BA4004 FINANCIAL DERIVATIVES

UNIT-1

1. Meaning of Derivatives-
   A derivative is a contract between two parties which derives its value/price from an underlying asset. The most common types of derivatives are futures, options, forwards and swaps.

2. Option writing: While the option buyer gets the right to buy or sell a security, there is no obligation on him to do so. The option writer, on the other hand, has an obligation to trade and his reward is only the premium. So, option writers take unlimited risk for limited reward.
3. TYPES OF OPTION:At the money options: Options where the strike price is same as the price of the underlying security.
In the money options: Put options where strike price is above the price of the underlying security or call options where strike price is below price of the underlying security. Here premiums will be higher.
Out of the money option: Put options where strike price is below the price of the underlying security or call options where strike price is above of the underlying security. Here the premiums will be lower.

4. Market lot: You can’t buy one share in the Futures & Options segment, and the minimum number of shares you can buy is called market lot. The market lot size is the minimum number of shares that can be traded on the stock exchange. For example, an investor must purchase at least 10,000 shares of a company depending on its shares to trade on the stock exchange.

5. Time decay: Since the option contract is for specific number of days, its value keeps on coming down every day and the same is called time decay. Time decay is a measure of the rate of decline in the value of an options contract due to the passage of time. Time decay accelerates as an option's time to expiration draws closer since there's less time to realize a profit from the trade.
6. American Style Option: A type of option that can be exercised at any time unlike the European Style option which can only be exercised at expiryAn American option, aka an American-style option, is a version of an options contract that allows holders to exercise the option rights at any time before and including the day of expiration. It contrasts with another type of option, called the European option, that only allows execution on the day of expiration.An American-style option allows investors to capture profit as soon as the stock price moves favorably, and to take advantage of dividend announcements as well.

7.What Is a Call Option?
Call options are financial contracts that give the option buyer the right but not the obligation to buy a stock, bond, commodity, or other asset or instrument at a specified price within a specific time period. The stock, bond, or commodity is called the underlying asset. A call buyer profits when the underlying asset increases in price.A call option may be contrasted with a put option, which gives the holder the right to sell the underlying asset at a specified price on or before expiration.

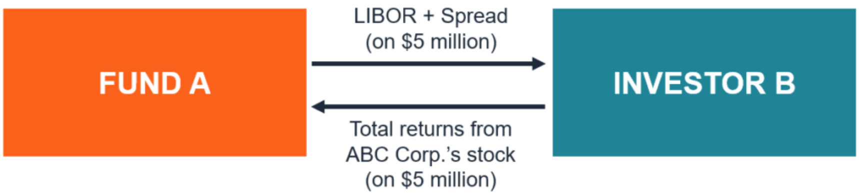
8. Commodity Swap: A contract in which counterparties agree to exchange payments related to indices, at least one of is a commodity index. Commodity options are useful risk management tools, particularly for the small stakeholders, as the option buyer does not generally have to maintain margins. They are akin to price insurance for the hedgers which can be bought by paying only a one-time option premium.

9.Currency Swap: A currency swap involves the exchange of an interest in one currency for the same in another currency. Currency optionsA currency option (also known as a forex option) is a contract that gives the buyer the right, but not the obligation, to buy or sell a certain currency at a specified exchange rate on or before a specified date. For this right, a premium is paid to the seller.

10.Delta & Gamma: Although Delta Gamma has no official jewel, the fraternity recognizes the anchor as its official symbol and bronze, pink, and blue as its official colors. The official flower is the cream-colored rose, registered as the Delta Gamma Cream Rose with the American Rose Society. This is the only sorority flower registered as such. The Hannah Doll is their mascot.[6][2]

The badge of Delta Gamma is a golden anchor and may be worn only by initiated members.[11] Before the adoption of the golden anchor, the symbol of Delta Gamma was simply an "H" for the word "Hope". In 1877,

11.Equity Swap: A contract in which counterparties agree to exchange payments related to indices, at least one of which is an equity index. An equity swap contract is a derivative contract between two parties that involves the exchange of one stream (leg) of equity-based cash flows linked to the performance of a stock or an equity index with another stream (leg) of fixed-income cash flows.



