THE ANALYSIS OF DERIVATIVES MARKET

Contents:

- Introduction
- Meaning and definition
- Features of derivative contract
- Role of derivative market
- Need of the derivative market
- Types of derivatives
- Difference between OTC and EXCHANGE traded market
- OTC market transactions
- conclusion

HOW MUCH DO YOU KNOW ABOUT CAPITAL MARKET ??

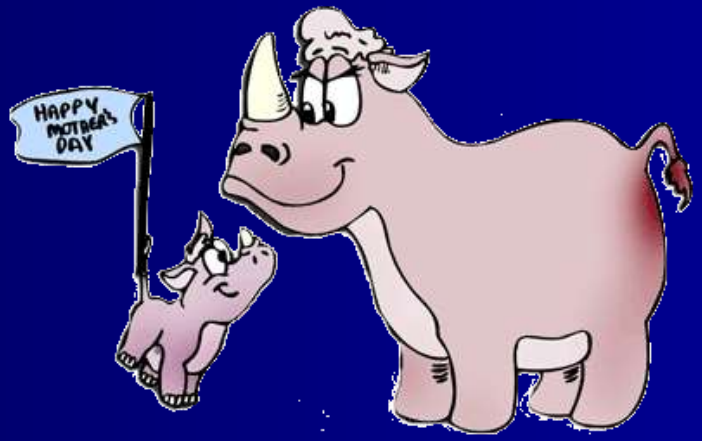
- LIKE A CRICKET IT IS MADE UP OF PLAYERS, RULES AND INSTRUMENTS

WHAT INSTRUMENTS ?

- BONDS
- DEBEUTURES
- GOVT. SECURESTES – LIKE TBs
- EQUTIES / STOCKS
- ?
- ?

"DERIVATIVE" ?

- IS IT SOMETHING DERIVED ON THE BASIS OF SOME OTHER ??



WHAT ARE DERIVATIVES ?

- NOT SECURITES ISSUED BY AN ENTITY
- A CONTRACT WHICH DERIVES VALUE FROM THE PRICES, OR INDEX OF PRICES OF UNDERLYING SECURITIES
- A SECURITY DERIVED FROM A DEBT INSTRUMENT, SHARE, LOAN OR ANY OTHER FORM OF SECURITY.

DERIVATIVE……..

- A DERIVATIVE IS BASICALLY A CONTRACT
- A CONTRACT FOR DELIVERING THE UNDERLYING ASSET ON SOME FUTURE DATE

DERIVATIVE……

- THE ‘UNDERLYING’ MAY BE ANYTHING :
  - STOCK
  - COMMODITY
  - CURRENCY
  - INT. RATE
  - AN INDEX, ETC.

FUNDAMENTAL DIFFERENCS

STOCKS / SHARES	DERIVATIVES
1. SPOT DELIVERY	1. DEFERRED DELIVERY
2. ISSUED BY AN ENTITY	2. WRITTEN BY PARTIES
3. VALUE IS REAL	3. VALUE IS NOTIONAL
4. TRADED IN BOTH PRIM./SEC. MARKETS	4. TRADED IN SECONDARY MARKET ONLY
5. BALANCE SHEET ITEMS	5. OFF – BALANCE SHEET ITEMS
6. LONG LIFE SPAN	6. SHORT LIFE SPAN

WHY WERE DERIVATIVES CREATED ??

- DEFINITELY NOT FOR FUN !!!

WHY WERE DERIVATIVES CREATED ??

