Chapter - III
CHAPTER III
AN OVERVIEW OF FUTURE AND OPTIONS IN INDIA

3.1 INTRODUCTION

This chapter presents a brief history of future, options, its growth and its importance in global and Indian Financial, and Commodities Markets. People have been trading goods and services since the beginning of time and evidence of organized markets can be traced back many thousands of years. In fact, evidence of organized markets in the Middle East and Asia have been discovered dating back as early as 1,000 years BC. These early markets have evolved into those of modern times where participants expect an efficient market to provide:

- A place to exchange goods or services
- Price discovery
- Facilities to transfer capital
- Ability to transfer risk
- Market information

3.2 Meaning of Future and Option Trading or Contract

A future is a derivative contract in which two parties agree to buy or sell something to each other in standardized form at a pre-specified price sometime in the future. Here, delivery is not immediate; it is at a much later date. And payment is also not immediate, it is at a later date, coming in the form of a "forward contract".
Future contract comes under the category of pre-agreed contract, where the buyer must sell and the seller must purchase the underlying item. Once they sign the contract, the contract has to be marked to market every day, they have to pay the margin and they have to square off, marking an obligation to square-off the deal.

Option contract comes as an alternative to future dealers to make more profits and fewer losses. It is a kind of derivative contract, which gives the holder, the option to buy or sell the underlying at a pre-specified price sometime in the future. An option to buy the underlying is known as a Call Option whereas an option to sell the underlying at a specified price in the future is known as Put Option.

The buyer of an option has the right, but not the obligation, to exercise the contract and it can be traded on the stock exchange or on the OTC market. Collectively, in future and options, there is no commodity and so the question of holding any shares does not exist.

3.3 HISTORY OF FUTURE AND OPTIONS TRADING

The texts show the presence of the characteristics of future and options or derivative contracts in incidents of Mahabharata and even in incidents that date back to the ages before Jesus Christ.

3.3.1 Existence of Future and options trading in Japan

The first recorded instance of future trading occurred with Yodoya rice market in Osaka, Japan, in the 17th Century. There may also have been rice future traded in China as long as 6,000 years ago.
The advent of derivatives trading is a natural outgrowth of the problems faced by farmers in maintaining a year-round supply of seasonal products like agricultural crops.

Previously, merchants used to store rice in warehouses for future utilization and to raise cash and in respond to this, warehouse holders sold receipts against the stored rice, known as "rice tickets". Later, the receipts accepted it as a kind of general commercial currency. Some rules also came to standardize the trading in rice tickets, similar to the current rules of American future trading.

3.3.2 Existence of the Future and options trading in the United States

In the U.S., derivatives trading started in the grain markets in the middle of the 19th Century. The Chicago Board of Trade (CBOT), the largest derivative exchange in the world, was established in 1848 where forward contracts on various commodities were standardized around 1865. The New York Coffee, Cotton and Produce Exchanges were born in the 1870s and 1880s. Today, there are ten commodity exchanges including some largest like the Chicago Board of Trade, The Chicago Mercantile Exchange, the New York Mercantile Exchange, the New York Commodity Exchange, and the New York Coffee, Sugar and Cocoa Exchange.

Some major future trading exchanges were established in over twenty countries in the world including Canada, England, France, Singapore, Japan, Australia, and New Zealand. The products traded range from agricultural staples like Corn and Wheat to Red Beans and Rubber traded in Japan. The biggest
increase in derivatives trading activity happened in the 1970s when future on financial instruments started trading in Chicago. An agency named as the Commodity Future Trading Commission from the Department of Agriculture regulated the future trading including the future exchanges, brokerage firms, money managers, and commodity advisors.

3.3.3 Existence of the Future and options trading in India

As said earlier, derivatives have had a long presence in India since the time of Mahabharata. The commodity derivative market has been functioning since the 19th century with organized trading in cotton through the establishment of Cotton Trade Association in 1875.

In June 2000, exchange-traded financial derivatives were introduced at the two major stock exchanges, NSE and BSE. There are various contracts currently traded on these exchanges. The National Commodity & Derivatives Exchange Limited (NCDEX) started its operations in December 2003, to provide a platform for commodities trading.

