Introduction to Derivatives

Video Title: What is Derivatives?

When you read a newspaper or watch financial and economic news on television, you always hear about financial products such as futures, options, and warrants. Did you know these financial products are normally referred to as "Derivatives"? And do you also know what derivatives are? There are a total of four parts in this training, and we hope this training can help you know more about derivatives, and understand their nature, types, applications, as well as their related risks.

However, different derivatives have different natures, when trading these financial products, remember to consult your professional investment advisor for further information before you invest.

Let's move on to the first part, the "Introduction of Derivatives".

Let's start by talking about what derivatives are.

Derivatives "evolved" from (i.e. were "derived" from) other products. In the financial market, derivatives are usually derived from spot market products (e.g. currency, stocks, gold, etc), which are called the "Underlying Assets". As derivatives are based on their underlying assets, their values will definitely be influenced by the underlying assets. Apart from this, derivatives' values can also be affected by other market factors such as interest rate changes, economic environment, etc.

Now let's move on to the differences between derivatives and spot market products.
"Spot market products" are those products that can be settled between buyers and sellers in a very short time. For example, when you are shopping in a supermarket, products on the shelves can be taken home right after paying for them. The same is true in the spot market, where you can settle the trade for currencies or stocks, usually within a day or a very short period. Thus, they are called spot market products.

Normally, the difference in settlement times is a way to differentiate spot market products and derivative products. In addition, if the prices drop rapidly after you bought spot market products, you would not have immediate losses unless you realize the holding. But, if you bought derivative products, which must be settled before a specific future date (e.g. a month later); when the prices drop rapidly, you would bear the risk of losses.
For example, you may be aware of one such derivative product, "Warrant". A warrant's value is

directly related to the movement of its underlying stock price. Now that you know how derivatives and spot market products are related, and also where derivatives evolved from, you should be able to tell why these financial products are called “Derivatives”.

Having concluded this section, let’s pause for a summary.

Derivatives are based on spot market products (e.g. currency, stocks, gold, etc). Derivatives are settled on a specific future date, while spot market products can be settles within a day or a very short time.

Finally, Derivatives’ prices are mainly influenced by the movements in the prices of their underlying assets.

Coming up, we will talk about the different natures and types of derivatives.

We hope to see you back here!

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