- CONVERTING PROBLEM IN TO AN OPPORTUNITY
- DERIVATIES MARKET WAS AN ANSWER FOR THE PHENOMENA OF RISK

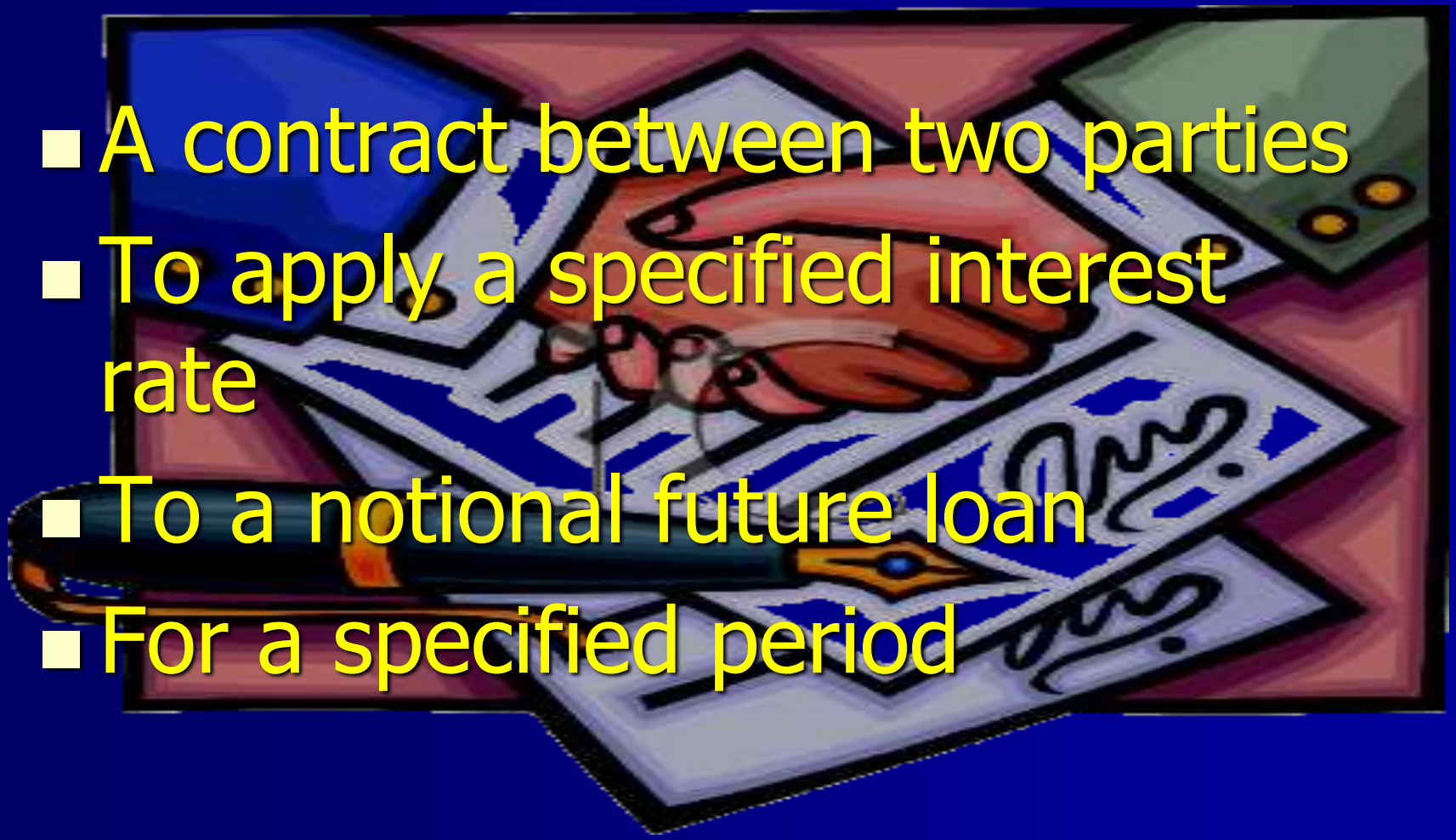
Types of Derivatives

Types of Derivatives

Forward Contract

- An agreement between two parties
- To buy/sell an asset
- At an agreed – upon price
- On a specified future date

