JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue

JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)

An International Scholarly Open Access, Peer-reviewed, Refereed Journal

"COMPARATIVE STUDY OF EQUITY AND DERIVATIVE MARKETS FOR NG RATHI INVESTRADES PVT LTD"

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Abstract:

Investing is both Arts and science. Every individual has their own specific financial need and expectation based on their risk taking capabilities, whereas some needs and expectation are universal. Therefore, we find that the scenario of the stock market is changing day to day, hours by hours and minute by minute. The evaluation of financial planning has been increased through decades, which can be best seen in customers. Now a day's investment have become very important part of income saving.

The project is about the study of financial services given by NG RATHI INVESTRADES PVT LTD. to investors. It gives the knowledge of market position of the company. I studied as to how this company proves to an option for the investors, by studying the performance of investing in equity & derivative for few months considering their analysis. I selected area of "COMPARITIVE ANALYSIS OF EQUITY & DERIVATIVE MARKETS", which attract different kinds of investors to invest in equity & derivative and to face high risk and get high returns. The major findings of the project are to overview of the comparison of equity cash segment and equity derivative segment, overview of the equity and Future & Option segment. The methodology of the project here is to analyze the Equity & Derivative performance based on EPS, P/E Ratio and other things.

The methodology of the project here is to analyze the investment opportunities available for those investors & study the returns & risk involved in various investment opportunities and also study of investment management & risk management. So for that we have to study & analyze the performance of Equity & Derivative in the market. We know that there is a high risk, high return in equity but in a long time only. While in derivative there is a high risk, high return in the short term, because derivative contract is for short time for 1 / 2 / 3 months only. So this project included different types of returns, margin & risk involved in equity, and types, need, use & margin involved in the derivatives market and also participants & terms use in derivative market.

Key Words: Investment, Stock Market, Analysis, Prediction, Equity, Derivatives.

Introduction:

The finance for any organization is very important. It is a heart of organization, hence it is necessary to study various method used by different organization for generating finance. Hence, this project aims at study Equity and Derivative.

CONCEPT OF SHARE MARKET:

Share Market trading includes buying and selling of company share either through Stock Exchange or Over the counter (OTC). It is also called an equity trading. Shares are certificate which represent ownership rights of the holder in a company. Share Market is the market for securities where organized issuance and trading of share takes place either through exchange or over the counter in electronic and physical form. It plays an important role in channeling capital from the investors to the business house which consequently leads to the availability of funds for business expansion.

SECURITIES MARKET AND FINANCIAL SYSTEM:

The securities market has two interdependent and inseparable segments, the new issues (primary market) and the stock (secondary) market.

Primary Market:

The primary market provides the channel for sale of new securities. Primary market provides opportunity to issuers of securities; government as well as corporate, to raise resources to meet their requirements of investment and/or discharge some obligation. They may issue the securities at face value, or at a discount/premium and these securities may take a Variety of forms such as equity, debt etc. They may issue the securities in domestic market and/or international market. The primary market issuance is done either through public issues or private placement.

Secondary Market:

Secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets.

Shares in the share market are either traded through:

- Stock exchange: These are organized market places where stocks, bonds, are other equivalents are traded between the buyer and sellers where exchange acts as counter –party to both the participants in case of any default. The contracts are standardized and not customized ones. For example: NYSE, BSE, NSE, etc.

- Over-the-counter (OTC): These are not centralized exchanges. Here, the trade takes place through a network of dealers. Generally, the OTC contracts are bilateral customized contracts and not standardized ones.

Share Trading are Done in Three ways:

- Offline share Trading: in this form trading of customer either goes to the share brokers and sits before the share trading terminal and ask to dealer to place order in his account, or rings the share broker, ask the share quotes and other relevant information.

- Online Share Trading: The client could avail the share market and could place his order on his own from any place he wants, provide he has a computer with an internet connection.

- Open outcry Trading: Here the investors put their orders through brokers and these share brokers in term place and execute order on behalf of them on the floor of the exchange. These brokers gather in a particular place on the trading floor known as Trading post. There is a person called as specialist present in the trading post who does the matching off the buy and sell orders. These types of action method is called Open outcry Method.