In equity swap contracts, the cash flows are based on a predetermined notional amount. However, unlike currency swaps, equity swaps do not imply the exchange of principal amounts. The exchange of cash flows occurs on fixed dates.

12. What Is a European Option?
A European option is a version of an options contract that limits execution to its expiration date. In other words, if the underlying security such as a stock has moved in price, an investor would not be able to exercise the option early and take delivery of or sell the shares. Instead, the call or put action will only take place on the date of option maturity.

Another version of the options contract is the American option, which can be exercised any time up to and including the date of expiration. The names of these two versions should not be confused with the geographic location as the name only signifies the right of execution.

13. What Is a Hedge Fund?
A hedge fund is a limited partnership of private investors whose money is managed by professional fund managers who use a wide range of strategies, including leveraging or trading of non-traditional assets, to earn above-average investment returns.

Hedge fund investment is often considered a risky alternative investment choice and usually requires a high minimum investment or net worth, often targeting wealthy clients.

14. Types of Money Spot: In-The-Money Spot: An option with positive intrinsic value with respect to the current market spot rate.

In-The-Money-Forward: An option with positive intrinsic value with respect to the current market forward rate.

15.Option: The right but not the obligation to buy (sell) some underlying cash instrument at a specific rate on a particular expiration date.The cost associated with a derivative contract, referring to the combination of intrinsic value and time value.

16. Put Option: A put option is a financial contract giving the owner the right but not the obligation to sell a particular amount of the underlying financial instrument at a pre-set price.

17. What is Spot Price

The spot price is the current price in the marketplace at which a given asset—such as a security, commodity, or currency—can be bought or sold for immediate delivery. While spot prices are specific to both time and place, in a global economy the spot price of most securities or commodities tends to be fairly uniform worldwide when accounting for exchange rates. In contrast to the spot price, a futures price is an agreed upon price for future delivery of the asset.

18.What is Strike Price?

In the derivative market strike price is a common terminology and the meaning of strike price is known to all the investors. The strike price is the future set price at which the derivative contract is to be traded on a pre-decided date. There are two types of options contracts mainly call and put options. In the call options, the strike price is referred to the cost at which the asset is bought. While for put options, the strike price is the cost at which the asset is sold.

19. CORRELTIONS: The act of taking advantage of differences in price between markets. For example, if a stock is quoted on two different equity markets, there is the possibility of arbitrage if the quoted price (adjusted for institutional idiosyncrasies) in one market differs from the quoted price in the other. The term has been extended to refer to speculators who take positions on the correlation between two different types of instrument, assuming stability to the correlation patterns. Many funds have discovered that correlation is not as stable as it is assumed to be.

20. Average Rate Options

An option whose payout at expiry is determined by the difference between its strike and a calculated average market rate where the period, frequency and source of observation for the calculation of the average market rate are specified at the inception of the contract. These options are cash settled, typically.

21. Average Strike Options

An option whose payout at expiry is determined by the difference between the prevailing cash spot rate at expiry and its strike, deemed to be equal to a calculated average market rate where the period, frequency and source of observation for the calculation of the average market rate are specified at the inception of the contract. These options are cash settled, typically.

22. Cash Settlement

Some derivatives contracts are settled at maturity (or before maturity at closeout) by an exchange of cash from the party who is out-of-the-money to the party who is in-the-money.

23. Commodity Swap

A contract in which counterparties agree to exchange payments related to indices, at least one of which (and possibly both of which) is a commodity index. A commodity swap is a type of derivative contract where two parties agree to exchange cash flows dependent on the price of an underlying commodity. A commodity swap is usually used to hedge against price swings in the market for a commodity, such as oil and livestock.

24. Credit Risk

Credit risk is the risk of loss from a counterparty in default or from a pejorative change in the credit status of a counterparty that causes the value of their obligations to decrease.

