Trading for Beginners: Everything you need to know to Start Trading on the Financial Markets

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1. What is a Market?

The word market itself has many uses, but most commonly people use it to refer to a place where commercial deals are concluded. This can be a physical market as in "I went to the market to pick up some fresh tomatoes" or a general like "the housing market is slowing down" or the "the stock market is going strong" etc.

In your daily life you are always participating in one market or another because you are constantly making deals and financial transactions. These can range from trivial things like buying groceries and filling up your tank with gas to bigger ones like buying a house or investing your savings in stocks.

Similarly, the financial markets are a place where people gather to make deals with financial instruments. According to the types of products traded, the financial markets are divided into stock markets (also known as equity markets), commodity markets, derivative markets, currency markets, etc.

The marketplace where you trade stocks is known as a stock exchange or stock market. You've probably heard of at least one of the major stock exchanges in the world:

- New York Stock Exchange, based in New York City, United States
- NASDAQ, based in New York City, United States
- London Stock Exchange, based in London, United Kingdom
- Deutsche Börse, based in Frankfurt, Germany
- Japan Exchange Group, based in Tokyo, Japan
- Korea Exchange, based in Seoul & Busan, South Korea
- Hong Kong Stock Exchange, based in Hong Kong, Hong Kong

The commodity market is a financial market where commodities are traded. Of course, the commodities are not physically exchanged on the market. Instead, the deals happen with futures contracts. There are "soft" commodities such as cocoa, soybeans, and sugar and "hard" commodities (usually mined) such as gold, copper, and oil. The most popular commodities and futures exchanges are the Chicago Board of Trade (CBOT) and Chicago Mercantile Exchange (CME) which merged into the world's largest futures exchange market – CME Group.

Another very popular financial market is the foreign exchange market, also known as FX market, Forex market, or currency market. This is a global marketplace where national currencies are exchanged against one another. For example, Euros are exchanged for US dollars, or British pounds to Japanese yen. In contrast to the equity and futures markets where the trading is centralized in an exchange, the forex market is decentralized and is traded over-the-counter (also known as OTC).

The traditional markets have been around for quite some time now. Commodity and currency trading and exchange have been around since ancient times. The modern foreign exchange, stock, and commodity markets emerged around the 1600s. A breakthrough in the financial markets was the adoption of electronic trading which started in the 1970s.

Now you have an idea of what is a market and particularly what is a financial market. You have also, got an idea of the world stock, commodity and futures exchanges, and the foreign exchange market.

2. How can I trade on the Market?

There are various ways in which you can access the markets. Generally, it depends on which asset class you have decided to trade.

2.1. How can I trade on the Stock/Futures/Forex Market?

In order to trade on the traditional financial markets, you would need to open an account with a broker.

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2.2. What is a Broker?

A broker is a financial institution that allows you to connect to a market or an exchange to place your trades. As an intermediary the broker charges you a fee in the form of a commission or a bid-ask spread. Brokers are usually supervised by a regulator according to the jurisdiction they reside to protect their client's assets.

Here are some important things to consider when you are looking for a broker to open your trading account.

2.3. Trading Costs – commission or Bid-Ask Spread

One of the first things to look at when deciding where to open your trading account are the brokerage conditions. The different brokers charge different commissions or offer different bid-ask spread.

2.4. What is a Broker commission?

A broker commission is a type of fee paid to a broker for handling financial transactions on a trader's behalf. As we mentioned earlier individual traders cannot trade directly on an exchange. Instead, they use the service of a broker who acts as an intermediary between the client and the exchange. The commission is the compensation which the broker receives for this service. The commission can vary in size and the way it is applied. Usually, it is in the form of a predefined fee. It can be charged by deal (flat fee, regardless of the volume traded per deal), per stock or futures contract traded (x amount per stock or contract) or as a percentage of the notional value of the deal.

