

The Impact of Different Financial Instruments on Investor Preferences

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Abstract. In contemporary society, as the economy steadily expands, individuals are increasingly exploring diverse financial avenues to maximize their returns. This article focuses on the analysis of prevalent financial methods, their associated risks, and their influence on investor inclinations. Through an examination of recent data and a review of pertinent literature, it is evident that the stock market carries substantial risk, rendering it suitable for investors with moderate to high risk tolerance. Conversely, bonds exhibit a comparatively stable trajectory, making them an apt choice for risk-averse investors. Options and futures exhibit moderate fluctuations aligned with the futures market, rendering them suitable for investors with a low to medium risk appetite. Selecting an appropriate financial method aligned with individual preferences can significantly enhance one's financial prospects. This prudent decision-making process contributes to more efficient and rational financial gains. However, it is imperative to recognize that these choices bear substantial consequences, underscoring the importance of informed decision-making in the realm of finance.

Keywords: Finance; investor; preference.

1. Introduction

The concept of finance is an economic activity that takes money itself as the business object and aims to increase the value of money through currency financing. In today's complex society, no one knows exactly what will happen in the future. There are many benefits to financial management, and the first is that people can be well prepared for these risks that may occur in the future when people have a good income. Even if the risk does come, people will be able to maintain their current standard of living. Second, managing money gives us a better understanding of people's financial situation. Third, to achieve the preservation and appreciation of assets, that is, people can make money and earn additional income through reasonable allocation of assets in hands, so as to realize the preservation and appreciation of assets. For example, using the funds in the hand to buy financial products and earning financial income through this move is to make money with assets. Fourth, provide security for future life; Reasonable planning and distribution of funds through financial management, leaving a certain amount of liquidity, investing to earn more money, and purchasing insurance according to personal needs can provide protection for future life. [1] In order to be able to better manage their property or make their property have a higher value in the future, many people basically participate in financial projects, whether it is a bank deposit with a high safety factor or a more risky stock investment, which can bring more or less returns and returns to investors. Financial instruments are various monetary means used for exchange, settlement, investment, financing, including basic financial instruments and derivative financial instruments. The underlying financial instruments are mainly interest rate or debt instrument prices, foreign exchange rates, stock prices or indices, and commodity futures prices. Derivative financial instruments are derived from basic instruments, mainly including forwards, futures, options and swaps, and a structured and complex derivative product derived from them through change, combination and synthesis. Everyone has their own understanding and ideas about financial instruments, and everyone's tolerance for risk is also different. An in-depth understanding of investors' investment preferences can help to develop a sound investment plan to help each investor obtain returns. This paper will examine the impact of different financial instruments on investor preferences, first of all, investment preferences are divided into 5 categories: conservative; Do not want to bear any risks, the purpose of investment and financial

management is to preserve value, prudent: afraid of risk, but hope to have a certain return on the basis of capital preservation, balanced: comprehensive consideration of risk and return, moderate risk tolerance, positive: tend to have high risk, but high return financial investment, radical: keen to earn high returns in high risk, not afraid of principal loss. From these preferences, it can be seen that it is important to find and develop a suitable financial instrument, and on the contrary, if investors are provided with tools that are contrary to their preferences, it can have a negative effect. In the subsequent article, the author will first start with the analysis of different financial instruments, such as stocks, bonds, option futures, etc., through information and data to clarify their investment patterns and risk levels, and then further analyze their impact on investor preferences according to the characteristics of different financial instruments.