25. Currency Swap (see also Interest Rate Swap)

An exchange of interest rate payments in different currencies on a pre-set notional amount and in reference to pre-determined interest rate indices in which the notional amounts are exchanged at inception of the contract and then re-exchanged at the termination of the contract at pre-set exchange rates.

26. Equity Swap (see also Interest Rate Swap)

A contract in which counterparties agree to exchange payments related to indices, at least one of which (and possibly both of which) is an equity index. . Examples include forward foreign exchange contracts in which one party is obligated to buy foreign exchange from another party at a fixed rate for delivery on a pre-set date. Off-market forward contracts are used often in structured combinations, with the value on the forward contract offsetting the value of the other instrument(s).

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27. European Style Option

An option that can be exercised only at expiry as opposed to an American Style option that can be exercised at any time from inception of the contract. European Style option contracts can be closed out early, mimicking the early exercise property of American style options in most cases.

28. Exercise Price (see also Strike Price)

The exercise price is the price at which a call’s (put’s) buyer can buy (or sell) the underlying instrument. Financial instruments listed on exchanges such as the Chicago Board of Trade.

29. Exotic Derivatives A derivative is a contract between two parties which derives its value/price from an underlying asset. The most common types of derivatives are futures, options, forwards and swaps.

Any derivative contract that is not a plain vanilla contract. Examples include barrier options, average rate and average strike options, lookback options, chooser options, etc.

30. Forward Contracts

An over-the-counter obligation to buy or sell a financial instrument or to make a payment at some point in the future, the details of which were settled privately between the two counterparties. Forward contracts generally are arranged to have zero mark-to-market value at inception, although they may be off-market. Examples include forward foreign exchange contracts in which one party is obligated to buy foreign exchange from another party at a fixed rate for delivery on a pre-set date. Off-market forward contracts are used often in structured combinations, with the value on the forward contract offsetting the value of the other instrument(s).

31. Forward or Delayed Start Swap (see also Interest Rate Swap)

Any swap contract with a start that is later than the standard terms. This means that calculation of the cash flows does not begin straightaway but at some pre-determined start date.

32. Forward Rate Agreements (FRAs) (see also Interest Rate Swap)

A forward rate agreement is a cash-settled obligation on interest rates for a pre-set period on a pre-set interest rate index with a forward start date. A 3×6 FRA on US dollar LIBOR (the London Interbank Offered Rate) is a contract between two parties obliging one to pay the other the difference between the FRA rate and the actual LIBOR rate observed for that period. An Interest Rate Swap is a strip of FRAs.

33. Futures Contracts

An exchange-traded obligation to buy or sell a financial instrument or to make a payment at one of the exchange’s fixed delivery dates, the details of which are transparent publicly on the trading floor and for which contract settlement takes place through the exchange’s clearinghouse.

34. Hedge

A transaction that offsets an exposure to fluctuations in financial prices of some other contract or business risk. It may consist of cash instruments or derivatives.

35. Historical Volatility

A measure of the actual volatility (a statistical measure of dispersion) observed in the marketplace.

36. Hybrid Security

Any security that includes more than one component. For example, a hybrid security might be a fixed income note that includes a foreign exchange option or a commodity price option.

37. Implied Volatility

Option pricing models rely upon an assumption of future volatility as well as the spot price, interest rates, the expiry date, the delivery date, the strike, etc. If we are given simultaneously all of the parameters necessary for determining the option price except for volatility and the option price in the marketplace, we can back out mathematically the volatility corresponding to that price and those parameters. This is the implied volatility.

38. In-The-Money Spot (see also Intrinsic Value; At-The-Money; Out-of-The-Money)

An option with positive intrinsic value with respect to the prevailing market spot rate. If the option were to mature immediately, the option holder would exercise it in order to capture its economic value. For a call price to have intrinsic value, the strike must be less than the spot price. For a put price to have intrinsic value, the strike must be greater than the spot price.

39. In-The-Money-Forward (see also Intrinsic Value; At-The-Money; Out-of-The-Money)

An option with positive intrinsic value with respect to the prevailing market forward rate. If the option were to mature immediately, the option holder would exercise it in order to capture its economic value. For a call price to have intrinsic value, the strike must be less than the spot price. For a put price to have intrinsic value, the strike must be greater than the spot price.