2.5. What is the Bid-Ask Spread

The bid-ask spread is the difference between the bid price and the ask price of a security. The bid-ask spread is typically the price of liquidity. Liquid markets have lower bid-ask spreads (thus they are cheaper to trade), while the spread in illiquid markets can be significant. I addition to the market spread some brokers add markup as an alternative to charging a broker commission. This way all the costs for the client are included in the spread.

2.6. Trading Tools

Nowadays most brokers provide web-based or desktop executable trading platforms. Some of them have also mobile applications or can be accessed by APIs. The most popular trading platforms for Forex trading that are not associated with a particular broker are MetaTrader 4 and MetaTrader 5. For stocks and futures trading the popularity prize goes to Trade Station and Ninja Trader. A lot of brokers have their own in-house build multi-asset trading platforms where you can trade almost every popular instrument – currency pairs, options, stocks, ETFs, futures contracts, etc.

Good stuff! You now know the basics about the markets and what are the ways you can access them. We have briefly mentioned the different types of products you can trade. It is now time to learn more about each one of them.

3. Financial Instruments

There is a huge variety of financial instruments to choose from when you decide to start trading. In the next few paragraphs, we are going to go over the most popular ones.

3.1. Stocks

Stocks or also known as shares or equities are most probably the most popular investment vehicle int the world. Almost everyone has heard about the stock market

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or at least has seen a movie about Wallstreet and is familiar that people can profit from trading stocks. But what exactly happens when you buy a stock?

A stock is a form of security that represents proportionate ownership of a company. When you purchase a stock, you receive a share of the equity. If the company is privately held, the equity deals are arranged directly between the parties. When a company wants to attract additional capital, it can decide to go public. This means that it should undergo an IPO (a process of Initial Public Offering) and if it is successful its shares can be listed for trading on an exchange. Once this is successful, the shares become available to the general public for trading. The market where the IPO happens is known as the primary market. The market where normal trading activity happens is known as the secondary market.

3.2. Derivatives

A derivative is commonly described as a financial instrument that derives its value from another security. This other security is referred to as an underlying asset. The underlying asset can be any other financial instrument: a stock, commodity, currency, etc. Below is a list of the most common derivatives:

3.2.1. Forward Contracts

Forwards are the simplest derivatives. A forward contract is a deal in which the buyer and seller enter a contract to exchange the underlying asset for cash on a specific price and on a specific date in the future. The price, the quantity, and the future date at which the transaction happens is decided on the day of the deal.

The parameters of the deal are agreed upon by the buyer and the seller without any intervention from a third party. This means that forward contracts are traded over-the-counter (also known as the OTC market).

The essence of the forward transaction is that the buyer is obligated to buy the underlying asset, while the seller is obligated to sell it on the agreed date and price.

3.2.2. Futures

Futures are very similar to forward contracts. What is different is that futures contracts are standardized. This means that the quantity, the date of the transaction (known as the expiry date), etc. are determined not by the buyer and the seller, but by a third party – the exchange. As a result, the buyer and seller of a futures contract can focus on the trading activity while the exchange is responsible for the additional aspects of the deal.

Futures contracts are classified based on their underlying assets. For example, the futures on stocks are called stock futures. Respectively other popular futures contracts are classified as commodity futures, index futures, and currency futures.

3.2.3. Options

Options are another variety of a deal that arranges a transaction on a later date. An option is a contract in which the buyer buys the possibility to purchase or sell the underlying asset on or before a specified date in the future but doesn't have the obligation to do so. At the same time the seller is obligated to buy or sell the underlying if the buyer decides to exercise his option. The buyer pays compensation to the seller for this choice, which is called option premium. If the buyer of the option contract decides not to exercise the option, the deal with the underlying asset doesn't occur, but the seller keeps the premium.

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Similar to futures contracts, options are also classified according to their underlying assets – commodity options, index options, stock options, currency options, etc.

