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A COMPARATIVE STUDY OF NIFTY 50 AND NIFTY NEXT 50 INDICES: PERFORMANCE METRICS AND INVESTMENT OPPORTUNITIES WITH REFERENCE TO INDIABULLS

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ABSTRACT

The Nifty 50, S&P CNX Nifty, or Standard & Poor's CRISIL NSE Index 50 is a popular stock market index. The impact of recent index additions to the benchmark Nifty index on the price and volume of Indian stock market transactions is examined in this research. There are substantial, positive, and persistently anomalous returns associated with index announcement and inclusion, according to this research. There is, to put it mildly, little evidence in favour of persistently anomalous volume around index increases.

This study's findings disprove the two main hypotheses put out to explain the index inclusion effect: a downward sloping demand curve and pricing pressure. By demonstrating that adding stocks to the benchmark Nifty index seems to transmit information, this research adds to the expanding body of knowledge on index inclusion.

Equipped with an ecosystem that includes exchange-traded funds (both onshore and offshore), exchange-traded futures and options (at NSE in India and at SGX and CME overseas), other index funds, and over-the-counter derivatives (mainly offshore), Nifty has grown into the biggest single financial instrument in India.

With the S&P CNX Nifty, investment managers may get exposure to the Indian market across 23 different sectors. Nearly 60% of the NSE's market capitalisation is attributable to the S&P CNX Nifty equities.

1. INTRODUCTION

The **Standard & Poor's CRISIL NSE Index 50** or **S&P CNX Nifty** nicknamed Nifty 50 or simply Nifty (NSE: ^NSEI), is the leading index for large companies on the National Stock Exchange of India. The Nifty is a well diversified 50 stock index accounting for 23 sectors of the economy. It is used for a variety of purposes such as benchmarking fund portfolios, index based derivatives and index funds. Nifty is owned and managed by India Index Services and Products Ltd. (IISL), which is a joint venture between NSE and CRISIL. IISL is India's first specialized company focused upon the index as a core product. IISL has a marketing and licensing agreement with Standard & Poor's.

The S&P CNX Nifty covers 23 sectors of the Indian economy and offers investment managers exposure to the Indian market in one portfolio. The S&P CNX Nifty stocks represent about 60% of the total market capitalization of the National Stock Exchange (NSE).

The index is a free float market capitalization weighted index. From inception, the index used full market capitalization as weight assigned to different constituents. From June 26, 2009, the index is computed based on free float methodology. As of November 2010, top four scrips in the index (Reliance Industries, Infosys Technologies, ICICI Bank and Larsen & Toubro) account for about one third of the weight in the index whereas the top eight scrips account for about half the weightage in the index.

The base period for the S&P CNX Nifty index is November 3, 1995, which marked the completion of one year of operations of NSE's Capital Market Segment. The base value of the index has been set at 1000, and a base capital of Rs 2.06 trillion.

The S&P CNX Nifty Index was developed by Ajay Shah and Susan Thomas.

It is the 9th largest stock exchange in the world by market capitalization and largest in India by daily turnover and number of trades, for both equities and derivative trading. NSE has a market capitalization of around US$1.59 trillion and over 1,552 listings as of December 2010. Though a number of other exchanges exist, NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India, and between them are responsible for the vast majority of share transactions. The NSE's key index is the S&P CNX Nifty, known as the NSE **NIFTY** (National Stock Exchange Fifty), an index of fifty major stocks weighted by market capitalisation.

NSE is mutually-owned by a set of leading financial institutions, banks, insurance companies and other financial intermediaries in India but its ownership and management operate as separate entities. There are at least 2 foreign investors NYSE Euronext and Goldman Sachs who have taken a stake in the NSE. As of 2006, the NSE VSAT terminals, 2799 in total, cover more than 1500 cities across India. NSE is the third largest Stock Exchange in the world in terms of the number of trades in equities It is the second fastest growing stock exchange in the world with a recorded growth of 16.6%.