STATEMENT OF THE PROBLEM:

There are several financial service companies playing their roles in Indian equity and derivative segment. But, people don't have basic knowledge regarding stock market. So, they don't understand there are various risk involved in trading in equity and derivative. Because, of the improper guidance most of the person takes stock market as speculation. Therefore study is undertaken to compare equity and derivative.

OBJECTIVE & SCOPE OF THE PROJECT

- OBJECTIVES OF THE PROJECT:
- PRIMARY OBJECTIVE
- To study share market trading with respect to equity and derivative.
- To analyze the performance of equity based on EPS, P/E ratio and Derivative contracts with reference to futures and options.
- To identify the most popular segment of trading among individual investors with respect to equity and derivative market.
- **SECONDARY OBJECTIVE**
- To identify investors awareness about share market.

SCOPE OF THE PROJECT:

This study covers two securities Equity and Derivative. This study will help to understand psychology of customers towards share trading and their advantages. This study will also help customers to know which is the best option they have through which they can invest their money and get very good returns.

RESEARCH METHODOLOGY

Research is of a great importance to find out the nature, extent, and causes of the research, issue under study, Research Methodology is the processes in which various steps are generally adopted by a research are outlined.

The study aims to delineate the methodology, employed to undertaken this study. Research is a common parlance, which refers to a search for knowledge.

Types of Research:

In this research two types of data are used.

- Primary sources.
- Secondary sources.

Primary source includes:

- Interact with Branch manager, Investors, and Experts.
- Live trading in the Market.
- Data collected from questionnaire.

Secondary source includes:

- Various books related to stock market.
- Books related to Financial Management.
- Reference given by Relationship Manager.
- NSE , BSE Websites.

SAMPLE DESCRIPTION:

The sampling method used was simple random sampling.

- Sample Size:

Total sample size was 150 in pune city and out of responses received of 100 respondents.

- Sample Analysis:

Total sample size was of 150 respondents in pune city, out of which received were from 100 respondents. The respondents who are aware of trading in Equity and Derivative was 82 and not aware was 18. As per this servey was conducted.

LIMITATIONS OF THE STUDY

This project was restricted for two months; hence exhaustive data is not available upon which conclusions can be relied.

Investment in Securities carry risk so investment in Equity & Derivative is also carrying risk on the basis of the market.

Factors affecting the Market Price of Investment may be due to Market forces, performance of the companies is not possible, and so all the data is not available.

Area of survey was limited to the pune city only.

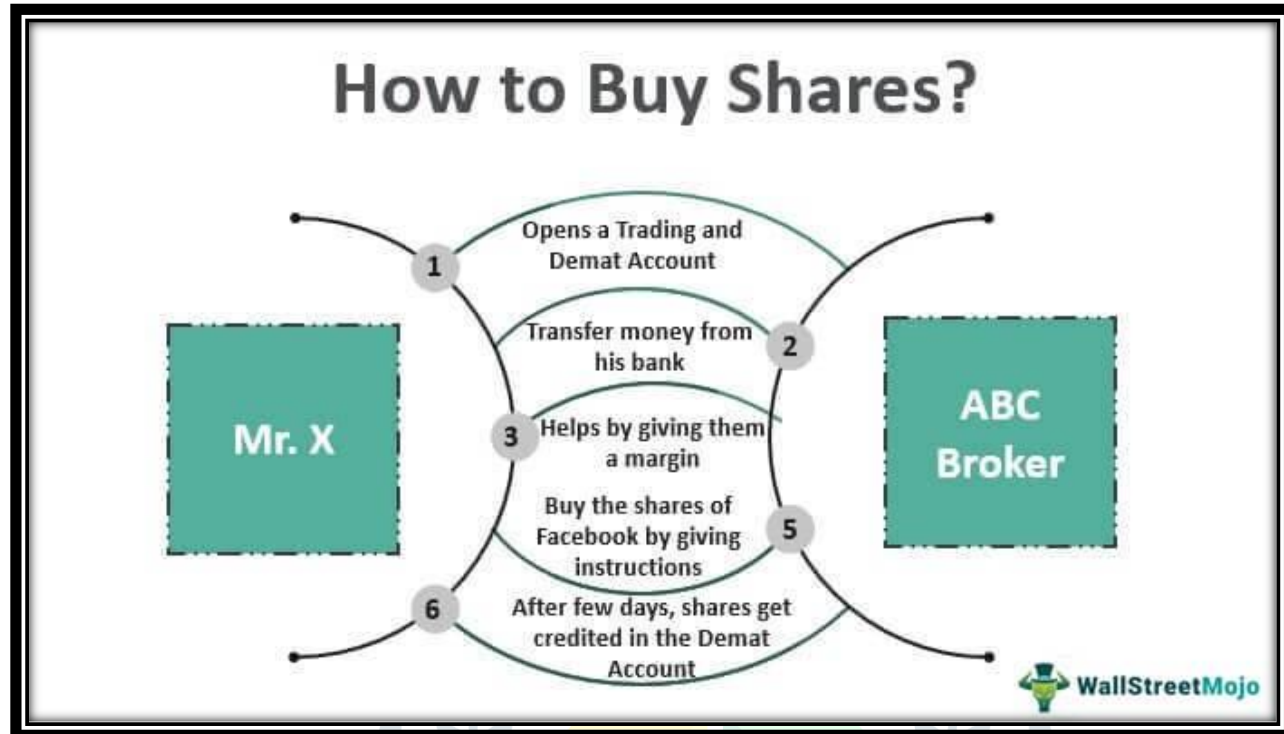
Time duration for the study was only 2 months