3.2.4. Contract For Difference (CFD)

A contract for difference, popularly known as a CFD is a derivative popular mostly in Europe which allows the traders to profit from price deviations of the price of the underlying asset without owning it.

In a contract for difference the two parties – the buyer and the seller take the current price of the underlying asset as a reference and make a deal without transferring ownership of the underlying asset. In case the price goes up, the seller agrees to pay the difference to the buyer (the buyer gains), and respectively if the price goes down the buyer agrees to pay the difference to the seller (the seller gains).

CFDs originally emerged in London in the 1990s as a type of equity swap. They were initially used mainly by hedge funds and institutional traders. They became very popular because they were traded on margin and were a cost-effective way to gain exposure to stocks on the London Stock Exchange, without having physical holdings. Later, CFDs were introduced to retail traders and became very popular because of the easy access and the possibility to trade on margin.

CFDs emerged as an instrument to swap single stocks but have proven to be a very effective way to gain diversified exposure to the stock market by trading a whole index instead of picking individual stocks. Right now, the most traded contracts for difference are Index CFDs, followed by commodity CFDs and single stock CFDs.

3.2.5. Financial Spread Bet

A spread bet is a derivative that is available to retail traders only in the United Kingdom. It is working the same way as a contract for difference, with the additional benefit that the profits realized in spread bets are exempt from capital gains tax.

3.2.6. Exchange-Traded Fund (ETF)

An Exchange-Traded Fund (ETF) is another popular exchange-traded security. An ETF is an alternative investment vehicle that is traded like a stock that tries to replicate a market index. It consists of a basket of securities based on an index. The basket can consist of stocks, commodities, or even bonds. For example, the SPDR S&P 500 ETF (known as SPY) is an ETF that tracks the S&P 500 Index and the SPDR Gold Trust ETF (known as GLD) is an ETF which tracks the price of Gold. What is specific to ETFs is that the fund has actual holdings of the assets which it is set to track. For example, the SPY has holdings of the stocks that are constituents of the S&P 500 index and the GLD has holdings of physical gold. This means that when you buy an ETF you are actually getting hold of a fraction of the underlying assets.

4. What is an Index?

An index is an indicator that is used to track the changes in the stock market. It is derived from the prices of a basket of stocks traded on an exchange. Usually these are the most liquid and actively traded stocks for the exchange. Any change in the prices of the stocks included in the index results in a change of the value of the index.

Indices are used by investors as a summary of the market movements. They can also be used as benchmarks for comparing the performance between different markets or sectors.

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Major indices are a good indicator you can check when you want to see how the market is doing. The most popular ones are:

Dow Jones Industrial Average (^DJI) – popularly known as Dow Jones or simply the Dow. This is a stock market index that measures the performance of the top 30 companies by market capitalization that are listed on the stock exchanges in the United States.

S&P 500 Index (^INX) – also known as the S&P or SP500 is another major US index. It measures the performance of the largest 500 publicly traded companies, listed on exchanges in the United States. It is one of the most followed equity indices, because it is considered to give the best representation of the US stock market.

Nasdaq Composite (^IXIC) – popularly referred to as the NASDAQ or NAS100. This is a stock market index of the stocks listed on the Nasdaq stock exchange. The composition of this index is heavily weighted towards information technology companies.

DAX Performance index (^DAX) – this is a stock market index that consists of the 30 major publicly traded companies that are traded on the Frankfurt Stock Exchange in Germany. It is commonly referred to as the DAX or DAX30.

FTSE 100 Index (^UKX) – the Financial Times Stock Exchange 100 index, also known as FTSE 100 and formally called “the Footsie” is the major stock index in the United Kingdom. It consists of the 100 companies with the highest market capitalization that are listed on the London Stock Exchange.

Nikkei 225 (^NI225) – the Nikkei 225, also known as just the Nikkei or the Nikkei Stock Average is the stock market index which represents the performance of the top 225 companies that are traded on the Tokyo stock exchange.