FRA

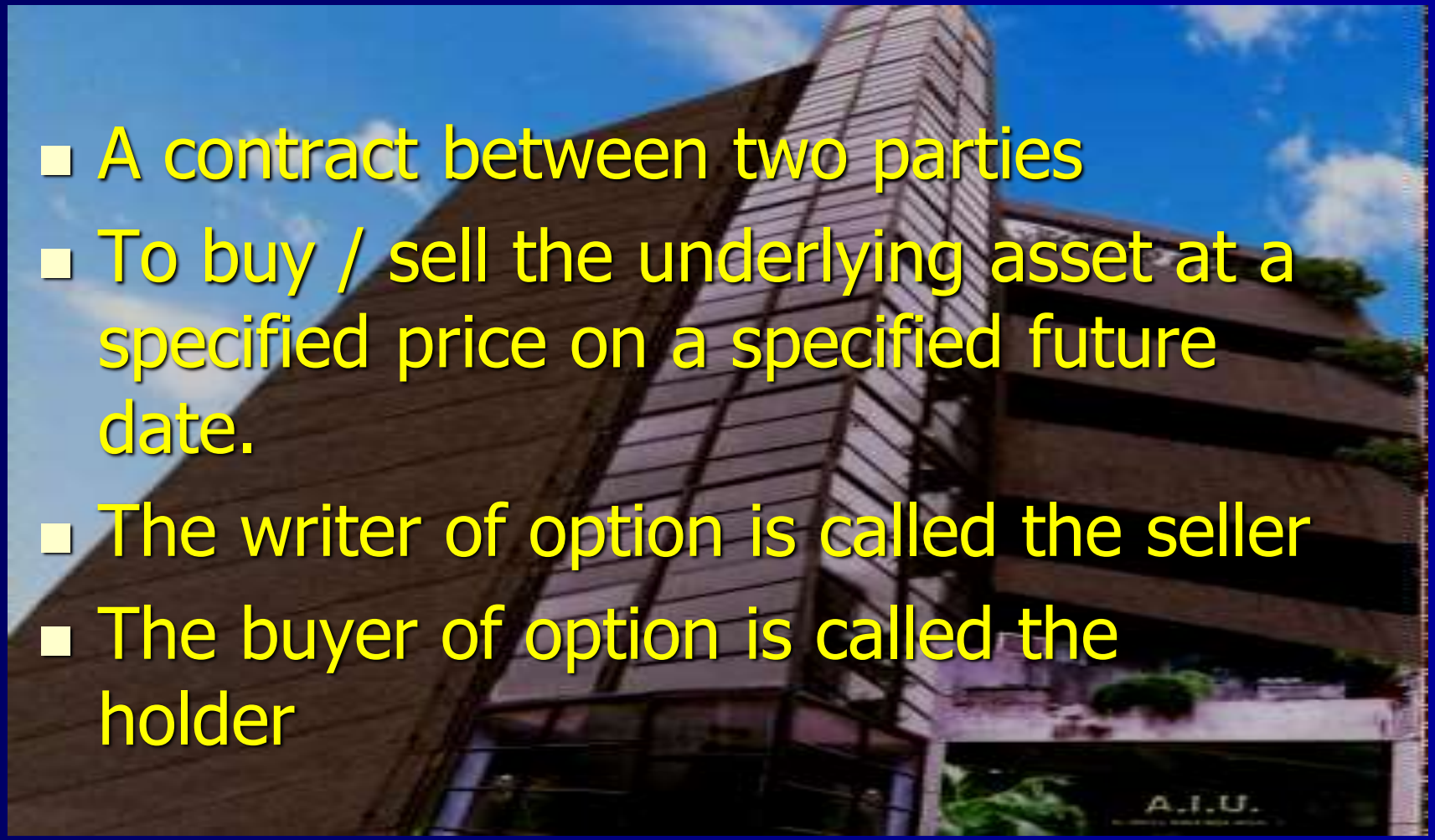


- A contract between two parties
- To apply a specified interest rate
- To a notional future loan
- For a specified period

Futures

- Standardised
- Transferable, and
- Exchange traded
- Forward contracts
- Futures contracts are ‘written’ and put to sale on bourses