WHEN TO BUY & SELL SHARES:

With high volatility prevailing in the market, major price fluctuations in equities are not uncommon. Therefore, apart from ascertaining 'which' stock to buy or sell, it becomes equally important to consider 'when' to buy or sell. Any investor should be aware of the fact where all the investor is following

I.e. Buy Low. Sell High.

That means we should buy stocks at a low price and sell them at a high price.



WHEN TO BUY SHARES:

Three ways by which we can figure that out what it is about this stock that makes it hot.

Earnings per share (EPS): How well the company is doing

EPS is the total earning or profits made by company (during a given period of time) calculated on per share basis. It aims to give an exact evaluation of the returns that the company can deliver.

Case-1: Calculation of earnings per share (EPS):

Company XYZ Ltd.

Capital: Rs 100 crore.

Capital is the amount the owner has in the business. As the business grows and makes profits, it adds to its capital. This capital is subdivided into shares (or stocks). The capital is divided into100 million shares of Rs 10 each.

Net Profit in 2003-04: Rs 20 crore.

EPS is the net profit divided by the total number of shares.

EPS = net profit/ number of shares

EPS = Rs 20 corer / 10 corer shares = Rs 2 per share

Conclusion:

- If a company's EPS has grown over the years, it means the company is doing well, and the price of the share will go up. If the EPS declines, that's a bad sign, and the stock price falls.
- Companies are required to publish their quarterly results. Keep an eye out for these results; check for the trend in their EPS.

Price earnings ratio (PE ratio): How other investors view this share:

An indicator of how highly a share is valued in the market. It arrived at by dividing the closing price of a share on a particular day by EPS. The ratio tends to be high in the case of highly rated shares. The average PE ratio for companies in an industry group is often given in investment journal. Two stocks may have the same EPS. But they may have different market prices. That's because, for some reason, the market places a greater value on that stock. PE ratio is the market price of the stock divided by its EPS.

