

# *Foreign Exchange Markets*

Foreign exchange markets are also known as currency, FX and forex markets. They are the biggest markets in the world by turnover.

The FX market is all over-the-counter (OTC). You have to deal with a bank or an FX broker to actually buy and sell currencies.

Other markets that are also mostly OTC are the debt markets, land and property markets and many types of derivatives such as swaps and forwards.

In contrast, exchange traded financial assets include shares and futures. Exchange-traded assets are more standardised.

## ***FX is not an Asset***

Foreign exchange rates are not an asset, they're a ratio of the price of one currency against another, usually the United States of America's Dollar (USD).

If someone says that they're 'investing in foreign exchange', it usually means that they're actually investing in short term debt denominated in another country's currency.

If an Australian buys US dollars, they're probably buying short term debt denominated in USD and selling short term debt denominated in AUD.

To 'buy US dollars' an Australian could:

- Borrow AUD from an Australian bank. This is the Australian person selling a **new** AUD short term debt contract to the bank, so the person will have a debt liability. Alternatively, the Australian could withdraw AUD deposits from their Australian bank which is reduced lending to that bank. Here the person is selling their **existing** AUD short term debt asset to the bank; After this, the Australian person can:
- Lend USD to a US bank. This is the same as buying the bank's USD-denominated short term debt, also known as depositing USD into a US bank. It's normally done electronically, there's no need to transport notes and coins.

However, instead of buying US banks' short term debt, the investor could also attain exposure to fluctuations in the USD by buying stocks or long term debt or land or any other asset in the US where assets are denominated in USD.

Another way to gain exposure to foreign currencies is to use derivatives such as FX forward agreements or options. Their value is determined by the underlying exchange rate.

# *Investable Assets in Finance*

It can be useful to think about finance in terms of three broad categories of investable assets, differentiated by their payoffs, liquidity and the type of market they trade in:

- Equity
  - Common stock, also known as ordinary stock.
- Debt
  - Short term money market debt such as bank accepted bills (BAB's), certificates of deposit (CD's) and promissory notes (PN's or commercial paper) which usually have an original maturity of less than one year. This market is also known as the 'cash market' since it's very liquid and short-term.

- Long term bond market debt such as bonds and debentures which have an original maturity of more than one year.
- Property
  - Land, buildings, apartments, equipment.

Hybrids such as preference stock and convertible bonds can be thought of as another category of investable asset.

Derivatives such as options, futures, forwards and swaps are another important category but since they are usually used for hedging and speculating they are not thought of as investable assets.

Some other investable assets which are not included are things like human capital which is too difficult to measure.