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DERIVATIVES AND RISK ANALYSIS



INTRODUCTION


Derivatives are securities whose value is based on an underlying reference object, which may be an equities, a security, a physical commodity or a rate of interest. It helps investors, traders or institutions use them to hedge risks or bet on fluctuating prices or use them during unfavorable financial conditions. Some forms of derivatives you may hear of include options, futures, forwards and swaps.





RISK ANALYSIS


Risk analysis is an important part of managing derivatives. As a matter of fact, due to their very structure, derivatives acts as aParallel to this theoretical expectations, derivatives also have the propensity for big gains and hefty losses. The three primary risks of derivatives are Market risk, credit risk and Liquidity risk.





HEDGING AND SPECULATION

Derivatives can be used for purposes of hedging, meaning the use of these contractual agreements to reduce a loss in the value of an asset. For instance, a firm may employ a derivative instrument to purchase or sell at a certain price some commodities such as oil to hedge in respect to price risk.






CONCLUSION

Basic knowledge of derivatives and the risks inherent in them is vital for every person who is concerned in the financial markets.

Thus, risk analysis and management that allow for minimizing possible losses and improving the company's financial situation can be the strong advantage turning derivatives into the significant vehicle in the contemporary financial systems.





RECOMMENDATION

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