Exponential growth of the derivatives market, especially, at NSE, has been found in India. After having a good trading history of more than two to three years, it is observed that the number of stocks trading in the Indian future and options markets has more than doubled. Even recently listed stocks with no price history such as Everest Kanto Cylinder, Parsvnath Developers, and Reliance Natural Resources are included in the future and options segment.
3.4 How to Start Future Trading

Starting the investment career with future trading is by no means an easy step, and for those with no experience of the markets and the basics of trading, it can be difficult to surmount the steep learning curve that will no doubt lie ahead. As an absolute beginner, knowing exactly where to start is seen by most treatments of the theory of investing as assumed knowledge, and as a result is given short shrift in discussions on the topic. However, for a new trader to become successful, it’s important to lay down a few basic guidelines towards trading to ensure the most common mistakes are avoided, and that the trader is given the best possible chance of succeeding in the future markets.

Before starting to trade future, a crucial preliminary step lies in choosing a broker – again, assumed knowledge, and while it is fairly clear that a broker is necessary for future trading, it isn’t necessarily the case that picking any old broker will yield results. The best advice that can take as far as choosing a broker is concerned is to spend time trying out various different demo accounts and interfaces with different brokers.

This is usually free of charge, and allows the people to sample the look, feel and functionality of different brokerage platforms in order to determine which is most suitable for their trading style. Simultaneously, this can also be an effective way to start applying the theoretical knowledge to real-life trading scenarios, and in doing so refine the trading strategies prior to launching on the markets for real.
3.5 Future Trading Developments

Since 1970s, future trading has been big business. Global stock trading has allowed future to be traded with a liquidity that is unprecedented in other markets, leading to a widespread uptake in trading future. From wooden etchings of commodity agreements through to hi-tech, instant global transactions, future trading has come a long way in recent times, and the continuing development of future as an instrument is paving the way for future generations of traders to get started investing in derivatives.

At the start of their lifespan, future contracts were little more than verbal or symbolic agreements, designed to allow traders to generate an immediate return on future delivery of commodities. This was particularly useful for farmers and merchants throughout the early to middle ages, and even as late as the 20th century future were used in personalised trading (as opposed to exchange trading) to provide the same cash flow benefits.

The ability to hedge against future manufacturing costs also made future an attractive option for manufacturing and secondary sector businesses. Bread manufacturers, for example, used future to guarantee the future cost of wheat to keep a lid of the costs of production, while car manufacturers turned to steel future in an attempt to curb the rising costs of raw materials.

While today, this is still a predominant feature of future trading, the advent of cash-settled future has opened up the market to a wider array of speculators and
investors with no direct interest in the underlying asset – rather, their main concern is with the ability to speculate on asset prices over the medium to long term.

Perhaps, the most significant changes to trading future have arisen over the last 30 years or so, with the development of automatic, electronic trading and the widespread uptake of the Internet as a platform for remote trading. As the global exchanges began to investigate the merits of moving away from physical trading systems to virtual platforms, so too did the trading experience become much more streamlined and ultimately more profitable as a result of the reduced transaction costs afforded by technology.

With the rise of the Internet and the wild growth of online brokerage platforms, future have also now been opened to a mass-market audience, and more private individuals are getting involved in trading than ever before thanks to the ease with which anyone can setup an online trading account. Over such a short space of time, the Internet has revolutionised the trading environment forever, and the future direction of future trading, not to mention other derivatives, is something of keen academic and practical interest for those involved.

The development of future contracts over the centuries has been marked, but none more so than the growth and evolution of future over the 21st century. As computer technology becomes an even more integral part of our daily lives, the whole trading outlook for future has been radically altered to make it much easier
and more intuitive process. As the electronic dimension continues to expand, so too will future become more refined and more streamlined as an instrument, which could pave untold opportunities for investors over time.

3.6 The Future for Future

Future trading, today, encompasses almost 30million contracts every month ranging in value and sector, to help fund managers and private investors speculate on long term price fluctuations and hedge against the risks of other investments/manufacturing costs. Throughout their long and illustrious history, future have proven to be a tool of convenience, and one that provides significant benefits for both the buyer and seller, and as one of the oldest derivative instruments around, future have stood the test of time as a vital trading asset.