40. Index-Amortizing Swaps (see also Interest Rate Swaps; Accreting Swaps)

An interest rate swap in which the notional amount for the purposes of calculating cash flows decreases over the life of the contract in a pre-specified manner.

41. Interest Rate Swap (see also Forward Rate Agreements; Index-Amortizing Swaps; Accreting Swaps)

An exchange of cash flows based upon different interest rate indices denominated in the same currency on a pre-set notional amount with a pre-determined schedule of payments and calculations. Usually, one counterparty will received fixed flows in exchange for making floating payments.

42. International Swaps Dealers' Association (ISDA) Agreements (see also Legal Risk)

In order to minimize the legal risks of transacting with one another, counterparties will establish master legal agreements and sidebar product schedules to govern formally all derivatives transactions into which they may enter with one another.

43. Intrinsic Value

The economic value of a financial contract, as distinct from the contract's time value. One way to think of the intrinsic value of the financial contract is to calculate its value if it were a forward contract with the same delivery date. If the contract is an option, its intrinsic value cannot be less than zero.

44. Knock-out Option

An option the existence of which is conditional upon a pre-set trigger price trading before the option's designated maturity. The option is deemed to exist unless the trigger price is touched before maturity.

45. Liquidity Risk

The risk that a financial market entity will not be able to find a price (or a price within a reasonable tolerance in terms of the deviation from prevailing or expected prices) for one or more of its financial contracts in the secondary market. Consider the case of a counterparty who buys a complex option on European interest rates. He is exposed to liquidity risk because of the possibility that he cannot find anyone to make him a price in the secondary market and because of the possibility that the price he obtains is very much against him and the theoretical price for the product.

46. Look-Back Options

An option which gives the owner the right to buy (sell) at the lowest (highest) price that traded in the underlying from the inception of the contract to its maturity, i.e. the most favourable price that traded over the lifetime of the contract.

47. Market-Maker

A participant in the financial markets who guarantees to make simultaneously a bid and an offer for a financial contract with a pre-set bid/offer spread (or a schedule of spreads corresponding to different market conditions) up to a pre-determined maximum contract amount..

48. Over-the-Counter

Any transaction that takes place between two counterparties and does not involve an exchange is said to be an over-the-counter transaction.

49. Put-Call Parity Theorem

A long position in a put combined with a long position in the underlying forward instrument, both of which have the same delivery date has the same behavioral properties as a long position in a call for the same delivery date. This can be varied for short positions, etc.

50. RiskMetrics (see also Value-at-Risk)

A parametric methodology for calculating Value-at-Risk using data conditioned by JP Morgan’s spinoff company RiskMetrics that is most useful for assessing portfolios with linear risks.

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51. Strike Price

The price at which the holder of a derivative contract exercises his right if it is economic to do so at the appropriate point in time as delineated in the financial product’s contract.

52. Value at Risk or VaR (see also RiskMetrics)

The calculated value of the maximum expected loss for a given portfolio over a defined time horizon (typically one day) and for a pre-set statistical confidence interval, under normal market conditions

53. Spot Contract: A spot contract is a contract for immediate delivery. Since derivatives, by definition include delivery at a future date, spot contracts usually do not form part of the derivatives market. However, they do form the basis for the pricing of futures, forwards and options. If a certain financial asset is being sold for X amount in the spot market and the future expectations are known, then the price of the derivative can be derived.
54. Expiration: Derivatives are time bound financial instruments. This means that they come with an expiration date. They have intrinsic worth only up till that date and post that date they are worthless. Expiration date is a term usually used when we refer to options in particular. When we talk about forwards, swaps or futures, the expiration date is replaced by the settlement date. However, the idea remains the same. Expiration date is when the contract is finally unwound and the profits and losses due become a reality. Simply put that is the end of the agreement.
55. Intermediation

The exchange traded derivatives provide another major advantage. In case of exchange traded derivatives, neither party is directly facing a counterparty risk. This is because neither party is actually directly dealing with the other party. Let’s say, A enters into a contract with the exchange wherein exchange goes short and A goes long. The exchange will simultaneously enter into another contract with B wherein the exchange takes an offsetting position i.e. goes long.

