How do I start trading futures?

Trading in futures is very simple. You just need to register yourself with a broker having membership of the NSE, fill up the KYC form, open a trading account, post margins as stipulated by member and then commence trading.

What happens on the expiry of a contract?

Upon expiry of the contract, all open positions in the futures contract are cash settled on the underlying closing price which is taken as the final settlement price of the futures contract.

Is it necessary to hold on to a position?

The period up to which you should hold on to a position in futures contract would depend on your personal preference and perspective. Once you have taken an open position, you may

i Exit from the position before contract expiration by taking an equal but opposite futures position (selling if you have bought, buying, if you have sold);

ii Make cash settlement at expiration;

How can I benefit from trading in futures?

" Protect your portfolio by using index futures contract.

- o For example, if you own a portfolio of securities you may sell equivalent value of Nifty futures. Assume the market falls because of which your portfolio suffers a loss. On expiration date of the futures contract, you can close both your positions (cash and futures) and the loss you have made in the cash market will get off-set by the profits made in the futures market.

" Trade based on view on the market

- o For example, if you think the market will be going up you may establish a 'long' (buy) position in Nifty futures. Similarly, if you think the market will go down, you may initiate a 'short' (sell) position. This way, the buying / selling of individual securities and the company specific price risks associated with it can be avoided.

How an arbitrageur can make profits by trading in index futures?

An arbitrageur can, in principle, capture the mispricing of the futures. If the index futures are mispriced at a higher level compared to the cash market, he would (a) buy the spot Nifty, (b) sell the futures, and (c) hold till expiration. This strategy is equivalent to riskless lending money to the market and if the index futures are mispriced at a lower level compared to the spot he would reverse the transaction.

What determines the fair price of futures?

$F = S \times e \wedge CT$

Where F - Futures price

S - Spot Price

C - Cost of carry (net funding cost till expiry)

T - Time to expiry of the contract.

e - Exponential Factor (value of e =2.71828)

About National Stock Exchange:

The National Stock Exchange (NSE) is India's leading stock exchange covering various cities and towns across the country. NSE was set up by leading institutions to provide a modern fully automated screen-based trading system with national reach. The Exchange has brought about unparalleled transparency, speed & efficiency, safety and market integrity. It has set up facilities that serve as a model for the securities industry in terms of systems, practices and procedures.

NSE has played a catalytic role in reforming the Indian securities market in terms of microstructure, market practices and trading volumes. The market today uses state-of-art information technology to provide an efficient and transparent trading, clearing and settlement mechanism, and has witnessed several innovations in products & services viz. demutualisation of stock exchange governance, screen based trading, compression of settlement cycles, dematerialisation and electronic transfer of securities, securities lending and borrowing, professionalisation of trading members, fine-tuned risk management systems, emergence of clearing corporations to assume counter party risks, market of debt and derivative instruments and intensive use of information technology.

Milestone

April 93	Recognition as a stock exchange
November 94	Capital Market (Equities) segment goes live
October 95	Became largest stock exchange in the country
April 96	Launch of S&P CNX Nifty
February 00	Commencement of Internet Trading
June 00	Commencement of Derivatives Trading (Index Futures)
June 01	Commencement of trading in Index Options
June 07	NSE launches new index derivatives
January 08	Introduction of Mini Nifty derivative
March 08	Introduction of long term option contracts
April 08	Launch of Securities Lending & Borrowing Scheme, Launch of VIX
August 08	Commencement of Currency Futures Trading
August 09	Launch of Interest Rate Futures
November 09	Launch of Mutual Fund Service System
December 09	Commencement of settlement of corporate bonds
February 10	Launch of Currency Futures on additional currency pairs
March 10	Launch of Hang Sang ETF
June 10	LOI Signed with London Stock Exchange Group

Disclaimer:

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NSE

An investment called India

FUTURES

STOCK FUTURES • INDEX FUTURES

What are "derivatives"?

A derivative is a financial instrument, which derives its value from some other financial price. This "other financial price" is called the underlying. For example, in the case of Nifty futures, Nifty index is the underlying.

What are futures contract?

