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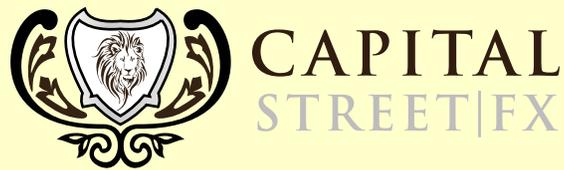
INTRODUCTION TO INDEX TRADING

CAPADEMY TUTORIAL SERIES



Capital Street FX

Level 6, GFin Tower, 42 Hotel Street, Cybercity, Ebene 72201, Republic Of Mauritius
Ph. No.- +1-949-335-4314, Mail Id- support@capitalstreetfx.com



An Index is a statistical indicator that provides a representative reference for the overall magnitude of change in a larger market.

Investors use indexes to track the performance of a market as it is difficult to track the performance of every single product trading within that market. Hence, a smaller, but relevant sample of the market is used as a representation of the whole. Indexes help investors gain exposure to particular markets or sectors without having to directly invest into individual products contained within that market.

The most commonly used term in financial markets, with reference to indexes, is “Stock Index”.

However, indexes are not monopolized by the stock market alone. Various other markets such as the bond market and the foreign exchange market, as well as the commodities market have their own barometers which are in the form of representative indexes such as the Dollar Index, The CRB Commodities Index, and The FTSE Global Government Bond Index etc.

The trading process in Index Trading is based on taking a position on which way an overall market will move, requiring minimal investment, and minimal risk by the trader.

In Index Trading, an investor is effectively making a 'directional judgment' on the change in value of the entire market, rather than trading or investing in individual securities.

Therefore investors and traders do not physically own their investment i.e. the index, because the index is only a statistical average. It is merely a number that provides the aggregated result of the change in its value from time to time. This change results from the changes in the value in its constituent securities.

Mentioned below are the different markets that use indexes.

Stock Indexes: 'Index Trade' refers to a trade that can be placed on whether a particular Stock Market Index moves up or down over a specified time period. Traders and Investors never actually own the instrument they are investing in; they only take a 'position' on a particular Index based on their judgment of whether the index shall move 'UP or DOWN'.

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Currency Indexes: A Currency index measures changes in the value of the currency it represents, by tracking the exchange rates of the index currency against a pre specified set of alternative currencies – a basket of currencies. The value of the index is composed of a weighted basket method which computes the value of the index currency against its major counterparts over a selected period of time, and therefore provides an indication of whether the currency is appreciating or depreciating against its major counterparts.

Bond Index: is a method of measuring the value of a section of the bond market. It is computed from the prices of selected bonds (typically a weighted average). It is a tool used by investors and financial managers to describe the market, and to compare the return on specific bonds. These bonds can be a mix of government bonds, municipal bonds, corporate bonds or a mix of different types of bonds.

Commodity Index: An index that tracks a basket of commodities to measure their performance. It's easier to buy or sell a commodity index instead of buying or selling a few barrels of oil, some cattle, a few grams of gold and a few bags of wheat, while still being able to gain exposure to the combined performance of commodity markets in general.

Indexes help gain exposure to the overall performance of a market by buying the appropriate index basket (a collection of securities that represent a sector or market index), which is sometimes more beneficial than transacting in the individual securities, as indices allow for diversification by including smaller quantities of a bigger number of securities. This helps smooth out sharp fluctuations in the value of individual securities.

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