From their early adoption in the ancient global civilizations as a tool for merchants and farmers, future have grown to become a massive international business, with investment funds and private investors diversifying their existing portfolios to spread the risk of wayward investments. Over the last 20 years, the leaps forward in technology have allowed future to blossom into a popular trading instrument, with the advent of exchanges and live markets making future trading a feasible option for both fund managers and consumer traders, and as technologies continue to develop and progress there is no doubt future will continue this path of development.
3.7 Advantages of Future Trading

High Leverage: A key advantage of future trading, and indeed all forms of derivatives trading, is the role of leverage, which amplifies the size of each transaction without requiring a further margin deposit from the trader. Leverage has single-handedly made many a trading millionaire, and it forms a key component of a bulk of modern day trading and fund investing.

Low Commission Charges: Compared to other trading instruments, future trading also benefits from comparatively low trading costs, with commissions seldom as high as the alternatives. This allows the trader to focus more on earning their profit portion from each trade, rather than worrying about covering a chunky commission portion for each and every transaction.

Highly Liquid Market: Traded on future exchanges, future contracts are extremely liquid, with a very high turnover of buying and selling taking place throughout the trading day. This means it is easy to close out positions when you want, and there is very limited delay in reversing positions (as there would be with less liquid asset classes).

Transparent Market: Unlike share dealing, trading in the future market is virtually guaranteed to be a more transparent, more open and legitimate market. While it might be easy to get that juicy tip-off from the city, it’s virtually impossible to get insider information that could impact on the integrity of the market, particularly, in light of the timeframes involved.
But what does the future hold for future? What possible innovations lie ahead with future, and how will the markets respond to meet the demands of future traders going forward? The answers almost certainly lie in technology, and in the integration of new trading methods and triggers. In recent years it is witnessed that the development of sophisticated trading, which will continue to improve in their efficiency and effectiveness when it comes to spotting profitable trades.

Similarly, as trading platforms and exchanged grow to facilitate even faster, even more intuitive trading, it is foreseeable that the future market will open even further to a consumer investor demographic, which will yield benefits both in terms of market liquidity and also for the future brokerage industry.

Likewise, as natural commodities run increasingly scarce over the course of the next century, the value of future contracts will be significantly enhanced.

3.8 Future vs. Options

Future and options are two of the most widely traded derivatives, used by private traders and investment funds the world over to provide much needed flexibility in leveraged trading. In an ideal world, a trader will make use of both instruments to varying extents, building on the strengths of each distinct instrument to enhance the available returns and provide opportunities for hedging against other leveraged and unleveraged positions. But being in a position to use both future and options as part of a trading portfolio requires a solid working knowledge of the make-up of both instruments, and the key differences of each in order to understand which instrument is the best in a given investment scenario.
Future is fundamentally obligations. They are contracts that specify the time of delivery, set the price for delivery and specify the nature and quantity of assets to which they relate. On expiry of a future contract, the bearer is compelled to follow through on the transaction, either on a physical transfer or cash-settled basis. This means that for the bearer of future, losses are not limited to the extent of their outstanding position – they are in fact open to potentially infinite losses given the compulsion to buy the specified assets at a specified price point.

As a result, future will suffer price decay as they near their expiry date and their value naturally diminishes with all things being equal on the approach to that date, but nevertheless future contracts provide traders and manufacturing businesses alike with the ability to lock in guaranteed prices for the underlying asset, to be delivered at the defined future point.

Options on the other hand, while appearing relatively similar, are in fact distinct in a number of important aspects. Unlike future, options are rights in an underlying asset. The trader is not compelled to execute the trade, but is merely acquiring the right to do so at a capped price. There is no defined end date for options, but like future they are freely tradable on exchanges to provide traders with the ability to call in their rights relative to underlying asset price movements at some undefined future point.

Options are also burdened by unlimited losses. It is because of the fact that options may or may not be used (i.e. it’s optional), as opposed to future which must be deployed on their expiry date, traders can either exercise their rights for
maximum gains when conditions suit them, or they can accept a much smaller loss and allow their future position to go unused – the choice depends on the financial outcome that’s most suited to the trader, but effectively caps the downside while allowing for an unlimited upside.

It is also possible to buy options on future contracts – known in trading lingo as future options. Future and options are effectively derivatives on a derivative, allowing enhanced leverage on already highly leveraged future contracts. Future options give the trader the right to acquire future contracts at a stipulated price at some later date if they wish, and as such they can be used to deliver significant profits over the long-term.