4.1. Stock Market Indices specifics

Indices are generally not tradeable. However, as you already know there are ETFs and derivatives such as CFDs and futures contracts that are based on indices that you can use easily to replicate the performance of the index.

Stock market indices are constructed through a price-weighted or market-capitalization-weighted approach. A price-weighted approach assigns more weights in the index to the stocks with a higher price. An example of an index constructed using this way is the Dow Jones Industrial Average.

The weight of each stock in a market capitalization-weighted index is assigned according to its market capitalization. An example of such an index is the S&P 500, where the large companies like Apple and Microsoft have significant weight in the index, while the stocks with smaller market capitalization contribute less to the changes of the index.

5. What are the Different Types of Markets?

Markets can be classified based on various factors. For example, what is the type of the transaction, which types of instruments are traded, etc.

5.1. Over The Counter (OTC) vs Exchange Trading

The type of transaction depends on the way it is conducted. Transactions can happen over the counter (OTC) or on a centralized regulated marketplace (Exchange).

OTC transactions happen directly between two market participants without any centralized intermediary. OTC markets are decentralized and unregulated. Forex is the biggest OTC market.

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Exchange-traded transactions are conducted on regulated marketplaces. These transactions happen on a centralized physical system according to the rules of the exchange. Exchanges provide a range of facilities that let the operations run smoothly. These vary from standardizing the way different instruments are traded to clearing the deals between the buyers and the sellers. The various entities submit their orders to the exchange where they are recorded in a common book. As a result, there is increased transparency about the transactions. Stock exchanges are a typical example of a regulated marketplace.

5.2. Markets according to the Type of Instruments Traded

The second market classification is based on the type of instruments traded. These are the most common:

5.2.1. Stock/Equity Markets

The stocks of companies are traded on the stock market, also frequently called the equity market. The most popular example of a stock market is the New York Stock Exchange (NYSE). Other popular stock marketplaces are the Deutsche Börse, the Euronext, the London Stock Exchange, The Tokyo Stock Exchange, etc.

5.2.2. Derivatives Markets

The derivatives markets are the marketplaces where derivatives contracts are traded. Some of these markets are conducting trade only in futures contracts, while others cover more types of derivatives contracts. The most popular example of such a market is the Chicago Board Options Exchange (CBOE).

5.2.3. Commodities Markets

Commodities such as gold, silver, corn, etc. are traded on commodities markets. Don’t imagine that physical commodities get transferred on the floor of the marketplace though. What happens is that derivatives such as futures based on the commodities get traded on the market. The physical delivery is arranged on a later date according to the specifics of the contract. The most popular commodity market is the Chicago Mercantile Exchange (CME), followed by the London Metal Exchange.

5.2.4. Currency Markets

Currency and their derivatives are traded on currency markets. These markets are usually OTC.

6. Who are the Market Participants?

There are two main types of market participants speculators and investors.

Speculators are market participants who make frequent transactions in and out of the market with the aim to earn profits from the short-term fluctuations of the prices. Speculators can use various techniques to gain their “edge” (the specific technique that makes them predict the fluctuations better). You can read more about these techniques in our article The 21 Most Popular Trading Strategies Every Serious Trader Should Learn To Succeed.

Investors are market participants who invest their money in financial instruments with a long-term expectation that this will increase their wealth over time. Investors are not so focused on gaining from the price fluctuations but are rather looking for instruments that provide steady growth and additional returns, usually in the form of dividends.

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7. Which Trading Style is for you?

There are several approaches you can adopt as a trader. Most probably you wouldn't feel comfortable using all of them. The majority of people are comfortable with just one or two. It is best to take some time and learn the differences. You can easily do that by trying a couple of trading strategies in different styles on a demo account.

7.1. Buy-and-Hold

Buy-and-hold is the most passive trading style you can adopt. Usually this is the choice of people who are looking for long-term investments. A typical buy-and-hold trade lasts for a couple of years or longer. This approach is considered less risky, due to the long periods of holding the positions. It works best for investors who do not want to spend too much time analyzing the markets. It can be profitable when there are strong up-trends but performs badly in periods of consolidation or bear markets.

