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HEDGING TECHNIQUES IN INDIAN STOCK MARKET: A SPOTLIGHT ON HDFC BANK

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Abstract

Participants in the stock market range from small individual stock investors to large hedge fund ((traders, who can be based anywhere in the world. Their orders usually end up with a professional at a stock exchange, who executes the order of buying or selling.

From experience it is known that investors may 'temporarily' move financial prices away from their long term aggregate price 'trends'. (Positive or up trends are referred to as bull markets; negative or down trends are referred to as bear markets). Over-reactions may occur—so that excessive optimism (euphoria) may drive prices unduly high or excessive pessimism may drive prices unduly low. Economists continue to debate whether financial markets are 'generally' efficient.

According to one interpretation of the efficient-market hypothesis (EMH), only changes in fundamental factors, such as the outlook for margins, profits or dividends, ought to affect share prices beyond the short term, where random 'noise' in the system may prevail. (But this largely theoretic academic viewpoint—known as 'hard' EMH—also predicts that little or no trading should take place, contrary to fact, since prices are already at or near equilibrium, The 'hard' efficient-market hypothesis is sorely tested and does not explain the cause of events such as the stock market crash in 1987, when the Dow Jones index plummeted 22.6 percent—the largest-ever one-day fall in the United States.

Introduction

Criteria for Hedging Techniques In Indian Stock Market

Hedging is defined as holding two or more positions at the same time, where the purpose is to offset the losses in the first position by the gains received from the other position.

Usual hedging is to open a position for a currency A, then opening a reverse for this position on the same currency A. This type of hedging protects the trader from getting a margin call, as the second position will gain if the first loses, and vice versa.

However, traders developed more hedging techniques in order to try to benefit from hedging and make profits instead of just to offset losses.

Following are the various types of derivatives.

Forwards

A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre-agreed price.

Futures

A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are special types of forward contracts in the sense that the former are standardized exchange traded contracts.

Options

Options are of two types-calls and puts. Calls give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a give future date. Puts give the buyer the right, but not the obligation to sell a given quantity of the underlying asset at a given price on or before a given date.

Warrants

Options generally have lives of up to one year; the majority of options traded on options exchanges having a maximum maturity of nine months. Longer-dated options are called warrants and are generally traded over-the counter.

Leaps: The acronym LEAPS means long-term Equity Anticipation securities. These are options having a maturity of up to three years.

Baskets: Basket options are options on portfolios of underlying assets. The underlying asset is usually a moving average of a basket of assets. Equity index options are a form of basket options.

Swaps: Swaps are private agreements between two parties to exchange cash flows in the future according to a prearranged formula. They can be regarded as portfolios of forward contracts. The two commonly used Swaps are:

Interest Rate Swaps: These entail swapping only the related cash flows between the parties in the same currency.

Currency Swaps

These entail swapping both principal and interest between the parties, with the cash flows in on direction being in a different currency than those in the opposite direction.

Swaption

Swaptions are options to buy or sell a swap that will become operative at the expiry of the options. Thus a swaption is an option on a forward swap. Rather than have calls and puts, the swaptions market has received swaptions and payer swaptions. A receiver swaption is an option to receive fixed and pay floating. A payer swaption is an option to pay fixed and received floating.

HDFC Bank Futures & Options

Date	Price		Call Option		
	Spot	Future	900	930	960
NOV/WED/25	922.75	921.85	100.05	85.75	73.10
NOV/THU/26	898.85	898.90	79.20	66.25	47.00
NOV/FRI/27	885.90	885.15	68.40	56.25	45.85
NOV/SAT/28	**Trading Holiday**				
NOV/SUN/29	**Trading Holiday**				
NOV/ MON /30	880.40	882.10	35.55	49.90	40.00
DEC/ TUE /01	911.95	914.60	54.90	62.35	50.45
DEC/WED/02	901.58	902.32	51.25	55.69	49.36
DEC/THU/03	898.00	902.55	46.00	45.10	34.50
DEC/FRI/04	**Trading Holiday**				
DEC/SAT/05	**Trading Holiday**				
DEC/SUN/06	**Trading Holiday**				
DEC/ MON /07	923.75	926.80	52.00	52.85	40.30
DEC/TUE/08	918.55	918.10	60.00	46.55	34.55
DEC/WED/09	919.95	921.55	54.00	43.70	31.70
DEC/THU/10	944.25	946.85	60.10	49.50	35.05
DEC/FRI/11	984.95	985.40	95.15	74.35	45.00

DEC/SAT/12	**Trading Holiday**				
DEC/SUN/13	**Trading Holiday**				
DEC/MON/14	1002.20	997.60	109.35	84.75	63.15
DEC/TUE/15	1058.65	1062.05	125.00	133.10	106.55
DEC/WED/16	1052.10	1056.15	153.95	125.35	98.35
DEC/THU/17	1018.50	1022.05	119.05	89.70	62.00
DEC/FRI/18	979.80	981.55	112.60	51.20	26.25
DEC/SAT/19	**Trading Holiday**				
DEC/SUN/20	**Trading Holiday**				
DEC/MON/21	912.32	902.54	89.32	75.64	55.21
DEC/WED/23	101.50	103.00	153.95	125.35	98.35
DEC/THU/24	104.80	104.50	119.05	89.70	62.00

Objectives of the Study

1. To analyze the **Hedging techniqesof** derivative market in India
2. To analyze the **Hedging** operations of futures and options
3. To find the profit/loss position of futures buyer and also the option writer and option holder.
4. To study about risk management with the help of derivatives.