Options



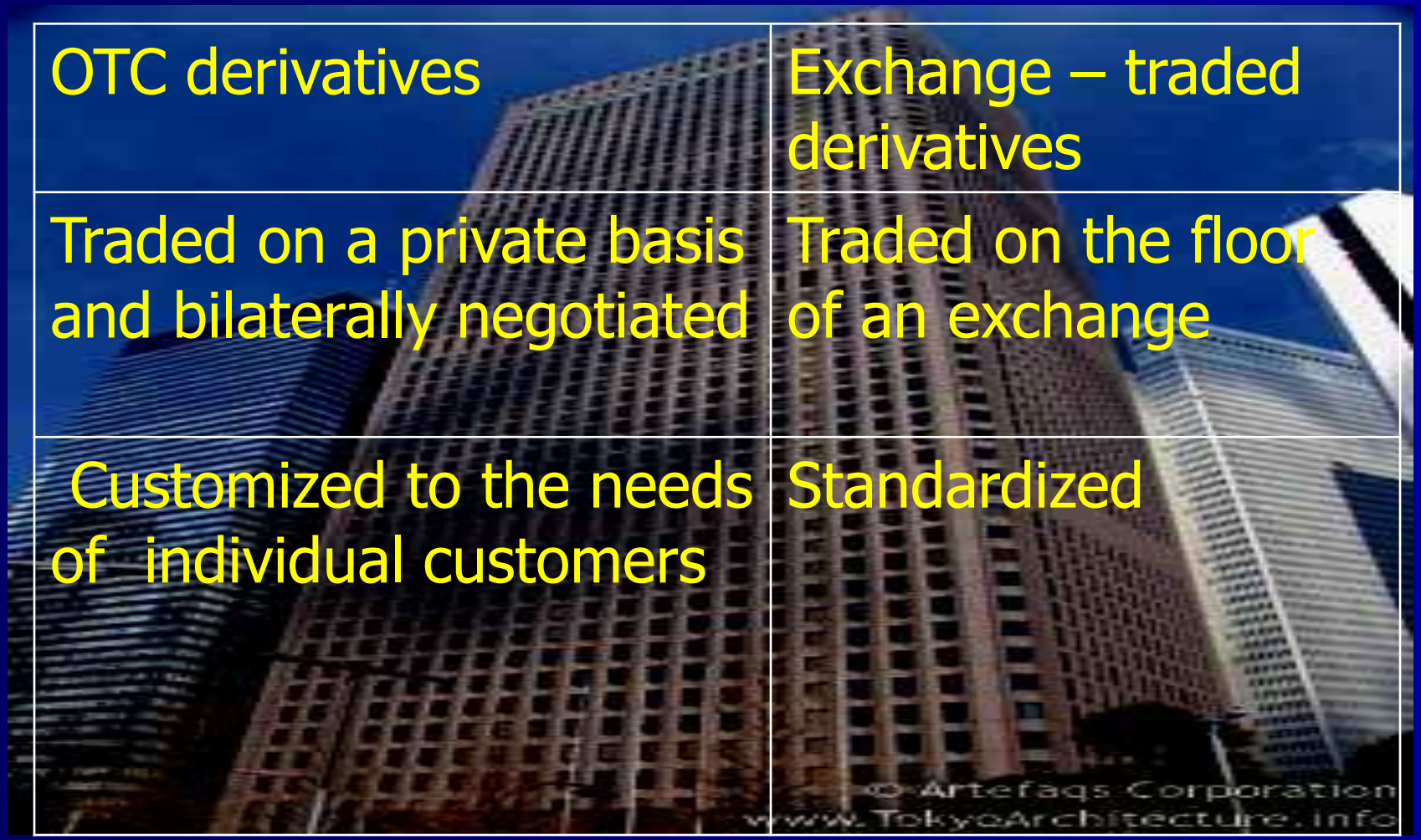
- A contract between two parties
- To buy / sell the underlying asset at a specified price on a specified future date.
- The writer of option is called the seller
- The buyer of option is called the holder

Swaps

- Agreements between two parties
- To exchange assets or sets of financial obligations
- For a specified period of time
- At predetermined intervals

DISTINCTION BETWEEN EXCHANGE TRADED AND OTC DERIVATIVES

OTC derivatives	Exchange – traded derivatives
Traded on a private basis and bilaterally negotiated	Traded on the floor of an exchange
Customized to the needs of individual customers	Standardized



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Prices are less transparent	Prices are transparent .
Market players known to each other.	Market players not known to each other.
Positions cannot be easily closed or transferred	Positions can be easily closed out

Contd…

Less liquid	Highly liquid
Open to counterparty and legal risk	Do not involve counterparty and legal risk

GLOBAL DERIVATIVES MARKET
(Organized Exchanges)

