



CAPITAL
STREET|FX

INTRODUCTION TO STOCK TRADING

CAPADEMY TUTORIAL SERIES



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A stock is a type of security reflecting ownership in a publicly traded company. Trading stocks, is the buying or selling of stocks in order to profit from price movements.

A stock exchange provides a venue where trading in the secondary market occurs. This is where buyers and sellers come together to do business. Stock trading takes place at exchange floors like the New York Stock Exchange, or the Euronext, or via electronic exchanges such as the NASDAQ or Eurex.

When buyers and sellers in a particular security agree on price, their orders are matched and the trades are then executed. Although the term “stock” exchange is used, many different securities may trade on a particular exchange, like options, bonds, warrants etc.

What makes a market interesting and active is that many people have many different opinions about the price of a security. Some expect the stock price to rise, and others expect the stock price to fall. It’s this mix of these expectations that makes up the market participants. The more the participants in the market, the greater is the number of traders, and trades, which is referred to as the “liquidity” in a security/market. High liquidity is optimal in the investment world because it usually means there is a competitive marketplace with people contesting to fill orders at the best available price.

Price Discovery: The method of determining the price for a specific security in the market is through basic supply and demand factors related to the specific security and the overall market. In simpler words, price discovery is the discovery of an agreeable price by buyers and sellers, so as to carry out transactions at a mutually agreeable price.

Since each transaction involves a buyer and a seller, it is not the number of buyers or sellers which moves the price of a stock. It is the aggressiveness i.e. the speed with, and the quantity for, which a buyer or seller acts. If buyers are more forceful than sellers, demand takes over and prices rise. If sellers are more powerful, supply becomes abundant and prices fall. If the strength of either side is closely matched, a tug-o-war ensues and prices don’t change much.

Stocks can be traded as spot/cash, futures, CFD’s or options. The main stock products are Cash Stocks (spot/delivery based), CFD’s on stocks (non-deliverable), Options (the underlying stock may or may not be deliverable) and Single Stock Futures (may or may not be deliverable).

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Cash Stock trading is a simple process of buying by paying the full amount due for the number of stocks bought and receiving the shares in return into the trading account post settlement. This allows an investor or trader to only buy the amount of stock that is afforded by the cash deposit in the account. Secondly, investors/traders need to possess a stock in their account, if they intend to sell a stock, when expecting its price to decline. “Short selling” i.e. “the practice of selling a product, when one does not possess it, in the hope of buying it back later, at a lower price, to make a profit on price declines”, is not possible when trading stocks in cash only.

A CFD or contract for difference is a trading instrument that mirrors the behavior of the stock, on which it is based. It is a non-deliverable instrument which allows investors and traders to buy/sell it in a fashion identical to the way they would trade the stock on which the CFD is based. The CFD moves up and down directly in response to the stock moving up or down. Buying or selling stock CFD's is much simpler than cash stocks, as it allows higher limits for buying/selling greater quantities than cash trading. It also allows investors and traders to easily buy long or sell short the stock.

A single-stock future is a futures contract between two parties to exchange a specified number of stocks in a company for a price agreed today (the futures price or the strike price) with delivery occurring at a specified future date, the delivery date. The contracts are traded on a futures exchange and usually in batches of 100. Delivery of stocks may or may not be taken/ provided, as the process of settling profits/losses in cash is a lot simpler and convenient.

Stock Options allow investors and traders to buy the right (but not the obligation) to buy or sell, a pre specified quantity of the underlying stock, for a specified price (the strike price), at or before a specified “expiry date”. This allows investors and traders to transact in larger quantities of stock, for variable durations, with minimal risk and capital.

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