Options are also immune from price decay, given that they do not have a set expiry date, and so they can be resold or kept for as long as trading account can bear the financing costs and margin of holding.

Options and future are both widely traded instruments but they are significantly different in their features and in the pros and cons they bring to the table. For the eager trader, trading one or the other is recommended (as opposed to a pluralistic approach) until become sufficiently confident in the features of both instruments to build them in to portfolio. With future and options both in the armory, the opportunities for profitable trading are significantly increased, giving the trader the flexibility to make more customised trading decisions.
3.9 Future vs. Forwards

When it comes to distinguishing between the different types of derivative, none appear more similar to the untrained eye than future and forwards. Future and forwards are both instruments that are used to lock in price points and guarantee future delivery, and they are both obligations for buyer and seller to settle on the terms of the agreement at a future date.

Future is contracts that declare a set amount of a set asset, to be exchanged on a set date at a set price. These are freely tradable on future exchanges, and open to be purchased by any trader with the funds to cover the margin. Future are standard, largely generic contracts that are sold with highly leveraged positions, allowing the trader to assume a fraction of risk, assuming appropriate stops are in place, for a significantly higher proportion of earnings.

Forwards differ in a number of essential respects, and as a result, are applicable to different trading scenarios than their cousin future. Like future, they are agreements that bind two parties to settle on a defined transaction at a defined rate at a defined future point, and they are obligations that must be settled on the date so specified. But unlike future, forwards are not traded on exchanges, but rather are sold over the counter (OTC).

This difference comes as a result of two separate but interrelated reasons. Firstly, forwards are designed to give the parties to the deal more flexibility to agree on
terms than future, and as such are non-standardized instruments that could not by virtue of their lack of standardization be subjected to easy, free-flowing exchange trading.

The knock-on implication for traders engaging in forwards contracts is that the terms must be negotiated with the second party, but also that there is a lack of price transparency in the forwards contract because it is so customised. Likewise, this means it may be more difficult to liquidate your position early, and so forwards are only recommended where they represent good value for money and are likely to be held until the expiry date.

Another critical difference between the two instruments comes in the form of margining. Future is a margined instrument, which means traders are required to cover a small deposit percentage in respect of the larger transaction, which is then offset when the future contracts are sold or settled, leaving the trader with the profit portion from the larger transaction having invested only the margin amount up front.

Forwards, on the other hand, are not margined instruments. This means that, while forwards do still carry some inherent gearing in their construction, they require a more significant investment from traders to take on a position, and represent a greater risk of default to the trader as a consequence. Nevertheless, these factors should be priced in to any forwards contract, so provided it is ensured in getting a good deal on the forward and it wouldn’t be more profitable to go with standardised, exchange-traded future, they can represent an additional layer of flexibility for traders.
Future and forwards are both popular instruments to a greater or lesser extent, and understanding their function and make up is important in deciding on how best to employ these derivatives within the trading account. While most new and inexperienced traders tend to stick to exchange traded instruments, OTC instruments can also provide a wealth of opportunities beyond those afford by exchange trading, and can pave the way for more attractive terms for the trader willing to assume the enhanced risk portion.

3. 10 Future vs. Share Dealing

The case for future on shares as opposed to regular, buy-low-sell-high share dealing is a widely spoken mantra amongst professional traders, and there are countless trading millionaires who made their wealth off the back of leveraged share trading. While share dealing is the backbone of investing, and one of the most popular choices for consumer investors looking to generate a better return on their savings, future trading has a number of key advantages to bring to the table over share dealing that make it a favorite amongst more serious, professional trading types.

Firstly, and most importantly, the role of leverage in making a transaction profitable should not be underestimated. A leverage ratio of even 10:1 can amplify any slight gains by a considerable portion, and often low margin percentages couple up with the inherent gearing function of future contracts to provide tightly leveraged, hefty transaction sizes on which even small movements can realise significant gains.
Likewise, the ability to lock in future prices through future contracts for less makes them attractive instruments for both speculators and those with a need for raw materials and commodities. As opposed to share dealing, where traders are acquiring an asset (i.e. shares) now at today’s prices, future allow the acquisition of assets, or rather the obligation to acquire assets, at today’s prices at some future point – thus locking in a price in the hope of a future rise in value, before actually making the acquisition.