PE = market price/ EPS

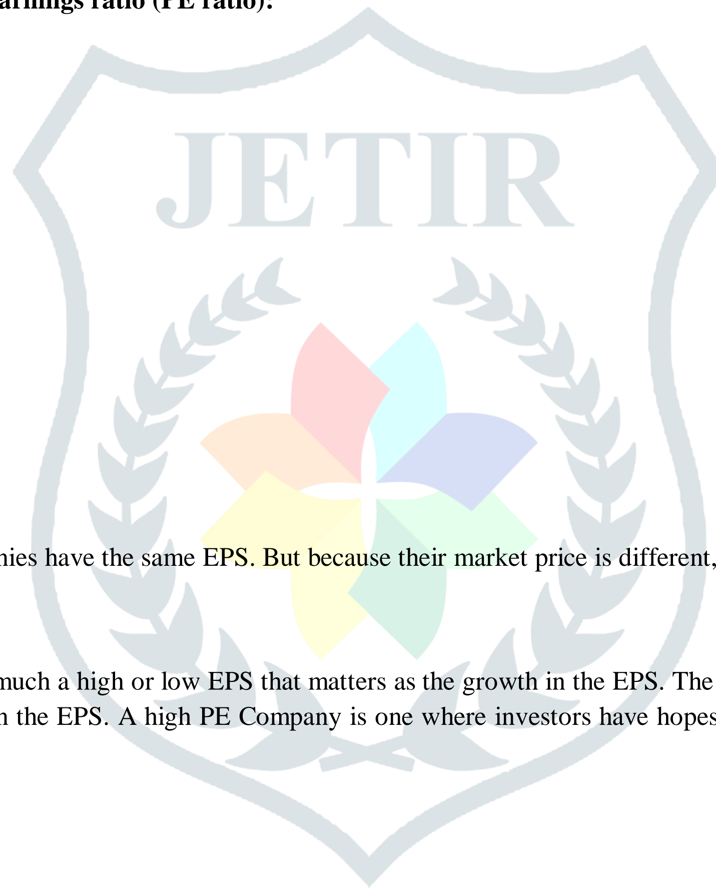
Case-2: Calculation of price earnings ratio (PE ratio):

Company XYZ Ltd

Market price = Rs 100

EPS = Rs 2,

PE ratio = 100/ 2 = 50



Company ABC Ltd

Market price = Rs 200

EPS = Rs 2

PE ratio = 200/ 2 = 100

In the above cases, both companies have the same EPS. But because their market price is different, the PE ratio is different.

Conclusion:

In the case of EPS, it is not so much a high or low EPS that matters as the growth in the EPS. The company's PE reflects investors' expectations of future growth in the EPS. A high PE Company is one where investors have hopes that earnings will rise, which is why they buy the share.

Forward PE: LOOKING ahead:

The stock market is not nostalgic. It is forward looking. For instance, it sometimes happens that a sick Company, that has made losses for several years, gets a rehabilitation package from its bank and a new CEO. As a consequence, the company's stock shoots up. Because investors think the company will do better in the future because of the package and new leadership, and its earnings will go up. And we think it is a good time to buy the shares of the company now.

Suddenly, the demand for the shares has gone up. Because stock prices are based on expectations of future earnings, analysts usually estimate the future earnings per share of a company. This is known as the forward PE. Forward PE is the current market price divided by the estimated EPS, usually for the next financial year.

Forward PE = Current market price/ estimate EPS for the next financial year.

To illustrate what we have been talking about, let's take the example of Infosys Technologies.

Trailing 12-month EPS = Rs 56.82 (EPS of the last four quarters)

Closing price on January 6 = Rs 2043.15

PE = Price/EPS = 2043.15/ 56.82 = 35.95

Estimated EPS for 2004-05 = Rs 67

Estimated EPS for 2005-06 = Rs 90

These figures are according to brokers' consensus estimates.

Forward PE = current market price/ estimated EPS for next financial year

Forward PE for 2004-05 = 2043.15/ 67 = 30.49

Forward PE for 2005-06 = 2043.15/ 90 = 22.70

With an EPS growth of over 30%, a forward PE of 22.7 is not high, indicating that there is scope to be optimistic about the stock's price.

Conclusion:

• Sometimes, investors look out for a low PE stock, expecting that its price will rise in the future. But sometimes, low PE stocks may remain low PE stocks for ages, because the market doesn't fancy them.

• Keep tab on the business news to check out the company's prospects in the future

WHEN TO SELL SHARES:

• Stock Reaches Fair Value or Target Price:

This is the easiest part of selling. We should sell when a stock reaches its fair value. It is the main reason why we chose to buy it on the first place.

The target price can be computed by assessing the company's estimated financial performance over the next 3 to 5 years, computing its EPS and using an acceptable P/E ratio to compute the future market price. Based on this future estimated price and our required return on our investment, compute our target price.

• When the prices reaches Stop loss:

It is advisable to always consider the possibility of a loss before making our investment. We should decide how much loss we are willing to book in the stock. The lower price i.e., the price at which we are willing curtail our loss, is called 'Stop Loss'.

