FIN 366: INVESTMENTS
BRIEFING

Chapter 2: Asset Classes and Financial Instruments

We consider three **Asset classes**: (1) **Fixed Income** or debt, (2) **Equity** or ownership interest in a firm, and (3) **Derivatives** or securities with values derived from other securities. Fixed income is split up into shorter-term **money market** and **longer-term** securities. Within the money market, there are **T-bills** or government debt securities with a term less than one year, **certificates of deposit** or accounts with banks that cannot be withdrawn early, **commercial paper** or corporate borrowing, **banker's acceptances** similar to a post-dated check, **Eurodollars** or dollar denominated bank deposits at foreign banks, **repos** and **reverse repos** or short-term borrow and lending of securities. Short term money market rates include the **Federal Funds Rate** at which banks borrow from one another to meet FED reserve requirements, and **brokers' call rates** or the rate banks charge brokers on money the broker lends to their clients. T-bills are considered to be **risk free** since they are short term and backed by the federal government. Longer term fixed income securities include **T-Notes** and **T-Bonds**, which have maturities of 1-10 years and up to 30 years, respectively. T-Notes and Bonds are quoted in the *WSJ*, and you can purchase one for the security dealer's **Ask** price, or sell one to the dealer at their **Bid** price. **TIPS** have bond interest and principal payments adjusted for inflation. **Federal Agency Debt** is issued by firms like Fannie Mae and Freddie Mac. **Municipal bonds** are issued by state and local governments and have tax advantages. **Corporate bonds** are how firms engage in long-term borrowing, international bonds or **Eurobonds** permit raising money in a different currency, and **Asset Backed Securities** receive cash flows from mortgage payments or other debt. A **residual claim** means that equity holders are paid *after* debt holders in the event of firm liquidation. **Stock market indexes** summarize stock price movements, and may be **equally weighted**, **value weighted**, or **price weighted**. In the derivatives space, we have **options, futures**, and **forwards**. Options give an investor the right to buy or sell at a specified price in the future, while forwards and futures require that they transact at the agreed upon price.