DERIVATIVE:

"Derivative is a product whose value is derived from the value of an underlying asset in a contractual manner. The underlying asset can be equity, Forex, commodity, securities, or any other asset." In other words, derivative means a forward, future, option or any other hybrid contract of pre-determined fixed duration, linked for the purpose of contract fulfillment to the value of a specified real or financial asset or to an index of securities.

A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage. Essentially, a derivative is a contract between two parties where the value of the contract is linked to the price of another financial instrument or by a specified event or condition.

1. Securities Contract (regulation) Act, 1956 (SC(R) A) defines as "debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security"
2. A contract which derives its value from the prices, or index of prices, of underlying securities.

The turnover of the stock exchange has been tremendously increasing from last 10 years. The number of trades and the number of investors, who are participating, have increased. The investors are willing to reduce their risk, so they are seeking for the risk management tools.

NEED AND IMPORTENCE OF THE STUDY:

The present study on futures and options is very much appreciable on the grounds that it gives deep insights about the futures and options market. It would be essential for the perfect way of trading in futures and options. An investor can choose the portfolio for investment which is risk free. The study would explain various ways to minimize the losses and maximize the profits.

The study would help the investors how then profit/loss is reckoned. The study would assist in understanding the futures and options segments. The study assists in knowing the different factors that cause for the fluctuations in the futures and options market. The study provides information related to the bye laws of futures and options trading. The studies elucidate the role of futures and options in India financial markets.

SCOPE OF THE STUDY:

The study is limited to "Derivatives" with special reference to futures and option in the Indian context and the National Stock Exchange has been taken as a representative sample for the study. The study can't be said as totally perfect. Any alteration may come. The study has only made a humble attempt at evaluation derivatives market only in India context. The study is not based on the international perspective of derivatives markets, which exists in NASDAQ, CBOT etc. The study can't be said as totally perfect. Any alteration may come. The study has only made a humble attempt at evaluation derivatives market only in Indian context. The study is not based on the International perspective of derivatives markets, which exists in NASDAQ, CBOT etc.

OBJECTIVES OF THE STUDY:

- To analyze the BSE and NSE market in India.
- To analyze the operations of futures and options.
- To find the profit/loss position of futures buyer and seller and also the option writer and option holder.
- To study about risk management with the help of derivatives.

2. RESEARCH METHODOLOGY

DATA COLLECTION:

The data of the Steel City Securitas ltd has been collected from the newspapers and the internet. The data consist of the one month contract and period of Data collection.

- **Primary data: -** The primary data is the data which is collected, by interviewing directly with the organizations concerned executives. This is the direct information gathered from the organization.
- **Secondary data: -** The secondary data is the data which is gathered from publications and websites.

3. LIMITATIONS OF THE STUDY:

The following are the limitation of this study.

- The scrip chosen for analysis is **M/s. HDFC LTD** and the contract taken is ending one –month contract.
- The data collected is completely restricted to the **M/s. HDFC LTD** hence this analysis cannot be taken universal.

4. FACTORS DRIVING THE GROWTH OF DERIVATIVES

Over the last three decades, the derivatives markets have seen a phenomenal growth. A large variety of derivative contracts have been launched at exchanges across the world. Some of the factors driving the growth of financial derivatives are:

- Increased volatility in asset prices in financial markets.
- Increased integration of national financial markets with the international markets.
- Marked improvement in communication facilities and sharp decline in their costs.
- Development of more sophisticated risk management tools, providing economic agents a wider choice of risk management strategies, and
- Innovations in the derivates markets, which optimally combine the risks and returns over a large number of financial assets leading to higher returns, reduced risk as well as transaction costs as compared to individual financial assets.

TYPES OF DERIVATIVES:

The following are the various types of derivatives. They are:

FORWARDS:

A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre-agreed price.

FUTURES:

A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the at a certain price.

OPTIONS:

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 give 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.

WARRANTS:

Options generally have lives of up to one year; the majority of options traded on options exchanges having a maximum maturity of nine months. Longer-dated options are called warrants and are generally traded over-the counter.

LEAPS:

The acronym LEAPS means long-term Equity Anticipation securities. These are options having a maturity of up to three years.

BASKETS:

Basket options are options on portfolios of underlying assets. The underlying asset is usually a moving average of a basket of assets. Equity index options are a form of basket options.