• Need the money:

The generally happens due to improper planning. However, things happen. Even the most carefully planned strategy may not work. Catastrophic events may force investors to sell an investment if his household is affected by it.

When Management left their post abruptly or when the SEBI conduct a criminal investigation one company, it may be time to sell. Our assumption may be inaccurate as a lot of fair value calculation is based on the company's balance sheet, cash flow or other financial statement published by management.

• Takeover news:

When one of your stock holding is getting bought by other companies, it may be time to sell. Sure, you might like the acquiring company but you still need to figure out the fair value of the common stock of the acquiring company. If the acquiring company is overvalued, then it is best to sell.

- Other Investment Opportunity:

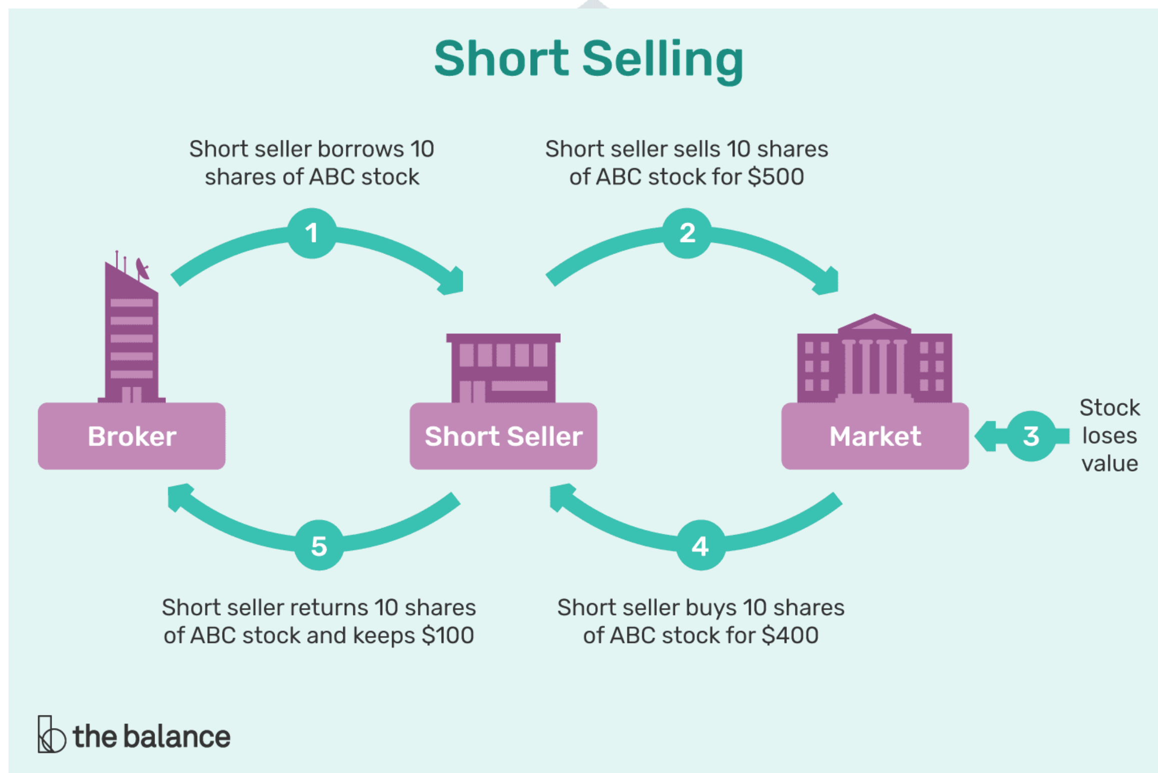
Let us consider we bought Stock A and it has risen to 10% below its fair value. Meanwhile, we noticed that stock B fallen to below 50% of our calculated fair value. This is an easy decision. We will sell our stock A and buy stock B. Our goal as an investor is to maximize our investment return. Sacrificing a 10% of return in order to earn a 50% return is a sensible way to do that.

- Inaccurate Fair Value Calculation:

As investors, we sometimes made errors in our fair value calculation. There are factors that we might not take into accounts when researching a particular company. For example sat yam scandal.