7.2. Position Trading

Position trading is very similar to buy-and-hold, but it requires more attention and action from the investor. Another difference is that the trades are not long only as in buy-and-hold but can be long or short. Position trading is the choice of people who want to feel more engaged in the markets, but still prefer to be on the passive side. Position traders use long term chart timeframes. Usually, they don't go lower than daily charts when looking for opportunities. The typical holding time of their positions is from a couple of weeks to a couple of months. Position traders usually focus on trend following strategies.

7.3. Swing Trading

Long terms strategies are suitable when the markets move in trends. Once a trend breaks, it is time to switch your trading style. Trends never end and reverse overnight. Normally there is a period of volatility and consolidation before the new trend is established. This period opens a lot of opportunities, but you have to be actively engaged in following the markets.

Swing trading is the most suitable trading style for the reversal periods. Swing trades are held from a couple of hours to a couple of days.

7.4. Day Trading

Day traders hold their positions from a couple of minutes to a couple of hours. They never leave positions open overnight. A typical day trader can make anything from five-ten trades to a couple of hundreds of trades during a day. Day traders usually rely on charts and technical indicators for their trading decisions. The short intraday repetitive patterns are also preferred by algorithmic traders when they design their strategies.

7.5. Scalping

Scalping is the most engaging trading style. Frequently it involves exploiting price anomalies and possibilities for arbitrage. Scalpers hold their positions for a very short period of time. Scalping trades can last from a fraction of the second to a couple of minutes. Since the trades are short-term, scalping can be a profitable technique only in liquid markets with low transaction costs. Most of the scalping is performed by algorithms. This is because computers more efficient than humans following the small repetitive tasks.

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8. Who regulates the Markets?

Regulated markets are overseen by regulatory boards or agencies. Every jurisdiction has its own regulatory authority. While these agencies are independent of each other, some of the governing rules are similar. These are the most prominent regulators worldwide:

- U.S. Securities and Exchange Commission (SEC), United States
- Financial Conduct Authority (FCA), United Kingdom
- European Securities and Markets Authority (ESMA), European Union
- Swiss Financial Market Supervisory Authority (FINMA), Switzerland

9. What are the Types of Analysis you can use to predict the Markets?

If you want to be successful in trading, you should follow some analytical approaches to make your trading decisions. If you are not following any trading strategy, then you are just gambling and trying your luck.

We are going to mention the three most common types of analysis that are used by retail traders – fundamental analysis, technical analysis, and quantitative analysis.

9.1. Fundamental Analysis

The fundamental analysis is based on studying fundamental factors that are driving the change in the prices of the instruments that you are trading.

When you analyze stocks fundamentally, you need to focus on the financial and economic factors that affect the company whose stocks you are willing to trade. Fundamental factors for companies are things like profitability, cash flow, balance sheet size, how good is the management of the company, etc. The goal of your analysis is to determine whether the particular security you are considering is valued correctly or not.

If you conclude in your analysis that the fair value of the company is higher than the current market price of its stock, this means that it is undervalued. As a result, you would expect its market price to go up and meet its fair value, so you can buy the stock.

On the contrary, if your analysis suggests that the fair value of the company is lower than the current market price, this means that itis overvalued. Therefore, you would expect its market price to decrease to its fair value, so you can sell the stock short.

The process is similar when you are performing fundamental analysis for commodities and currencies. You are again trying to conclude if the current price of the instrument you are analyzing is over or undervalued.

When you are analyzing commodities, you are looking for factors that affect the supply and demand. For example, soft commodities like corn, coffee, sugar, soybean, etc. are very dependent on the weather. In this case you can monitor the rainfall expectation, hurricanes, drought, etc. Hard commodities like oil and metals are affected by supply disruptions – mining or drilling problems, sea transport issues, etc.