With share dealing is not naturally leveraged in the way it is constructed. This, of course, mitigates much of the risks presented by leveraged trading, as small share price movements will not usually have a devastating impact on trading capital. Additionally, the trader also acquires the correlative rights with being a shareholder, including the ability to vote on strategic company decisions and the all-important dividend entitlement, presenting a yield above simple price speculation. While there is no lock-in component, traders can still forecast long-term price growth – just without the intermediary step of the future contract.

Of course, the big advantage of share dealing over future trading is the lack of a threat from leverage gone wrong. While a few positive price ticks can deliver wild returns on a leveraged future position, just a few negative ticks can wipe out the trading account. Essentially, this means that future is a higher risk to traders than a share transaction, although the potential rewards are significantly higher on those transactions that do work out well.
There are also factors of ownership to be considered when weighing up the advantages and disadvantages of both forms of trading, namely in the field of tax liability. Shares attract stamp duty, payable on their sale, while future are free from stamp duty entirely. This might mean that future present a better value for money transaction.

3. 11 Future vs. Commodities Dealing

Future contracts and commodity dealing naturally go hand in hand, with future being one of the most common ways to speculate on the price of commodities. Originally designed to facilitate commodities trading across the ancient civilisations, future are inherently designed to help both commodity suppliers and buyers to reap mutual early advantage, tying in a future real price today in order to make business planning and financial forecasting more feasible. But how does future trading compare with commodities dealing as an investment strategy, and what advantages does it bring to the table when compared to trading in its rawest form?

Commodities are a natural choice for traders because there is a constant source of both supply and demand, and as a result, prices are in a constant state of flux. Manufacturers keep on manufacturing, while raw material providers keep on providing – there is a cyclical need for all commodities which drives the motions of commodity price movements. For the trader looking to make a profit on commodities, riding these price cycles makes it possible to reap a return on investors’ money, but often the costs of storage, shipping and warehousing are prohibitive for smaller physically settled orders.
Aside from being an ideal way to provide parties with early certainty on their business dealings, future contracts also provide the ideal cash-settled environment for speculating on commodity prices. There is no need for physical delivery, with most future traders opting to accept the cash equivalent of their holding if they chose to sell at current market value, while the ability to leverage up transactions means the volatile nature of commodity prices are perfectly suited to this form of trading.

Unlike straight commodities dealing, where would be required to source funding in order to obtain anything like the leverage with future contracts, at exorbitant rates to match the levels of return possible, future trading builds in the requirement for a fractional margin payment in respect of the larger transaction size – effectively, this allows a trader to buy thousands of pounds worth of commodity future for as little as 5% margin, which in itself will entitle the bearer to possibly tens of thousands in underlying commodity. Thus, the potential for profit, and indeed loss, posed by leverage in future contracts makes them highly lucrative for traders looking to make a return from commodity price movements.

Future on commodities is probably preferable for most traders without the resources to store and handle the relevant goods. While prices do tend to fluctuate rapidly and in response to supply and demand, the benefits of a leveraged position on commodities which is ultimately cash settled makes trading on commodity prices more of a realistic option for ordinary traders and professional investment funds.
With the ability to leverage positions to a significant extent and thereby increase the notional trading clout, future contracts delivers a higher reward, albeit complemented with a higher risk, that enables traders to make significant gains from their commodity price speculation.

### 3.12 OPTION BASICS

#### 3.12.1 Options

An option is a contract to buy or sell a specific financial product officially known as the option's underlying instrument or underlying assets. For exchange-traded equity options, the underlying instruments are stocks of listed companies. The contract itself is very precise. It establishes a specific price, called the strike price, at which the contract may be exercised or acted on and it has an expiration date. When an option expires, it no longer has value and no longer exists. Option is known as security, or contingent claim, or contract, or derivative security or simply derivative. An option gives its holder the right to purchase or sell, a specified quantity (lot size) of an underlying asset for a specified price (exercise price or strike price) on or before some specified date called expiration date, but the holder has no obligation to purchase or sell.