- New Competitors with Better Products:

When new competitors sprung up, the company that you hold might have to spend more money in order to fend off competition. Recent example includes the emergence of pay-per click advertising by Google. Any advertising business such as newspapers or cable network, this new product by Google might hurt profit margins and eventually the fair value of the stock.



Futures Terminology:

- Spot price: The price at which an underlying asset trades in the spot market.

- Futures price: The price that is agreed upon at the time of the contract for the delivery of an asset at a specific future date.

- Contract cycle: It is the period over which a contract trades. The index futures contracts on the NSE have one-month, two-month and three-month expiry cycles which expire on the last

Thursday of the month. Thus a January expiration contract expires on the last Thursday of January and a February expiration contract ceases trading on the last Thursday of February. On the Friday following the last Thursday, a new contract having a three-month expiry is introduced for trading.

- Expiry date: is the date on which the final settlement of the contract takes place.

- Contract size: The amount of asset that has to be delivered under one contract. This is also called as the lot size.

- Basis: Basis is defined as the futures price minus the spot price. There will be a different basis for each delivery month for each contract. In a normal market, basis will be positive. This reflects that futures prices normally exceed spot prices.

- Cost of carry: Measures the storage cost plus the interest that is paid to finance the asset less the income earned on the asset.

- Initial margin: The amount that must be deposited in the margin account at the time a futures contract is first entered into is known as initial margin.

- Marking-to-market: In the futures market, at the end of each trading day, the margin account is adjusted to reflect the investor's gain or loss depending upon the futures closing price. This is called marking-to-market.

- Maintenance margin: Investors are required to place margins with their trading members before they are allowed to trade. If the balance in the margin account falls below the maintenance margin, the investor receives a margin call and is expected to top up the margin account to the initial margin level before trading commences on the next day.

- Options Contracts:

Options give the buyer (holder) a right but not an obligation to buy or sell an asset in future. 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 given 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. One can buy and sell each of the contracts. When one buys an option he is said to be having a long position and when one sells he is said to be having a short position.

THERE ARE TWO TYPES OF OPTIONS:

- Call option

- Put option

Call option: A call option gives the holder the right but not the obligation to buy an asset by a certain date for a certain price.

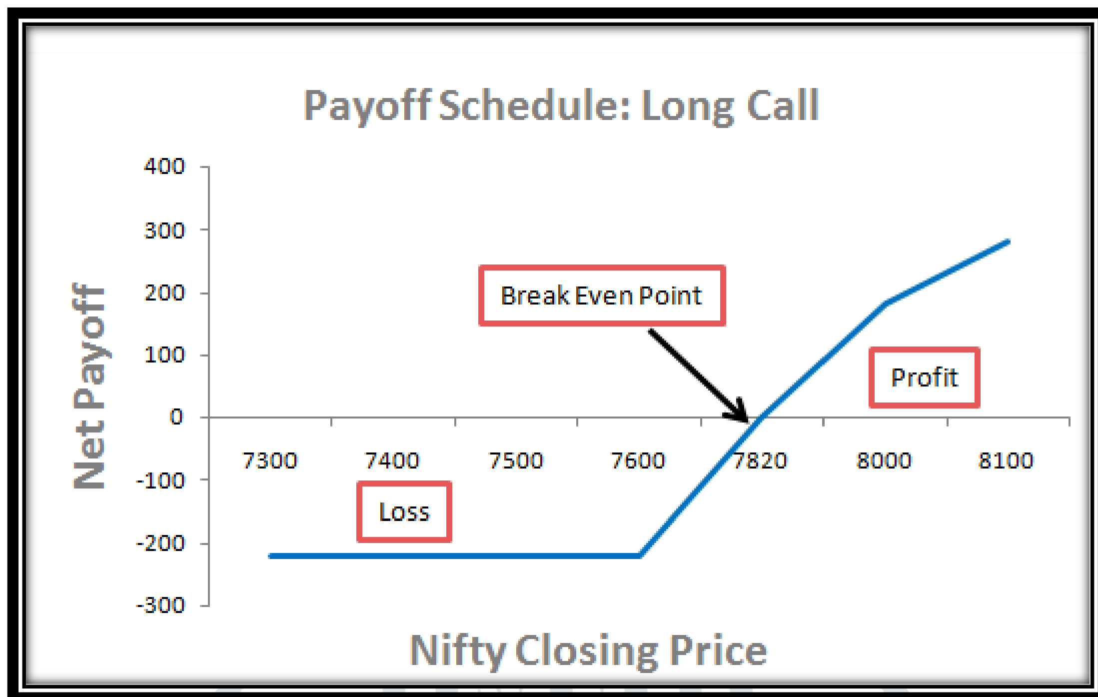
- Long a call: Person buys the right (a contract) to buy an asset at a certain price. We fell that the price in the future will exceed the strike price. This is a bullish position.