Research Methodology

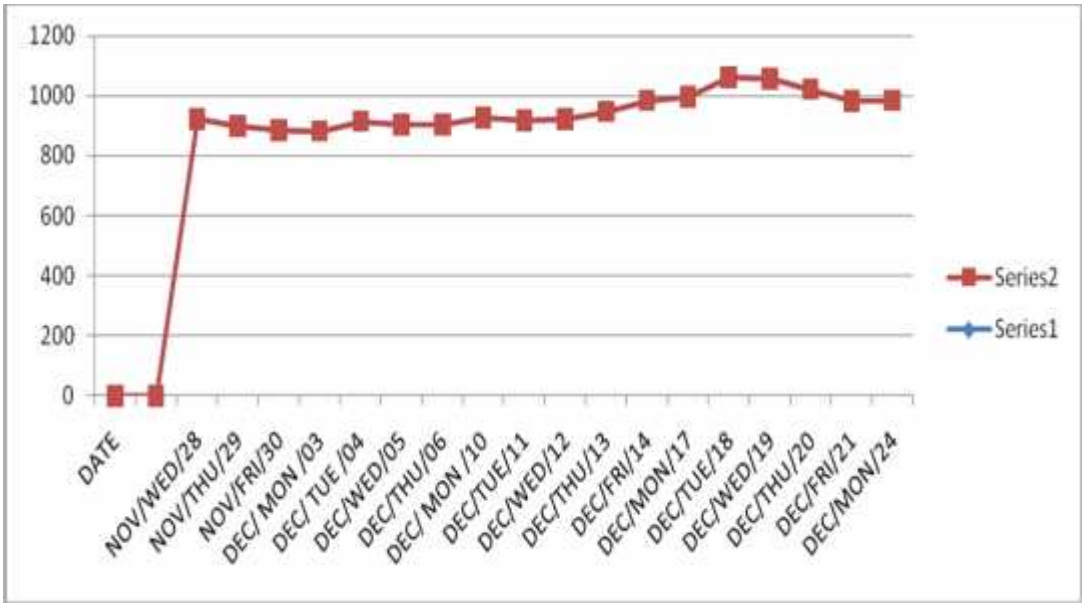
The data collection methods include both the Primary and Secondary Collection methods.

1. Primary Collection Methods:
   This method includes the data collected from the personal discussions with the authorized clerks and members of the Exchange.
2. Secondary Collection Methods:
   The Secondary Collection Methods includes the lectures of the superintend of the Department of Market Operations, EDP etc, and also the data collected from the News, Magazines of the NSE, HSE and different books issues of this study.

Sample of the Study

Data Analyses and Interpretation

Calculation of risk Return of TATA Motors



Future Market

		Buyer			**Seller**
25/11/2015 (Buying)		921.85			921.85
24/12/2015(Cl., period)	984.20			984.20	
Profit	62.35		Loss	62.35	

Profit 200 x 62.35=12470, Loss 200 x 62.35=12470

Findings and Suggestions

1. A positive derivative means that the function is increasing
2. A M/S. DLF LTD derivative means that the function is decreasing
3. A M/S. DLF LTD derivative means that the function has some special behavior at the given point. It may have a local maximum, a local minimum, (or in some cases, as we will see later, a "turning" point)
4. As a last remark we should remember that the derivative of a function is, itself, a function since it varies from point to point. If we want to, we could plot it on its own set of axes. You can compare the signs and slopes of the individual tangent lines of the original curve with the

Conclusion

Derivates market is an innovation to cash market. Approximately its daily turnover reaches to the equal stage of cash market. The average daily turnover of the NSE derivative segments. In cash market the profit/loss of the investor depend the market price of the underlying asset. The investor may incur huge profits or he may incur huge profits or he may incur huge loss. But in derivatives segment the investor the investor enjoys huge profits with limited downside. In cash market the investor has to pay the total money, but in derivatives the investor has to pay premiums or margins, which are some percentage of total money. Derivatives are mostly used for hedging purpose. In derivative segment the profit/loss of the option writer is purely depend on the fluctuations of the underlying asset.

Suggestion

1. In bullish market the call option writer incurs more losses so the investor is suggested to go for a call option to hold, where as the put option holder suffers in a bullish market, so he is suggested to write a put option.
2. In bearish market the call option holder will incur more losses so the investor is suggested to go for a call option to write, where as the put option writer will get more losses, so he is suggested to hold a put option.
3. In the above analysis the market price of **M/S. DLF** is having low volatility, so the call option writers enjoy more profits to holders.
4. The derivative market is newly started in India and it is not known by every investor, so SEBI has to take steps to create awareness among the investors about the derivative segment.

Books

1. Derivatives Dealers Module Work Book–NCFM.
2. Financial Markets And Services–Gordan And Natrajan.
3. Financial Management – Prasanna Chandra.

Websites

1. www.bseindia.com.