Currencies are affected by macroeconomic factors, economic cycles, central bank decisions on monetary policy and interest rates.

9.2. Technical Analysis

Technical analysis is a methodology for forecasting the direction of prices through the study of past market data. The most common approach for performing technical analysis is by using trading software for “reading” the charts. In this approach the technical analyst is looking for price patterns and technical indicators to form his expectations for the future price movement.

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9.2.1. Subjective Technical Analysis

The subjective technical analysis is the most widespread approach. Subjective analysis practitioners are interpreting the patterns that emerge on the historical price charts when trying to predict where the market will go next. Most frequently they are looking for lines of support and resistance and channels. However, there are quite a lot of intriguing complex formations like flags, pennants, cup and handle, head and shoulders, double top/bottom other reversal patterns. Unfortunately, too frequently, the outcomes of such interpretations are subjective to the views, believes, and experience of the person performing the analysis.

9.2.2. Objective Technical Analysis

The objective technical analysis approach is more scientific because it is based on well-defined repeatable procedures. As a result, the objective technical analysis is producing unambiguous signals. The objective technical analysis is the preferred methodology for creating trading algorithms because they can be successfully backtested and the results can be properly measured and optimized.

Objective technical analysts focus on using technical indicators instead of interpreting the charts. The technical indicators are mathematical transformations of the price. They are used for assessing whether a market is trending or ranging and how strong is the momentum in each direction. Popular technical indicators are moving average, relative strength index (RSI), MACD, Bollinger Bands, etc.

10. What is Trading Strategy Backtesting?

Trading strategy ideas can come from different sources. You can get inspiration for your next trading system from a research paper, trading magazine, internet forum, blog, a discussion group with other traders, and so on. How would you know if these trading ideas work? The answer is backtesting.

Backtesting is one of the most important steps in the trading system development workflow. Through backtesting you can validate or reject your trading strategy idea using historical data.

Backtest results show you how the trading strategy performs in terms of popular performance metrics. The most used performance metrics are the Sharpe Ratio, Sortino ratio, Return to risk ratio, Drawdown, etc. They help to quantify the strategy's performance and allow you to compare different trading systems using unified metrics.
When the performance metrics meet your acceptance criteria, the strategy can be implemented with a degree of confidence. If the results don't meet your expectations, you can modify and optimize the strategy to achieve the desired result.

11. What are Corporate Actions?

Corporate actions are events initiated by a publicly traded company that can lead to changes in the price of its shares. Typical corporate actions are dividends, stock splits, rights issues, etc. These events happen at the company's discretion. Let's look at the most popular ones and what is their effect on the market price of the stocks of the company.

11.1. Dividend

When companies are profitable, they can decide to issue a dividend. Through dividends the shareholders get their part of these profits. Companies usually pay dividends when their earnings are good. The amount that is paid to a shareholder depends on the number of shares held by him and the amount per share the company decided to distribute.

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Not all companies decide to pay dividends, even if they have strong earnings. Dividend payments effectively reduce the retained earnings that can be reinvested back into the business which limits the growth capacity. As a result, younger companies that are still in their growth stage, usually avoid issuing dividends and prefer to reinvest most of their profits. This way they can expand quicker.

More mature companies that have already passed their initial expansion stage, prefer to pay regular dividends to keep their shareholders happy. Dividends are considered as a positive signal because they show that the company is stable and is willing to share the excess profits with the shareholders. There are a lot of investors who prefer companies that pay regular dividends.

11.2. Stock Split

A stock split is a corporate event that increases the number of shares of a company. When this happens the price of each share must be reduced in such a way that the market capitalization, before and after the event remains the same. As a result, the market participants who hold shares before the split end up owning a bigger number of shares at a lower price, but don't lose any of their value.