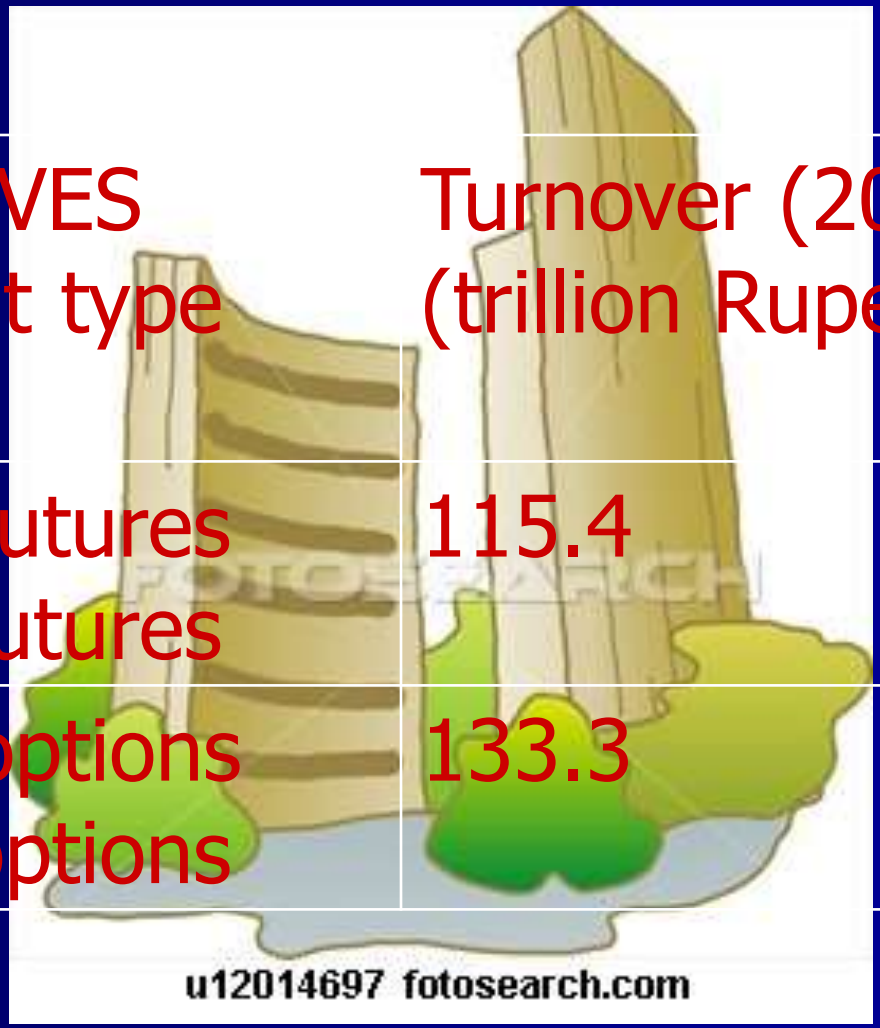
Derivatives Instrument type	Notional value (Jan 10) (in trillion $)
1. Futures	
a. interest rate	23.5
b. Currency	0.1
c. Equity index	1.0
2. Options	
a. Interest rate	51.3
b. currency	0.2
c. Equity index	5.3
Total	81.4

GLOBAL DERIVATIVES MARKETS (OTC MARKET)

Derivatives Instrument type	Notional value - Jan 10 (trillion $)
1. Fx contracts (forwards + swaps + options)	49.2
2. Interest rate (FRA + swaps + options)	449.8
3. Equity linked (forwards+ swaps + options)	6.6
4. Commodity contracts (forwards + swaps + options)	2.9
5. Credit default swaps	32.7
Total	541.2

DERIVATIVES MARKET IN INDIA

DERIVATIVES instrument type	Turnover (2008-09) (trillion Rupees)
1. Index futures 2. Stock futures	115.4
3. Index options 4. Stock options	133.3



COMMODITY FUTURES MARKET IN INDIA

- **FMC is the regulatory authority**
- **Three national level com exchanges:**
  - NCDEX
  - NMC of India
  - Multi Comm. Exchange of India
- **Over 70 commodities traded (over 50 are agri-commodities)**
  - Cotton, Maize, Coffee, Sugar, etc.,

ROLE OF DERIVATIVES MARKET

- Price discovery
- Risk management
- Transactional efficiency
- Catalyze entrepreneurial activity
- Revitalizing the capital markets