SWAPS:

Swaps are private agreements between two parties to exchange cash floes in the future according to a prearranged formula. They can be regarded as portfolios of forward contracts. The two commonly used Swaps are:

Interest rate Swaps:

These entail swapping only the related cash flows between the parties in the same currency.

Currency Swaps:

These entail swapping both principal and interest between the parties, with the cash flows in on direction being in a different currency than those in the opposite direction.

SWAPTION:

Swaptions are options to buy or sell a swap that will become operative at the expiry of the options. Thus a swaption is an option on a forward swap. Rather than have calls and puts, the swaptions market has received swaptions and payer swaptions. A receiver swaption is an option to receive fixed and pay floating. A payer swaption is an option to pay fixed and received floating.

NSE's DERIVATIVES MARKET

The derivatives trading on the NSE commenced with S&P CNX Nifty index futures on June 12, 2000. The trading in index options commenced on June 4, 2001 single stock futures were launched on November 9, 2001. Today, both in terms of volume and turnover, NSE is the largest derivatives exchange in India. Currently, the derivatives contracts have a maximum of 3-month expiration cycles. Three contracts are available for trading, with 1 month, 2 month & 3 month expiry. A new contract is introduced on the next trading day following of the near month contract.

GLOBAL DERIVATIVES MARKET

The global financial centers such as Chicago, New York, Tokyo and London dominate the trading in derivatives. Some of the world's leading exchanges for the exchange-traded derivatives are:

- Chicago Mercantile Exchange (CME) & London International financial Futures Exchange (LIFFE) (for currency & Interest rate futures)
- Philadelphia Stock Exchange (PSE), London stock Exchange (LSE) & Chicago Board options exchange (CBOE) (for currency options)
- New York Stock Exchange (NYSE) and London Stock Exchange (LSE) (for equity derivatives)
- Chicago Mercantile Exchange (CME) and London Metal Exchange (LME) (for commodities)

These exchanges account for a large portion of the trading volume in the respective derivatives segment.

5. FINDINGS

- A **positive** derivative means that the function is increasing
- A M/S. DLF INDIA LTD derivative means that the function is decreasing
- A M/S. DLF INDIA LTD derivative means that the function has some special behavior at the given point. It may have a local maximum, a local minimum, (or in some cases, as we will see later, a "turning" point)

As a last remark we should remember that the derivative of a function is, itself, a function since it varies from point to point. If we want to, we could plot it on its own set of axes. You can compare the signs and slopes of the individual tangent lines of the original curve with the graph of the derivative.

6. SUGGESTIONS

- In bullish market the call option writer incurs more losses so the investor is suggested to go for a call option to hold, where as the put option holder suffers in a bullish market, so he is suggested to write a put option.
- In bearish market the call option holder will incur more losses so the investor is suggested to go for a call option to write, where as the put option writer will get more losses, so he is suggested to hold a put option.
- In the above analysis the market price of **M/S. DLF INDIA LTD** is having low volatility, so the call option writers enjoy more profits to holders.
- The derivative market is newly started in India and it is not known by every investor, so SEBI has to take steps to create awareness among the investors about the derivative segment.
- In order to increase the derivatives market in India, SEBI should revise some of their regulations like contract size, participation of FII in the derivatives market.

- Contract size should be minimized because small investors cannot afford this much of huge premiums.
- SEBI has to take further steps in the risk management mechanism.
- SEBI has to take measures to use effectively the derivatives segment as a tool of hedging.

7. CONCLUSIONS

An innovation to the cash market is the derivatives market. Every day, it approaches the level of the cash market in terms of turnover. Quantity traded in the NSE derivative divisions on a daily basis. Investors in the cash market stand to gain or lose according to the movement in the value of the underlying asset. The investor stands to gain or lose a substantial amount of money. Nevertheless, investors in the derivatives industry may reap substantial gains with little risk. Instead of paying the whole amount in the cash market, investors in derivatives must pay premiums or margins, which are percentages of the total. Hedging is the primary usage of derivatives. In the derivatives market, an option writer's gain or loss is directly tied to the movement of the underlying asset.

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