For example, if a company that has shares trading at 1000 USD per share decides to do a 4 for 1 split, an investor who holds 1 old share would receive 4 new shares at the price of 250 USD. As you can see the value of the investment remains 1000 USD before and after the split, so the investor does not lose any value.

But why would a company want to do that? Usually, companies decide to do a stock split when the price per stock becomes so high that investors and speculators lose interest in it, so the trading volume decreases significantly.

11.3. Reverse Stock Split

A reverse stock split is a corporate action that decreases the number of shares of a company. When this happens the price of each share must be increased in such a way that the market capitalization, before and after the event remains the same. As a result, the market participants who hold shares before the reverse split end up owning a lower number of shares at a higher price, but don't lose any of their value.

For example, if a company that has shares trading at 5 USD per share decides to do a 1 for 10 split, an investor who holds 500 old shares would receive 50 new shares at the price of 50 USD. As you can see the value of the investment remains 2500 USD before and after the split, so the investor does not lose any value.

Why do companies decide to do reverse stock splits? Usually this happens when the price per stock becomes so low that it affects the image of the company negatively. If the price of the stocks of a company is very low, it can look like the company is struggling, so investors lose interest in it.

11.4. Spinoff

A spinoff is a corporate action that occurs when a publicly traded company decides to create a new independent company by selling or distributing new parts of its existing business. Usually this happens when the parent company decides that the part of the business that is being spun off will be more lucrative on its own. The spin-off company usually has a separate management structure and a different name, but it is based on the same assets, intellectual property, and human resources that it held in the old company.

Why would a company decide to do a spinoff? Usually this happens when it is decided that some divisions of the company will perform better if they are separated. For example, a company might decide to spin off a mature business unit that is

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established but is experiencing no growth, so it can focus on a newer division with higher growth prospects.

Another frequent reason for the spinoff is when a division of the business is heading in a different direction and has different strategic priorities from the parent company. As a result, it can be spun off so it can unlock its value under new management and a new brand as an independent operation.

A company may also decide to separate division into a separate entity if it is looking for a buyer to acquire it. This usually happens when the parent company considers that it can provide more value to its shareholders by spinning the unit in question off.

11.5. Rights Issue

A rights issue is a corporate action in which the existing shareholders are given the opportunity to purchase additional new shares of the company. It gives the existing shareholders securities called rights. A shareholder who received rights can purchase new shares at a discounted price on a predefined future date.

The rights owners can trade their rights on the market the same way that they could trade ordinary shares, prior to the date at which the new shares can be purchased. The rights have value because they are compensating the current shareholders for the future dilution of their existing shares' value. Dilution occurs because a right offering increases the number of shares outstanding.

The target of a rights offering is to raise additional capital. The most common reasons for companies to need to raise extra capital are to meet their current financial obligations or to expand their business. Financially troubled companies typically use rights issues to repay debt, especially when they are not able to borrow money anymore. Financially strong companies use rights issues to raise extra capital to fund further expansion of their business. This additional capital can be used for acquisitions or investments in new manufacturing or sales facilities. When a company is using the extra capital to fund expansion, this will eventually lead to increased capital gains for shareholders. As a result, despite the dilution of the outstanding shares, the shareholders would be better off after the rights offering.

12. What Tools Do You Need To Start Trading Online?

There are lots of tools that you can use to improve your performance when you start trading online. However, if you are just starting, a good PC, a reliable internet connection, and a trading platform are more than enough.

13. Commonly Used Terminology

13.1. Quote

A quote is the reference price you see as a current price for the financial instrument you are willing to trade. The quote is the current price which is available for a deal. A typical quote looks like this: 1.1398/1.1400, or 77.56/77.69, or 13357.02/13358.56.