DERIVATIVES MARKET !! THERE IS OTHER SIDE TO IT

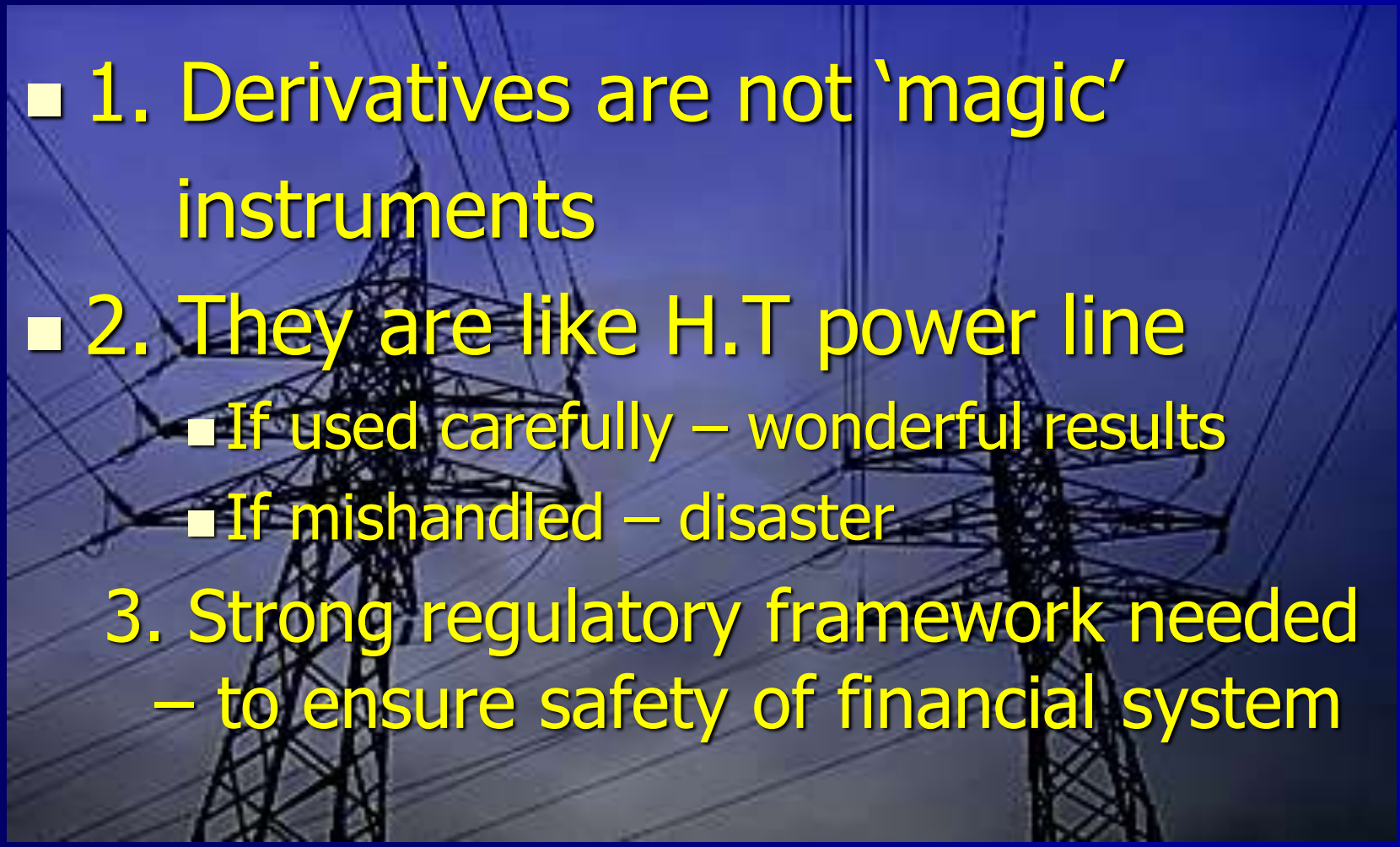
- May flare up speculative pressure
- Increase the risk (OTC Market)
- Destabilize the financial system
- Complex FI to understand and trade

OTC market transactions (2005-2010)

	2005	2006	2007	2008	2009	2010
Foreign Exchange	18,011	14,344	15,666	16,748	18,460	24,484
Forwards and forex swaps	12,063	9,593	10,134	10,336	10,719	12,387
Currency swaps	2,253	2,444	3,194	3,942	4,503	6,371
Options	3,695	2,307	2,338	2,470	3,238	5,726
Interest rate contracts	50,015	60,091	64,668	77,568	101,658	141,991
Forward rate agreements	36,262	43,936	48,768	58,897	79,120	111,209
Interest rate swaps	7,997	9,380	9,476	10,933	13,746	20,012
Options	1,488	1,809	1,891	1,881	2,309	3,787

Equity linked contracts	146	283	335	320	364	601
Forw & swaps	1342	1527	1555	1561	1944	3186
Options	415	548	662	598	923	1406
Commodity contracts	415	548	662	598	923	1406
Gold	182	243	218	231	315	344
Other commodities	233	305	445	367	608	1062
Forw & swaps	137	163	248	217	402	420
Options	97	143	196	150	206	642

CONCLUSION: GLOBAL CAPITAL MARKETS ARE NOT PERFECT; AREN'T RATIONAL EITHER !!!