56. What is Margin Trading ?

Margin trading, at its core is a risk management procedure. Since most of the contracts pertaining to exchange traded derivatives are highly leveraged, a margin procedure is required. It allows the investor to borrow money from the market and invest this borrowed money. Even though the derivatives market is highly speculative, the safety of the principal and interest of the borrowed money is guaranteed via margin trading.

At first, the buyer i.e. the borrower puts up a small fraction of their own money. This is called an initial margin. Then, as the market prices move concepts like margin call and revaluation margin come into picture. Let’s have a closer look at them in this article.

67.Initial Margin

The initial margin is like a down payment on a loan. Just like when we buy a house we need to put a certain amount of money down, similarly in case of exchange traded derivatives we need to put a certain amount of money in the form of an initial margin.

Let’s say that a person wants to buy a contract worth $1000. However, they only have $100. In this case, they can begin the trade using their own $100 as initial margin and borrowing the rest of the $900 from the broker. The broker lends this money at a certain interest rate. The interest on this money is calculated on a daily basis and is calculated till the borrower returns the entire amount in full. Also, it needs to be understood that not all borrowers are allowed to lend money to buyers. There are certain approved brokers that are authorized to do so because these approved brokers in turn maintain margin accounts with the exchange. Hence, the initial margin basically acts as collateral. It can be used to offset any losses from any adverse price movements by the lender.

57. Currency Related

Derivatives contracts pertaining to currencies are also commonly listed on many exchanges for trading. Thus investors can go long or short on these currency pairs. The over the counter market provides a wide range of contracts that can negotiated as and when needed. Contrary to this, the exchange traded derivatives market only provides a few popular currency pairs that are listed. Since the contracts are standardized and liquidity is a concern, the index offers standardized contracts on for a few pairs of currencies which are highly traded.

For instance, the National Stock Exchange in India offers exchange traded derivatives on only four pairs of currencies which are:

Indian Rupee and United States Dollar
Indian Rupee and Euro
Indian Rupee and Great Britain Pound
Indian Rupee and Japanese Yen

68.Hedge Funds as Entrepreneurial Ventures

Many traders who were working for banks and mutual funds realized that they could realize their entrepreneurial dream via the hedge fund route. This led to the proliferation of hedge funds in the market. After making a name for themselves as a trader, most managers would quit their job and launch their own fund.

The amount they received as salaries at these corporations was replaced by an annual management fee. Also, the bonuses that they received at these corporations were replaced by an incentive fee. Traders who were confident in their ability to manage investments and profit from them had no reason to stick to a job. This is when the idea of hedge funds really caught on.

69.Hurdle Rate

Many investors feel that it would be inappropriate for the hedge funds to charge an incentive fee on any and every return that they generate. For instance if the fund generates a 3% return and the management charge a 20% incentive fee on that, it would be unfair.

A low rate like 3% can be generated by investing in a risk free security like treasury bonds as well. This kind of dismal performance should not be rewarded.

Therefore, these funds follow the concept of a hurdle rate. This rate is the minimum benchmark which is expected from the fund. Performance above this benchmark is rewarded with an incentive fee. However, performance up to this level is ignored. For instance, if 3% is the hurdle rate and the fund generates 8% return. In this case, the incentive fee would be charged on the additional 5% only and not the entire 8%.

70. Surrender Fee

Hedge funds provide investors with an opportunity to divest their money whenever they feel that the fund is not doing well. Such meetings are usually held monthly. However, if one investor decided to pull out his/her money, the interests of the other investors are affected too.

For instance, there are transaction costs incurred while liquidating the money. Also, the total budget is reduced and hence the investment strategy has to be modified. To recover these costs as well as to deter the investors from withdrawing their money, a surrender fee is charged to the client. However, many funds that are very confident about their performance usually do not charge such a fee.

