DERIVATIVES

DERIVATIVES:

* It has no independent value
* Its value is derived from underlying asset
* Securities , commodities, currency, livestock etc., are underlying asset
* It is a contract

(or)

* Derivative is a forward, future, option of predetermined fixed duration linked to the value of a specified real or financial asset

It includes:

* A security derived from a bond or share
* A contract which derives its values from the prices or index of prices

Need for derivatives:

* Transferring risks
* Discovering future or current prices
* Catalysing entrepreneurial activity
* Increasing saving and investment in long run

Participants:

* Hedgers
* Speculators
* Arbitrageurs

Basic terminology

1. Spot contract
2. Spot price
3. Spot date
4. Short position
5. Long position
6. Delivery price

How are derivatives traded?

OTC

* Two parties sign an agreement
* Quantity, price and date are defined
* Third party cannot be involved

Exchange traded derivative market

* It is in market
* Standard
* Contract is marketable and is to holder of contract
* No counter party risk

Types

OTC

1.Forward

2.Swaps

Exchange traded derivative market

1.Future

2.Option

1. Forward

Customised contract between two entities, where settlement takes place on a specific date in the future at todays pre agreed price.

1. Swaps

A **swap** is a **derivative** contract through which two parties exchange the cash flows or liabilities from two different financial instruments. Most **swaps** involve cash flows based on a notional principal amount such as a loan or bond, although the instrument can be almost anything.

1. Future

It is a agreement between two parties to buy or sell an asset at certain time, certain price.

1. Options

It gives right but not obligation, to buy or sell the underlying

* Calls: to buy a given quantity
* Puts : to sell a given quantity

Warrants

Options have live upto one year. Longer dated options are called warrents

European options:

Can be exercised on expiry date

American options:

Can be exercised anytime

Bermuda options:

Can be exercised on predetermined date typically every month. It’s a combination of European and American options.

Option premium:

* While buying an option contract, the buyer has to pay premium
* It is paid to option buyer
* They are always paid upfront

DERIVATIVE PRODUCTS TRADED ON NSE:

Interest rate future:

<https://www.angelbroking.com/knowledge-center/futures-and-options/interest-rate-futures>

Bond future:

* Based on govt of India
* Maturity between 4 and 8 , 8 and 11 , 11 and 15

Index derivatives:

* Nifty 50 Index
* Nifty IT Index
* Nifty Bank Index
* Nifty Midcap 50 Index
* Nifty Infrastructure Index
* Nifty PSE Index
* Individual Securities

Currency derivatives:

**Currency Derivatives** segment of NSE provides trading in derivative instruments like Currency Futures on 4 currency pairs, Currency Options on US Dollars and Interest Rate Futures on 10 Y GS 7 and 91 D T-Bill.

* **NVIX Futures and Global Indices** are also offered as derivative products on NSE.

COMMODITY EXCHANGE:

An association or a company organising future trading in commodities

* Trade is routed through one mechanism
* Allows effective competition among buyers and sellers
* MCX
* NCDEX
* ICE

COMMODITY:

Every kind of movable property other than auction able claims, money and securities.

COMMODITY DERIVATIVE MARKETS:

Commodity derivatives market trade contracts for which the underlying asset is commodity. It can be an agricultural commodity like wheat, soybeans, rapeseed, cotton, etc. or precious metals like gold, silver, etc.

D/W COMMODITY AND FINANCIAL DERIVATIVES:

IN FD:

* Most contracts are cash settled
* Not bulky
* No storage facility is required
* No concept of varying quality of asset

IN CD:

* Warehousing
* Quality can vary

Conclusion:

Derivatives are a specialised class of financial instruments whose value is derived from the underlying asset on which it is based. Derivatives are of four types: forwards, futures, options and warrants. On NSE, derivatives trading takes place on bonds, index futures, stock futures, currency derivatives and interest rate futures. Commodities derivatives are derivative trading on commodities, as the name suggests. Commodity exchanges operate facilitating trade on such products