

Margin Trading

Introduction to Investments
Prof S G Badrinath
How Margin Works

- Loan facility given by the broker to his investor to increase his trading capacity is called Margin facility.
- Margin transactions involve borrowing part of the money needed to purchase or sell a security i.e. Buying/selling securities with borrowed money.

Borrowing Cost < Rate of return earned on securities ➡ Good for the Investor



Regulation of the Fed

Minimum Initial Margin – 50%

Minimum Maintenance Margin - 25%

- **Initial Margin** – part of the initial cost that is to be contributed by the investor.
- **Maintenance Margin**- It requires the investor to maintain a minimum equity in the investment through out the life of the trade (till the time trade is not squared-off).

How Margin Works?

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Buy 1000 Shares @ \$20 ; Margin = 50% \Rightarrow Market Value = \$20,000; Debt = \$ 10,000 and Equity = \$10,000

Price
 \uparrow
\$25

Market Value = \$25,000; Debt = \$10,000
Equity = \$ 15,000; Margin = $15/25 = 60\%$
Price $\uparrow = 5/20 = 25\%$; Return = $5/10 = 50\%$

- Higher Margin implies more borrowing capacity till margin comes down to initial level.
- Here increased equity of \$15,000 can support upto \$30,000 of market value.
- So one can borrow \$5,000 more ($5000/25 = 200$ shares).

Price
 \downarrow
\$14

Market Value = \$14,000; Debt = \$10,000
Equity = \$ 4,000; Margin = $4/14 = 28.6\%$
Price $\uparrow = -6/20 = -30\%$; Return = $-6/10 = -60\%$

Margin drops to 28.6% , lower than initial margin but greater than maintenance margin of 25% . So no margin call.

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