71. What are the differences between trade with commodity futures and the cash markets?
In cash market trading (eg. B. the sale of potatoes from the farmer to the detection traders) are transactions between two parties with the effective accomplishment based. The actual exchange of goods is therefore the main motivation to be active in the spot market. The term includes both spot trading (timely fulfillment) as well as the forward trading (subsequent fulfillment) with goods. The prices obtained are called spot market prices. A key differentiator between the cash market and the futures market is that the actual exchange of goods in commodity futures transactions neither intentional and eg in potato futures at Eurex in Frankfurt also not possible. The futures market is a parallel market to the spot market and can therefore be used to hedge price risks, as well as for speculative purposes.
Furthermore, the operations can be differentiated by

- their trade object (individual versus standardized specification)
- the type of business transaction (Physical delivery of potatoes versus trading with a derivative)
- the organizational form of the associated market (clearing).

72. What is the general definition of a commodity futures contract (futures)?
Commodity futures contracts (futures) are

- legally binding agreements,
- a well-defined performance
- to perform at a specified time in the future.

73. How are futures designed and what is standardization for?
An essential feature of commodity futures contracts is their mutual acceptability. The price-determining parameters

- amount
- quality
- Compliance period and possibly
- Place of Performance

are not individually negotiated between buyer and seller, but are in the Future specifications accurately determined (eg. B. 25 tons processing potatoes from production site in Germany, the Netherlands, Belgium and France, loose loaded on the means of transport by the buyer). This exact normalization is called standardization. It does not mean that you can only participate in the futures trading, if the actually traded commodity (eg. B. purchased on the spot market potatoes) corresponds exactly to the specifications. On the contrary, you can also participate in the commodity futures trading when trading different goods in the spot market, or buy any goods or wants to sell.
74. Where are commodity futures contracts traded?
Commodity futures contracts are traded on commodity futures exchanges. Exchanges are highly organized market events are strictly defined in terms of the place, the time, the market participants and with the sequence. Because of modern communication technologies, these are in many cases to computer exchanges. Supply and demand flow together here over an electronic network and are bundled into a central computer. Consequently, you can participate from anywhere in trading.

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75 .Who can trade on commodity futures exchanges?
Theoretically, anyone can participate in commodity futures trading. There are, however, to meet certain requirements, which may differ across exchanges. The personal requirements as well as play at the opening of a securities account the experience, the objective and the financial situation of the applicant a role. These aspects also determine the extent to which the relevant

market participant may act. The technical prerequisites an account with a clearing bank and connected a contractual agreement are to lead to a connected broker.

76. What happens exactly during trade on commodity futures exchanges?

All exchanges have in common that the orders converge at a central location (trading floor or central computer). With regard to the order entry but there are differences. So-called proprietary traders (individuals acting on their own behalf) may enter orders directly into the electronic trading system or have on stock exchanges a seat. For all other market participants entering orders to the commandments orally, by telephone, by fax via a broker, be transmitted or via computer. In exchanges with electronic trading system, the incoming requests are stored and executed in the appropriate order situation. In floor trading, the broker takes care locally to an execution of the order.

77. When will an order be executed?

Since commodity futures contracts all price-determining parameters are normalized, the execution depends largely on whether another market participant is willing to offer (demand) contracts to purchase at a desired price (sell). In addition, it is relevant that order type of market participant has chosen. Suppose a trader wants to capture 20 contracts potatoes well sell, then this job could (usually called market order) are carried out in good order situation immediately to a uniform price. It would also be conceivable, the ten contracts for at best and ten contracts are traded for zweitbestmöglichen price. In a small market depth could occur due to lack of buying interest corresponding to a partial execution. Then a limit order in which z., 15 contracts were traded immediately and the other five were initially available at a limited rate in the system is recommended. Such partial execution could also be used with an all-or-nothing order prevented. Probably the most common order type is the limit order. You will only be executed if the stock price is above (sell order) or below (purchase order) the limit is reached or this.