#### 3.12.2 Types of Options

Options come in two varieties, calls and puts, and anyone can buy or sell either type. The investors make those choices - whether to buy or sell and whether to choose a call or a put - based on what you want to achieve as an options investor. Call option gives its holder the right to purchase the underlying assets. Put option gives it holder the right to sell the underlying assets.
3.12.3 Option terminology

- **Index options:** These options have the index as the underlying. Some options are European while others are American. Like index future contracts, index options contracts are also cash settled.

- **Stock options:** Stock options are options on individual stocks. Options currently trade on over 500 stocks in the USA. A contract gives the holder the right to buy or sell shares at the specified price.

- **Buyer of an option:** The buyer of an option is the one who by paying the option premium buys the right but not the obligation to exercise his option on the seller/writer.

- **Writer of an option:** The writer of a call/put option is the one who receives the option premium and is thereby obliged to sell/buy the asset if the buyer exercises on him.

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

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

- **Option price:** Option price is the price which the option buyer pays to the option seller. It is also referred to as the option premium.
• **Expiration date:** The date specified in the options contract is known as the expiration date / the exercise date / the strike date or the maturity.

• **Strike price:** The price specified in the options contract is known as the strike price or the exercise price.

• **American options:** American options are options that can be exercised at any time up to the expiration date. Most exchange-traded options are American.

• **European options:** European options are options that can be exercised only on the expiration date itself. European options are easier to analyze than American options, and properties of an American option are frequently deduced from those of its European counterpart.

• **In-the-money option:** An in-the-money (ITM) option is an option that would lead to a positive cash flow to the holder if it were exercised immediately. A call option on the index is said to be in-the-money when the current index stands at a level higher than the strike price (i.e. spot price > strike price). If the index is much higher than the strike price, the call is said to be deep ITM. In the case of a put, the put is ITM if the index is below the strike price.

• **At-the-money option:** An at-the-money (ATM) option is an option that would lead to zero cash flow if it were exercised immediately. An option on the index is at-the-money when the current index equals the strike price (i.e. spot price = strike price).
• **Out-of-the-money option:** An out-of-the-money (OTM) option is an option that would lead to a negative cash flow if exercised immediately. A call option on the index is out-of-the-money when the current index stands at a level which is less than the strike price (i.e. spot price strike price). If the index is much lower than the strike price, the call is said to be deep OTM. In the case of a put, the put is OTM if the index is above the strike price.

• **Intrinsic value of an option:** The option premium can be broken down into two components – intrinsic value and time value. The intrinsic value of a call is the difference between stock price and the strike price, if it is ITM. If the call is OTM, its intrinsic value is zero. Putting it another way, the intrinsic value of a call is Max [0, \( S_t - X \)] which means the intrinsic value of a call is the greater of 0 or \( S_t - X \) Similarly, the intrinsic value of a put is Max [0, \( X - S_t \)], i.e. the greater of 0 or \( X - S_t \) where X is the strike price and \( S_t \) is the spot price.

• **Time value of an option:** The time value of an option is the difference between its premium and its intrinsic value. Both calls and puts have time value. An option that is OTM or ATM has only time value. Usually, the maximum time value exists when the option is ATM. The longer the time to expiration, the greater is an option’s time value. At expiration, an option should have no time value.
3.13 Option Pricing:

The price of the option is determined by many methods like Binomial method, Black Scholes option pricing formula, Volatility jump model etc. out of which the Black Scholes option pricing model is most popular and widely used throughout the world. It is based on the assumption that the stock prices as per continuous – time, continuous – variable stochastic Markov process. Markov process states that the future value of stock price depends only on the present value not on the history of the variable. The Markov property implies that the probability distribution of the stock prices at any particular future time is not dependent on the path followed by the price in the past. The Markov property of the stock prices is consistent with the weak form of market efficiency. It is competition in the marketplace that tends to ensure that weak-form market efficiency holds. There are many, investors watching the stock market closely. Trying to make a profit from it, leads to a situation where a stock price, at any given time, reflects the information in past prices. Assume that it was discovered a particular pattern in stock prices, which always gave a 65% chance of subsequent steep price rises. Investors would attempt to buy a stock as soon as the pattern was observed, and demand for the stock would immediately rise. This would lead to an immediate rise in its price and the observed effect would be eliminated, as would any profitable trading opportunities.
3. 14 OPTION AND THE STOCK MARKET

3.14.1 Market Efficiency

The derivatives make the stock market more efficient. The spot, future and option markets are inextricably linked. Since it is easier and cheaper to trade in derivatives, it is possible to exploit arbitrage opportunities quickly, and keep the prices in alignment. Hence, these markets help ensure that prices of the underlying asset reflect true values.