2. Financial Instruments

2.1. Stock

2.1.1 Fundraising method

Shares are a form used by a business to prove its ownership and are issued by a joint stock company [1]. Stocks are widely recognized financial instruments, essential to comprehend when assessing their impact on investor preferences. A stock represents ownership in a joint-stock company and is issued as a certificate of ownership to shareholders. It serves as a tradable security, granting shareholders a share in the company's profits and exposing them to associated operational risks. Each share signifies a unit of ownership within the company, with public companies issuing shares of equal value. Shareholders' ownership percentage is determined by their shareholding relative to the company's total share capital. Stocks are a fundamental component of a company's capital structure, tradable in the market, and a primary long-term financial instrument within the capital market. However, it's important to note that the company is not obligated to reimburse capital contributions. Equity financing encompasses various methods: Attracting direct investment: This involves diverse forms of capital contributions, including currency, assets, intellectual property rights, land use rights, and more. It's a common approach for non-joint-stock enterprises to raise equity capital; Issuing common shares: Typically associated with listed companies, this method involves raising funds by offering the company's shares in the market, often through an Initial Public Offering (IPO). Financing through retained earnings: Companies utilize retained earnings like surplus reserves and undistributed profits as internal sources of financing. In summary, stocks play a crucial role in the capital structure of joint-stock companies, facilitating trading, and serving as a primary long-term financial instrument within the capital market. Equity financing encompasses various methods, including attracting direct investments, issuing common shares, and utilizing retained earnings, all of which have distinct implications for investor preferences.

2.1.2 Risk

Stock prices are not fixed. From the moment an A-share is listed, its price fluctuates up and down according to the forces of the free market. The price of a company's own stock can change depending on a variety of factors, such as positive and negative news about the industry, new government policies, and public pressure, which can make the short-term trend of the stock market so difficult to predict. That's why short-term stock market investments are so risky. [2] Systemic risk and non-systematic risk cause high risk of stocks, and systemic risk refers to the reasons caused by a series of events arising from the listed company's own operations or events related to the company. Non-systemic risks are divided into three categories: enterprise operational risk, corporate financial risk and corporate moral risk. First of all, enterprise operation risk specifically refers to the price fluctuation caused by changes in the company's industry that cause the products produced to not meet the expected value, or the demand for commodities declines and the relative supply rises. These can affect the company's future earnings and cause stock price fluctuations. Second, financial risk refers to financial problems caused by unbalanced capital structure or financial imbalances, which cause

price fluctuations in stocks. Third, corporate moral hazard refers to unethical behaviors such as enterprises not operating within the scope permitted by law, and fabricating financial reports, which affect the company's external image and cause stock price fluctuations [2].

2.1.3 Investor preferences

Based on the frequent fluctuations of the stock market and the unpredictable changes in the future, investors may lose more funds in the process of financial management, so its consumer preference is suitable for investors with higher risk appetite. In the past 20 years, there have been many problems in the development of the stock market, such as the majority of major investors are still small retail investors, stocks are not only suitable for those investors with high risk appetite, but also attractive to investors with gambling preferences and betting psychology. Looking at the increasingly thriving stock exchange market, the common characteristic of investors is that they expect high returns but have a low probability of events [3]. There is a two-way fluctuation spillover effect between stock returns and investor sentiment, in which rational emotions and irrational emotions have opposite effects on stock returns; After the stock reform, the fluctuation relationship between sentiment and portfolio income has weakened significantly. The strong correlation between changes in investor sentiment and stock returns is of practical significance for grasping the transmission process of market information and predicting future stock income fluctuations.

2.2. Bonds

2.2.1 Fundraising method

Debt financing is suitable for the needs of large-scale production of commodity economy and society, and has a positive effect on the social economy [4]. Bonds are financial instruments issued by various entities, including governments, corporations, banks, and other borrowers, as a means to raise capital. They follow legal procedures and include a commitment to repay both the principal amount and interest to creditors on a predetermined maturity date. Bonds essentially represent a financial contract, issued to investors when entities seek external funding. They promise to pay interest at a specified rate and return the principal according to agreed-upon conditions. In essence, a bond serves as a formal certificate of debt and holds legal validity. The relationship between the bond purchaser or investor and the issuer is akin to that of a creditor and debtor. Bonds are classified as securities, with their interest typically predetermined, making them fixed-interest securities. In well-established financial markets, bonds can be listed and traded. In China, listed companies primarily employ four main methods for bond financing: Corporate Bonds: Marketable securities issued by a company following legal procedures, with agreed-upon repayment of principal and interest within a specific timeframe. This term often refers to bonds issued by various enterprises, including non-joint-stock companies; Medium-Term Notes: Notes with maturities generally ranging from 5 to 10 years; Short-Term Financing Bonds: Unsecured short-term promissory notes issued by enterprises to secure immediate funding. In summary, bonds are crucial financial instruments used by entities to secure funding. They encompass a legally binding commitment to repay creditors, with interest typically predetermined. In China, listed companies employ various bond financing methods, including corporate bonds, medium-term notes, and short-term financing bonds, to raise capital for their operations.