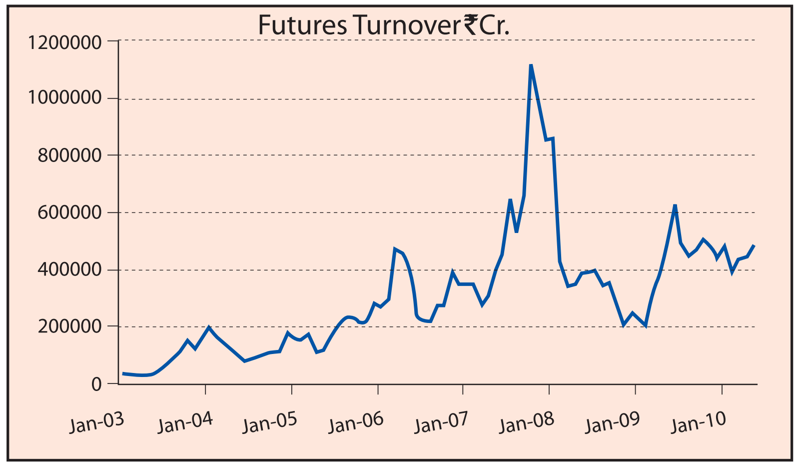
Futures are standardized contract between two parties to buy or sell an asset (underlying) at a certain time in the future at a certain price unlike Forwards where contracts are customized.

Futures trading provide, transparency, liquidity, anonymity of trades, and also eliminate the counter party risks due to the guarantee provided by National Securities Clearing Corporation Limited.

A typical Futures transaction:

On July 1, 2010, "A" enters into one July2010 Futures contract of an underlying say ABC of lot size 2000 at a market price of ₹100. On the expiry i.e. by 29th July2010 if the prices of ABC moves up to ₹110 "A" would gain profit of ₹20,000 i.e. {(110-100) x 2000} and if the price of the ABC moves down to ₹90 "A" would incur loss of 20,000 i.e. {(100-90) x 2000} on each lot of ABC held. The price of this derivative is driven by the spot price of the "underlying".

Volume growth in futures trading on NSE



Benefits of trading in futures on NSE

Low margin & high return - Future contract are known for high leverage and return maximization. The margin requirement depends upon volatility of the underlying and is disseminated from NSE from time to time.

Price transparency - High; as the contracts are standardized, online real time screen based.

Liquidity - High; as margins equate all participants.

Accessibility - High; 1300 + trading members for faster and easier accessibility.

Credit Exposure - Very Robust as Clearing Corporation guarantees all trades.

Risk Management System - Daily marked to market settlement for better management of trade.

Final Settlement - Cash settled in Indian Rupees.

Some basic terminology

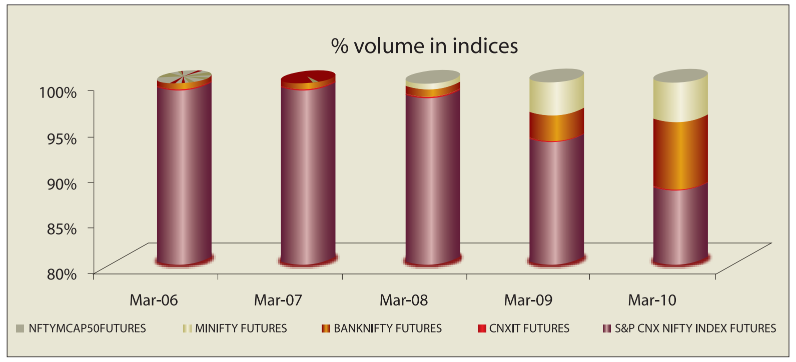
- *Spot price:* The price at which an asset trades in the spot market.
- *Futures price:* The price at which the futures contract trades in the futures market.
- *Contract cycle:* The period over which a contract trades. The futures contracts on the NSE have one- month, two-month and three months expiry cycles which expire on the last Thursday of the month.
- *Expiry date:* This is the last day on which the contract will be traded, at the end of which it will cease to exist.
- *Lot size:* The amount of asset that has to be delivered under one contract.
- *Basis:* Basis can be defined as the futures price minus the spot price. In a normal market, basis will be positive. This reflects that futures prices normally exceed spot prices.
- *Cost of carry:* The relationship between futures prices and spot prices can be summarized in terms of what is known as the cost of carry. This 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:* This is somewhat lower than the initial margin. This is set to ensure that the balance in the margin account never becomes negative. 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.