As you can see quotes usually show prices in pairs. This is because quotes always have:

13.2. Bid And Ask

There are a lot more details for bid and ask, but at this time it is important to remember that the bid is the price you could currently SELL at (you expect the price to go DOWN) and the ask is the price you could currently BUY at (you expect the price to go UP). The bid is the price on the left in a quote (1.2398/1.2400) and the ask is the price on the right in a quote (1.2398/1.2400)

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13.3. Spread

The spread is the difference between the Bid and the Ask Price. An important thing you need to remember about the spread is that it is the cost of each deal you make.

13.4. Pip

Pip is short for Price Interest Point. This is one of the basic terms in currency trading. A pip is the smallest fraction a currency quote can move. For most currency pairs this is 0.0001, but for some it is 0.01. It is used for calculating profits, comparing spreads and slippage.

13.5. Bull Market / Bullish

A bull market is a period when the market is in an uptrend, that is the prices are moving in an upwards direction for some time. As a result, when people are expecting the prices of stocks to go up, it is said that they are bullish on stocks.

13.6. Bear Market / Bearish

The opposite of a bull market is a bear market. A bear market is a period when the market is in a downtrend, that is the prices are moving in a downward direction for some time. As a result, when people are expecting the prices of stocks to go down, it is said that they are bearish on stocks.

13.7. Long Position

When you buy a financial instrument, you have a long position. For example, when you buy a stock of a company, you have a long position in the stock of the company. Or when you hear someone is long on oil for example, this means that the person has long positions (bought) oil futures contracts.

13.8. Short Position

Selling-short is a trade in which you are selling a financial instrument without owning it in the first place. In a short sale you borrow the asset and sell it on the market, expecting the market price to go down. When you sell-short a financial instrument, you have a short position. If the price goes down as you expected, you could buy the financial instrument at a lower price from the market and return it to the lender. In a short sale you lock a profit from the market price going down. For example, when you sell a stock of a company, you have a short position in the stock of the company.

13.9. Square Off

Square off means that you are closing an existing buy or sell position. For example, if you have a long position in some stock, squaring off means, that you sell your stock and nullify your position. If you have a short position in some stock, squaring off means that you must buy the stock in order to become flat on your position.

13.10. Volume

Volume commonly refers to the traded volume. This is the total number of transactions (buy and sell) that occurred for a particular period of time. For example, if you read that a daily volume of a stock is 3 million, this means that 3 million shares got traded during that day.

13.11. OHLC

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OHLC is an abbreviation to Open, High, Low, and Close. OHLC refers to a dataset of prices or a chart where you can find these four prices for each data point (period). For example, if you have a daily price OHLC data set this means that each data point (each day) would have four records referring to the daily open price, the highest price for the day, the lowest price for the day, and the daily close price.

13.12. Trend

A trend is a tendency of the price to move in a certain direction over a period of time. When the prices are moving in an upward direction over some time, we say that there is an uptrend. Respectively when the prices are moving in a downward direction for a while, we say that there is a downtrend.

13.13. Arbitrage

Arbitrage is a process of trying to profit from the discrepancies in the prices of connected securities. For example, you can buy and sell the stocks of the same company, that are listed on two different exchanges if you notice that their prices are not in line with each other. There are other forms of arbitrage. For example, you could try to profit from seasonal arbitrage by simultaneous buying and selling futures contracts with different maturity or merger arbitrage, where you buy the stock of a company being acquired and sell the stock of the acquiring company at the same time. Arbitrage is frequently considered a risk-free strategy, but this is not always the case. Their risk factor for arbitrage deals is execution risk. In case of high volatility or low liquidity in the market you might not be able to complete the deals at favourable prices. As a result, your arbitrage opportunity might diminish, or you could even end up in loss.

13.14. Portfolio

A portfolio is a collection of different financial instruments that are held by a trader or an investor at the same time. The portfolio can consist of stocks, futures, bonds, options, etc. The objective of a portfolio is to achieve a level of return to risk. Investors usually construct their portfolios according to their investment objectives such as expected returns, risk tolerance, investment horizon, etc.

We hope that this essential guide on everything you need to know to start trading on the financial markets was useful for you!

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