2.2.2 Risk

As a popular financial instrument, bonds are favored for their inherent returns and stable interest rates. However, there are also many uncertainties and risks associated with investment bonds. The risks of bond investment mainly include the following aspects: Credit risk: The bond issuer may not be able to repay the principal and interest on time, resulting in losses for investors. In this case, investors need to bear the risk of default and credit risk. Inflation risk: If inflation is higher than the coupon rate of the bond, then the actual return may be lower than expected. Liquidity risk: Some bonds may be illiquid or illiquid, resulting in investors being unable to sell or buy in time. Market risk: The bond market is affected by macroeconomic, policy and market factors, and the price

fluctuates greatly, and investors need to bear market risks. It is important to note that different types of bonds have different degrees of risk. For example, government-issued bonds such as government bonds and local government bonds have lower credit risk, while corporate bonds and convertible bonds have higher credit risk. Therefore, when making bond investment, people need to choose the bond variety suitable for people according to their own risk tolerance and investment goals, and pay attention to diversifying investment risks. At the same time, it is also necessary to understand the relevant laws and regulations and market information to make informed investment decisions.

Default Risk: Default risk pertains to the possibility that the bond issuer may fail to meet interest payments or repay the principal on time, resulting in financial losses for bond investors. Treasury bonds issued by the Ministry of Finance are often considered low-risk due to government backing, thus posing minimal default risk. However, bonds issued by local governments and non-central government entities carry varying degrees of default risk. Credit rating agencies evaluate bonds to assess their default risk. Generally, bonds perceived as having a higher default risk will require higher yields to compensate for potential losses.

Interest Rate Risk: Interest rate risk refers to the potential losses investors may incur due to fluctuations in interest rates. Interest rates significantly impact bond prices; as rates rise, bond prices tend to fall, and conversely, as rates fall, bond prices often rise. Even government bonds, which are relatively safe from default, are subject to interest rate risk.

Purchasing Power Risk: Purchasing power risk relates to the possibility of diminishing the real value of money due to inflation. During inflationary periods, the investor's actual interest rate is determined by subtracting the inflation rate from the coupon rate. For instance, if a bond offers a 10% interest rate while inflation is at 8%, the real yield is only 2%. Purchasing power risk is a prevalent concern in bond investment, especially during times of high inflation.

Liquidity Risk: Liquidity risk arises when investors are unable to sell bonds at a reasonable price in the short term. If an investor seeks to sell their existing bonds to capitalize on a more favorable investment opportunity but cannot find a buyer offering a reasonable price promptly, they may need to accept a lower price or wait an extended period to secure a buyer. This can lead to reduced gains or missed investment opportunities.

Reinvestment Risk: Reinvestment risk pertains to the challenge of reinvesting temporary cash flows at rates equal to or exceeding those originally determined when the bond was purchased. To maintain an equivalent return as initially anticipated, these interim cash flows must be reinvested at rates consistent with the bond's original return.

Operational Risk: Operational risk encompasses errors made by the management and decision-makers of the bond-issuing entity during operational and managerial processes. These errors can lead to asset depreciation and result in financial losses for bond investors.

