with predetermined repayment terms. Hybrid securities exhibit characteristics of both equity and debt. Common examples include stocks, bonds, and derivatives. These instruments underpin the functioning of capital markets, enabling investors to participate in asset ownership, trade, and risk management.

2. Types of securities:

In the world of finance, there are several different types of financial securities.

1. Equity securities: Equity securities, commonly known as stocks or shares, represent ownership in a company. When you own equity securities. you own a portion of the company's assets and have the potential to earn profits through capital appreciation and dividends. Equity shareholders also have a voice in the company's decisions through voting rights. Investing in equity securities carries the potential for high returns, but it also comes with a higher level of risk compared to other types of securities.

2. Debt securities: Debt securities, on the other hand. represent loans made by investors to governments, corporations, or other entities. These securities include bonds. deberntures, and notes. When you purchase a debt security. you are essentially lending money to the issuer in exchange for regular interest payments and the promise of principal repayment at a future date. Debt securities are considered lower-risk investments compared to equities, as they offer a predictable stream of income and are backed by the issuer's creditworthiness.

3. Hybrid securities: Hybrid securities combine features of both equity and debt securities. Convertible bonds and preference shares/ preferred stocks are common examples of hybrid securities. Convertible bonds allow bondholders to convert their bonds into a predetermined number of company shares, providing the potential for capital appreciation along with the safety of a fixed-income investment. Preferred stocks, while similar to common stocks, offer preferential treatment in terms of dividends and liquidation proceeds, making them a middle ground between equity and debt investments.

4. Derivative securities: Derivative securities derive their value from an underlying asset, such as stocks. bonds, commodities, or currencies. Options and futures contracts are prominent examples of derivatives. Options provide investors the right, but not the obligation, to buy or sell an underlying asset at a specified price within a certain timeframe. Futures contracts obligate traders to buy or sell an asset at a predetermined price on a specific future date. Derivatives are commonly used for hedging against price fluctuations, speculating on market movements, and managing risk.

5. Asset-backed securities: they are financial instruments backed by a pool of underlying assets. These assets can range from mortgage loans and auto loans to credit card Asset-backed securities (ABS) are financial instruments backed receivables. The issuer packages these assets into securities that are then sold to investors. ABS offer an opportunity for diversification and can be structured to cater to different risk appetites.

3. Role of securities in finance:

Financial securities play a crucial role in the world of finance in the following ways:

1. Portfolio diversification: Investors use different asset allocation methods to diversify their investment portfolios with different types of financial securities. A diversified portfolio with a healthy mix of assets helps protect investors against market volatility.

2. Risk management: Financial securities play a key role in risk management as well. Securities with low or or zero orrelation can be used to hedge investment risks and offset losses arising from a particular asset class. For instance, equity and gold have a negative corelation. Therefore, investors can hedge risks of equity investment by investing a portion in gold ETFS.

3. Raising capital: Securities are tradable instruments used to raise capital in public and private markets. Both corporations and governments issue financial securities to raise the capital required for funding various operations. Instead of applying for a costly loan, corporations list equity shares on the stock market to raise capital for growth and expansion. Similarly. governments sell bonds to raise funds for various projects to ensure the development of the country

4. Maintaining market liquidity: Securities are also crucial in maintaining market liquidity. Since there are multiple readily available buyers and sellers of any given type of financia security. these instruments can be converted into cash more easily than other assets like, say, real estate.

5. Reflect the health of the economy: Financial securities serve as a barometer for the economy's overall health. For instance, investors often assess the health of the economy by analysing the stock market.

The logic is simple: If the equity shares of companies are performing well. the companies linked to them are probably performing well too.

4. What is the difference between stocks and securities?:

Stocks and securities are closely related financial instruments, but they have distinct characteristics.

Stocks, often referred to as "equities or "shares. represent ownership in a specifc company. When you buy stocks. you become a shareholder and have a claim on a portion of the company's assets and earnings. Stockholders may have voting rights and can benefit from capital appreciation and dividends .

Securities., on the other hand, is a broader term encompassing various tradable financial instruments. While stocks are a type of security, securities can also include bonds. mutual funds,. options, and other financial assets. Securities represent a financial interest or a right to assets or income and can be traded in financial markets. Unike stocks which represent ownership, securities can represent both ownership and debt.