

# International Financial Markets Operations

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# Investing abroad

- Investing in stocks, bonds, real estate, direct investment, mergers and acquisitions, derivatives
- Aims: Market share, market access, cost efficiency, diversification
- Additional risks: country risk in the form of political risk, payment risk, currency risk

# Diversification

- The right kind of diversification will reduce risk without loss of revenue or increase revenue at the same overall risk level
- Problem: With increased internationalization, the diversification effect has been lowered, particularly with stocks and bonds
- Currency diversification still intact

# Hedging

- Hedging and Speculation bilateral
- Any selling needs buying
- Different expectations and needs make markets
- Futures markets serve this need
- Derivatives: futures and options, over-the-counter (OTC)

# Techniques

- Short: right to sell
- Long: right to buy
- Sell short
- Buy short
- Sell long
- Buy long

# Operations

- Sell – Buy + Short – Long +
- Winning market direction +/-
- - . - = +
- + . + = +
- - . + = -
- + . - = -

# Currency speculation

- Dollar short versus Euro
- You buy dollars now, exchange into Euros
- Leverage through borrowing
- You have a liability in dollars
- You have asset in euros
- Risk is interest rate differential

# Currency hedging

- Exporter expects dollar income in the future
- He sells dollars now on the futures market
- Importer has to pay dollar bill in the future
- He buys dollars now on the futures market
- Speculators make the market more liquid

# Options

- Calls and puts and combinations
- Call +, put –
- Same basic arithmetic as in slide 6
- However, seller earns premium, buyer pays premium
- You sell a put, win when quotation rises
- You buy a put, win when quotations falls

# Financial Engineering

- Highly complex and mathematical
- Discussion whether it is market stabilizing or has increased systematic risk
- Risk of chain reaction (LTCM)
- “fat tails”-problem
- Historical volatilities, regression to the mean, monetary policy, liquidity