2.2.3 Investor preferences

As a financial instrument with as many investors as stocks, the preferences of the investor population are very different. There are also two ways to buy bonds, one is to rely on the rise in bond prices, of course, provided that the bond is listed, and the other is to rely on the interest of the bond. Although the price of bond prices is uncertain, the interest rate of bonds is certain, when people buy a bond, people have locked in a part of the interest income, as long as the bond issuer does not default, when the bond matures will inevitably get this part of the interest income. It can be seen that based on the stability of bonds, its preferred groups are mostly risk aversion or risk neutral. However, there are also factors that affect investment risk appetite, such as when market investors' preference for risky assets such as stocks increases, it may decline in appetite for risk-free or low-risk assets such as government bonds. Investors should consider the interest rate of the bond when choosing the bond products they invest, and when the interest rate of the investment product is high, the investor's preference will increase [5]. According to the survey, the risk appetite of investors who buy treasury bonds is mostly risk-averse investors, and a small number of investors are willing to take low risks under the premise of asset preservation. Due to the stability of bonds, investors prefer risk-averse bonds [6].

2.3. Futures

2.3.1 Fundraising method

Futures, often known as futures contracts, are standardized agreements established by futures exchanges. They outline the future delivery of a specified quantity of an underlying asset at a predetermined time and location. This underlying asset can encompass commodities, financial instruments, or financial indicators. The comprehensive notion of futures also encompasses exchange-traded options contracts, with many futures exchanges featuring both futures and options. As a trading right to buy and sell futures, futures options have become an indispensable member of today's financial market, and their convenience of trading and the creation of value for investors while avoiding credit problems have played an important role in the financial environment [7].

2.3.2 Risk

When investing in any financial product, people need to be aware of the risks at all times. Options are different from stocks people are familiar with, as well as futures and warrants. The option buyer assumes limited risk but still loses the premium; The potential loss of an option seller can be unlimited. This is why investing in options requires certain option knowledge, trading experience, financial strength and risk tolerance. The uncertainty of the outcome leads to risk, because the direction of the asset itself changes from moment to moment, the magnitude is uncertain, and the value of the option changes accordingly [8]. The risk of futures options comes from futures, and fluctuating prices are closely related to futures, while futures options are much less volatile than futures. Reasonable control of futures trading can reduce risk [9].

2.3.3 Investor preferences

Options have the ability to manage investment risk and meet the needs of investors with different risk appetites. Stock index options are more suitable for speculative trading, investors can buy and sell according to market conditions and obtain high profits. Suitable for investors who can accept low to medium risk. In order to protect the rights and interests of investors, the government will set many restrictions such as concession term guarantee, restriction competition guarantee, etc. to enhance investor confidence [10].

3. Conclusion

Through comprehensive data analysis and meticulous investigation, this study substantiates the assertion that individual investment preferences exhibit notable diversity. People's inclinations towards risk vary considerably, with some inclined to embrace risk, while others prioritize the preservation of capital and are averse to financial losses. A third category of investors adopts a risk-neutral stance. This spectrum of risk tolerance necessitates a nuanced approach to financial instrument selection. Within the spectrum of available financial instruments, each asset class possesses distinctive characteristics and associated risk profiles. For instance, as elucidated earlier, stocks are considered high-risk financial instruments due to their susceptibility to price volatility. This diversity in financial instruments empowers investors to align their choices with their unique risk preferences, thereby optimizing their investment strategies. Moreover, this individualized approach fosters financial literacy and encourages a more discerning public when it comes to financial matters. It serves as a safeguard against unexpected economic setbacks arising from ill-informed or improper financial decisions. This informed decision-making process, underpinned by a nuanced understanding of various financial instruments, paves the way for prudent and rational investment choices. Looking ahead, it is foreseeable that new financial instruments will continue to emerge, diversifying the investment landscape. Nevertheless, the fundamental methodology of aligning financial instrument characteristics with individual preferences remains a steadfast and indispensable principle. It is the firm belief that as society evolves, people will persist in analyzing the distinctive traits of each financial instrument. This collective endeavor will not only facilitate the creation of a conducive

investment environment but also contribute to broader social economic development and overall well-being.

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