- Short a call: Person sells the right (a contract) to someone that allows them to buy an asset at a certain price. The writer feels that asset will devaluate over the time period of the contract. This person is bearish on the asset.

Put option: A put option gives the holder the right but not the obligation to sell an asset by a certain date for a certain price.

- Long a put: Buy the right to sell an asset at a predetermined price. We feel that the asset will devalue over the time of the contract. Therefore we can sell the asset at a higher price than is the current market value. This is a bearish position.

- Short a put: sell the right to someone else. This will allow them to sell the asset at a specific price. We feel the price will go down and we do not .this is a bullish position.



Trading of Derivatives Contracts:

Futures and Options Trading System:

The futures & options trading system of NSE, called NEAT-F&O trading system, provides a fully automated screen-based trading for Index futures & options and Stock futures & options on a nationwide basis as well as an online monitoring and surveillance mechanism. It supports an order driven market and provides complete transparency of trading operations. It is similar to that of trading of equities in the cash market segment.

The software for the F&O market has been developed to facilitate efficient and transparent trading in futures and options instruments. Keeping in view the familiarity of trading members with the current capital market trading system, modifications have been performed in the existing capital market trading system so as to make it suitable for trading futures and options.

FINDINGS OF THE STUDY

- According to the sample data, respondents who liked to trade in Equity segment, (cash market) are 71.95% (i.e.59 people) and remaining 28.05% (i.e.23 people) liked to trade in Derivative segment. The reason given for preference of trading in Equity segment is due to the "High profits in intraday trade" and some respondents "Hold it as an investment i.e.in their portfolios."

- According to the survey conducted, the derivative segment is being used for speculation purpose which is about 65% is made by buying and selling the contract at the most favorable time.

- The respondents think that "Equity is more risky to trade" as intraday trade might result into heavy losses considering volatility in stock market due to news which affect investor interest. However in derivative market i.e. Future & Option segment, the risk is minimized as the contracts traded are "Exchange traded specified contract" having specific maturity i.e. 1 month due to which making profit is possible.

- There 18 respondents who are not aware of stock market because, they are not having the information and knowledge about the market.

- With the help of EPS and P/E ratio, an investor can know whether to buy a particular company's share or not. The EPS indicates the amount of profits available per share and P/E ratio indicates the market value of every rupee earned per share.

SUGGESTIONS

- The Derivatives market should be developed in order to keep it at par with other derivative markets in the world. Nowadays, more number of investors shows their interest in derivatives market because; it includes high return by bearing high risk.

- SEBI should conduct more seminars regarding the use of derivatives to educate individual investors and they should explain the benefits of trading in derivatives.

- Most of the people prefer to keep their money in the banks as they consider it as the safest mode since they consider stock market as a gamble. Hence such people should be made aware, by providing the proper information to them and explaining the right method to trade.

- The investors should study the market condition and do fundamental analysis of the stock of a company before investing.

- The speculation should be discouraged because it affects the market conditions badly and new investors are reducing their interest in the market.

Conclusion:

Financial instruments enhance the ability to minimize risk and allocate it to those investors most able and willing to task it.

The derivatives i.e. future gives the safe and standardized contract to its investors and individuals who are aware about the derivative market or predict the movement of price so they will get the right platform for the trading in futures. Because, of exchange traded future contract and its standardized nature minimizes counter party risk.

Initially only NSE had the permission but now BSE has also started trade in derivatives in select stocks. It shows that how derivative market is gaining ground as compared to the equity (cash market) stocks. Not only High Net worth Individuals (HNI) large traders uses this but individual investor who is interested and has knowledge about equity and derivative market also invest in stock market.

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