Options can be used in a variety of ways to profit from a rise or fall in the underlying asset market. The most basic strategies employ put and call options as a low capital means of garnering a profit on market movements, known as leveraging. Option route enable one to control the shares of a specific company without tying up a large amount of capital in the trading account. A small portion of money say, 20% (margin) is sufficient to get the underlying asset worth 100 percentages. Options can also be used as insurance policies in a wide variety of trading scenarios. One, probably, has insurance on his / her car or house because it is the responsible act and safe thing to do. Options provide the same kind of safety net for trades and investments already committed, which is known as hedging. The amazing versatility that an option offers in today's highly volatile markets is welcome relief from the uncertainties of traditional investing practices. Options can be used to offer protection from a decline in the market price of available underlying stocks or an increase in the market price of uncovered
underlying stock. Options can enable the investor to buy a stock at a lower price, sell a stock at a higher price, or create additional income against a long or short stock position. One can also use option strategies to profit from a movement in the price of the underlying asset regardless of market direction.

There are three general market directions: market up, market down, and market sideways. It is important to assess potential market movement when the investors are placing a trade. If the market is going up, the investors can buy calls, sell puts or buy stocks. Does one have any other available choices? Yes, one can combine long and short options and underlying assets in a wide variety of strategies. These strategies limit the investors' risk while taking advantage of market movement.

The following tables show the variety of options strategies that can be applied to profit on market movement:

<table>
<thead>
<tr>
<th>Bullish Limited Risk Strategies</th>
<th>Bullish Unlimited Risk Strategies</th>
<th>Bearish Limited Risk Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy, Call, Bull, Call Spread, Put Spread, Call Ratio, Back spread</td>
<td>Buy, Stock, Sell, Put Covered, Call Ratio Spread</td>
<td>Buy, Put, Bear, Put Spread Bear, Call Spread, Put Ratio, Back spread</td>
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It is of a paramount importance to be creative with trading. Creativity is rare in the stock and options market. That is why it is such a winning tactic. It has the potential to beat the next person down the street. One has a chance to look at different scenarios that he does not have the knowledge to construct. All need to do is take one step above the next guy for you to start making money. Luckily the next person, typically, does not know how to trade creatively.
Thus, the risk managing ability, low cost and its act as sentiment indicator of option drives the market more efficient.

3.15 Leverage and Risk

Options can provide leverage. This means an option buyer can pay a relatively small premium for market exposure in relation to the contract value (usually 100 shares of underlying stock). An investor can see large percentage gains from comparatively small, favorable percentage moves in the underlying index. Leverage also has downside implications. If the underlying stock price does not rise or fall as anticipated during the lifetime of the option, leverage can magnify the investment’s percentage loss. Options offer their owners a predetermined, set risk. However, if the owner’s options expire with no value, this loss can be the entire amount of the premium paid for the option. An uncovered option writer, on the other hand, may face unlimited risk.

3.16 RISK MANAGEMENT TOOL

The market price reduction of the share is called as downside risk of the investor. The profit from the increase in the share price is known as upside potential. Option strategies help the investors to cap the downside risk at the same time keep the upside potential unlimited. This is the most desired need of the investors. Buying a call option and selling a put option works well in the bull market, limiting the loss to the premium paid but the upside potential in unlimited as market price increases. Similarly, in a bearish situation, selling a call and
buying a put are the strategies of capping the downside risk. Apart from the above plain vanilla strategies, bull – spread, bear – spread, calendar spreads, butterfly spreads, diagonal spreads, straddle, strangle, strips, and straps are some of the famous strategies to cap the downside risks in any level required by the investors. “How this can be achieved?” is not the scope of the study but are practiced by the investing community as on date, but the upside potential is slightly reduced by using these strategies, which are minimum compare to the advantage gained by the investors. This property makes the option a unique tool for risk management and a preferred one.

CONCLUSION

In this chapter, the researcher discussed about the overview of future and options in India and future trading developments. Further, the researcher presents the advantages of future trading, future vs. forwards, future vs. share, future vs. commodities and some basic concepts involved in options.