- 1. Derivatives are not 'magic' instruments
- 2. They are like H.T power line
  - If used carefully – wonderful results
  - If mishandled – disaster
- 3. Strong regulatory framework needed – to ensure safety of financial system

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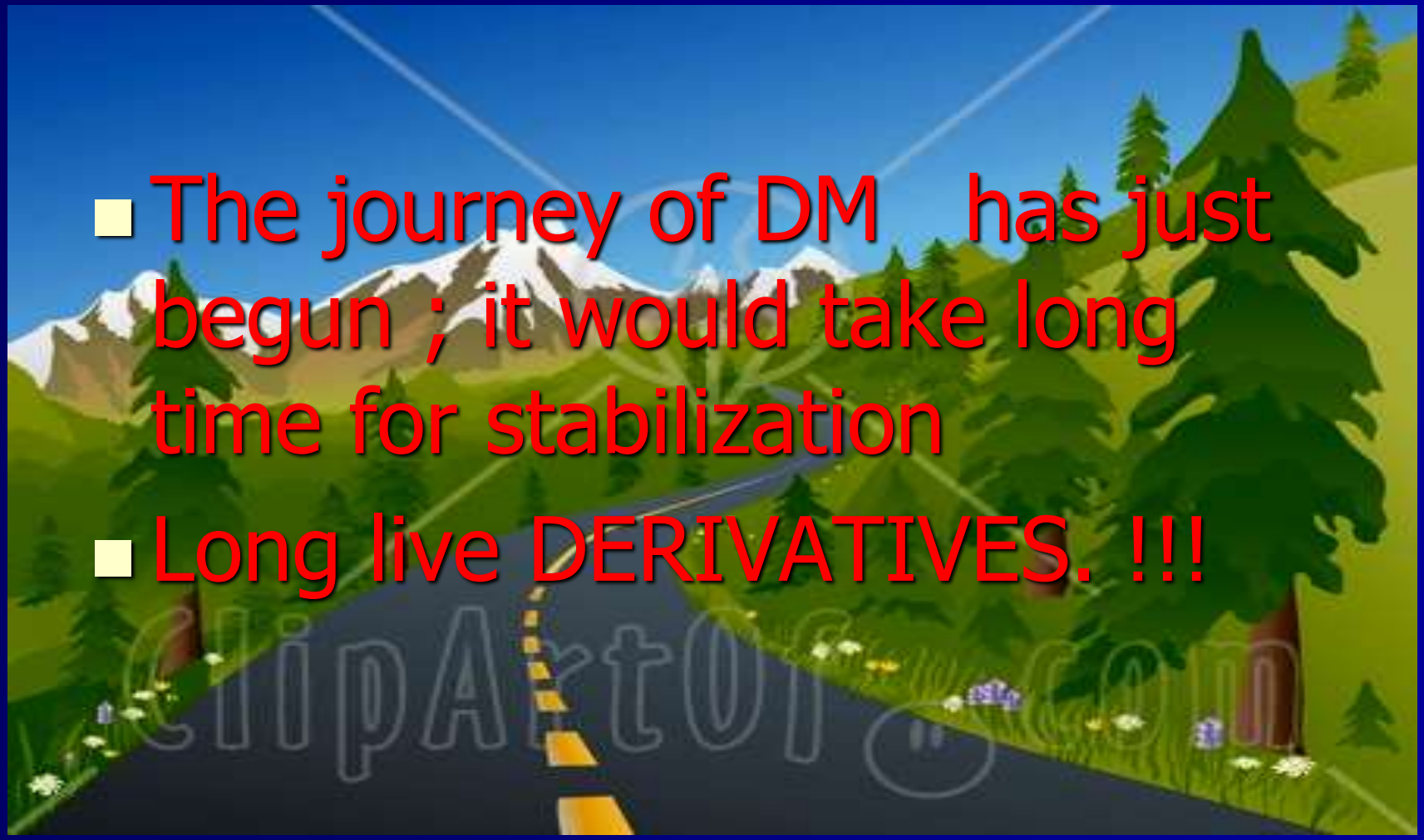

- The journey of DM has just begun ; it would take long time for stabilization
- Long live DERIVATIVES. !!!

Bibliography

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  - Dr G.Kotreshwar
- Financial services
  - Shashi k gupta

Thank you

One & All