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What are Financial Derivatives?

DEFINING FINANCIAL DERIVATIVES

Financial derivatives, commonly referred to as "derivatives," are securities (or tradable instruments) whose value is determined by the price of other assets. Derivatives can be traded on an exchange or transacted over the counter, and may be used to access certain markets or hedge and reduce risk in a portfolio.

THE PRIMARY TYPES OF DERIVATIVES

FUTURES	FORWARDS	OPTIONS	SWAPS
Standardized contracts to buy or sell an asset at a given price and time.	Customizable contracts to buy or sell an asset at a given price and time.	Standardized contracts giving the right, but not the obligation, to buy (call option) or sell (put option) an asset at a given price and time.	Customizable contracts to exchange the cash flows or liabilities from two different assets for a given period.

HYPOTHETICAL OPTIONS TRADE

An investor is bullish on U.S. large-cap equities over the long term and is invested accordingly. However, they fear a short-term correction could be looming. To protect the value of the portfolio, the investor buys put options on an S&P 500 ETF. These put options provide the right, but not the obligation, to sell shares of the ETF at a predetermined level in the future. The value of the put options increases as the value of the S&P 500 decreases, which creates a hedge for the investor's portfolio.

Overweight U.S. Large-cap Equities > **Buy Put Options on an S&P 500 ETF** > **Options Value Increases as S&P 500 Decreases** > **Hedge for the Portfolio**

BENEFITS

- Hedge or reduce short-term and/or unwanted portfolio exposures
- Diversify current portfolio exposures
- Create exposure to a different asset class for the potential to enhance returns

KEY RISK CONSIDERATIONS

Key risk considerations may include, but are not limited to, the following:

- **Loss of capital:** The loss of capital may be greater than the amount initially invested.
- **Complex securities:** Derivatives require specialized knowledge or expertise, given the complexity involved and the number of factors affecting a trade.
- **Counterparty risk:** The probability that one party in a transaction defaults or does not fulfill their contractual obligation.
- **Underlying assets and strategy:** Each underlying asset and strategy will exhibit their own inherent risks.

Please contact your financial professional or wealth management platform to learn more.

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