Who can participate in Futures trading?

Futures trading will be of interest to those who wish to:-

1) *Invest* - take a view of the market and buy or sell Nifty futures accordingly.
2) *Hedge* - reduce risks associated with underlying market exposure by taking a counter position in the futures market, i.e. buy stock, sell stock futures.
3) *Arbitrage* - take advantage of the price difference between the futures market and the cash market.

Index Futures



Contract Standards

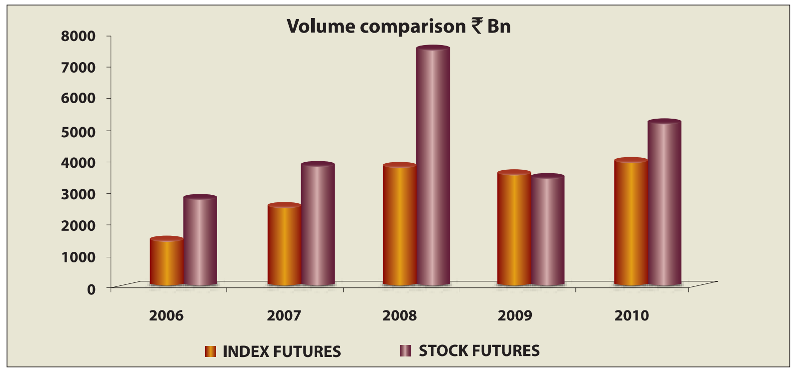
Particulars / Symbol	NIFTY	MINIFTY	CNXIT	BANKNIFTY	NFTYMCAP50
Base Value	1000	1000	1000	1000	1000
Base Period	Nov-95	Mar-95	Dec-95	Jan-2000	Jan-04
MCAP* (₹Bn)	14699.55	14699.55	2222.83	3155.04	1584.45
VOLATILITY	1.93	1.93	2.04	2.37	2.11

As on May 2010

Contract Specification:

Parameters	Specifications	Remarks
Contract Size	Must be at least ₹200,000 at the time of introduction for all futures contracts except Mini Nifty contracts	
	Must be at least ₹100,000 at the time of introduction for Mini Nifty contracts	
Trading Cycle	3-month trading cycle - Near month (one) Next month (two), far month (three).	On expiry, new far month contracts are introduced
Expiry Day	last Thursday of the expiry month	(if last Thursday is holiday previous trading day)
Price Steps	₹0.05 or 5 paisa	
Price Bands	Operation range of 10% of the base price	
Base Prices	Daily settlement price	or theoretical futures price for illiquid contracts
Daily Settlement Price	last half an hour volume weighted average price	For unexpired illiquid futures contract it is the theoretical pricecomputed as per formula F = S*e^CT
Final Settlement Price	Closing price of the relevant underlying index, on the last trading day of the futures contracts	

Stock Futures



Contract Specification:

Parameters	Specifications	Remarks
Contract Standards	Eligible stocks from the cash market	(refer www.nseindia.com>F&O> Contracts Information for list of F&O stocks
Trading Cycle	3-month trading cycle - Near month (one), Next month (two), far month (three)	On expiry, new far month contracts are introduced
Expiry Day	last Thursday of the Expiry month	(if last Thursday is holiday previous trading day)
Contract Size	at least ₹200,000 at the time of introduction	Lot sizes realigned every 6 months
Price Steps (tick size)	₹0.05 or 5 paise	
Price Bands	Operating range of 10% of the base price	
Base prices	Daily settlement price	or theoretical futures price for illiquid contracts
Daily Settlement Price	last half an hour volume weighted average price	For unexpired illiqui futures contract it is the theoretical price computed as per formula F = S*e^CT
Final Settlement Price	Closing price of the relevant underlying security on the last trading day of the futures contracts	