78. What do the terms money (bid) and letter (ask) mean?

The purchase and sales readiness is expressed by the bid and ask prices. When the bid price (bid) is called the rate (price), is willing to pay a buyer for the Future and the moment there is no offer. Under the ask price (ask) refers to the course that requires a salesperson for the Future. Suppose the equilibrium price of a potato contract would be at 20, then the order book (order book) might look like this:

- Number (volume)
- Money (bid)
- Letter (ask)
- Number (volume)

The number of columns it can be seen how many contracts offered at the applicable rate (ask) or demand (bid) are. In the example, stood 5 contracts at a rate of 20.1 for sale. The number of requested contracts at a price of 19.9 cheating 20 The difference between these best rates (the highest bid to buy and the lowest offer to sell) is called the bid-ask spread - here 0.2. A stock market is all the more powerful, the narrower the bid-ask spread and the higher the market depth (market depth) is. A market is described as deep, when sufficient orders, which are staggered close to the equilibrium price and also in the depth (in the example, there are 20 Bids 19.9. Were only two, would be the market depth is lower. It).

79. What is meant by opening (price), high, low and closing (price)?

The terms are used in a session for each contract pursuant to the above order for the opening, the highest, the lowest and the closing price. According to the Name is the opening price (closing price), the price of the first (last) trade accounts one day and the maximum price (lowest price), the price of the highest (lowest) trading accounts at the time of the inspection.

80. Do closing and settlement prices differ?

The closing price of the trading day, the price of the last trade accounts. With settlement price of the valuation price is referred to, is significant to the daily profit and loss calculation. It may correspond to the closing price, but is also often calculated from the last sales a day.

81. Who the respective contract partner who takes on the opposite position?

If a contract is sold, is not another stock exchange customer contract partner of the seller, but between the two market participants a clearinghouse is connected. The counter position for all contract purchases and sales is taken from this clearinghouse (Clearing Bank). They are all stock brokers performance guarantee. Therefore, the parties have to fear no default risk. In addition, the anonymity of trading is guaranteed by the clearing house.

82. What are the financial requirements related to creating an opening position?

If contracts are traded and opened in accordance with futures positions, are buyer and the seller to pay the commission and to deposit collateral. With the commissions involved in trading institutions / companies are paid (broker, exchange, clearing house of the stock exchange, clearing bank, and a guarantee fund) for their services. The amount of the guarantee also initial margin, margin, Origin or initial margin called depends on the current price level, the current and / or historical price volatility and the creditworthiness of the dealer. She is usually only a fraction of the contract value and will cover the loss of value that can be sustained per contract within a specified period. An impairment loss occurs when the contract price to the detriment of the position holder changes (either by sale or price increase declining price of purchase). The initial margin described are an integral part of a security system that guarantees the fulfillment of the transactions on exchanges.

83. What do the terms long and short mean?

In commodity futures trading, the holders of long positions as long (in the future) and the positions are referred to as long positions. Analogously, holders of short positions (short positions) short (in the future). The terms can be used also for the trade of physical goods. In this case, farmers producing potatoes or already have in stock and sell them later want as long referred to in the goods. In the cash market are short as Potato processors who have not sold yet produced goods. Therefore, it is advisable to buy futures and hedge against the risk of rising prices, because they are the product eg Processing potatoes not yet possess.

84. What is understood by the daily loss and profit calculations?

From the moment of opening position a profit and loss calculation (mark-to-market method) performed for each purchase and each sale position. An operator has contracts sold (purchased), the growth in value is his account when prices are falling (loss of value) credited the positions (loaded). When prices rise, however, the buyer will receive a credit, while the seller's account is debited. The recorded changes in value are called variation margin. The price changes constantly, to the detriment of the position holder, his account is debited again and again. It has a shortfall on, the position holder will receive a margin call (Margin Call).

85. What is a closeout?

By standardizing the contracts long or short positions may be opened when the corresponding order situation at any time. At the same time, the standardization also allows the reverse process, the closing of positions prior to the maturity of a contract. Since the conclusion and fulfillment of the commodity futures trading - unlike the spot trading on the cash market (eg the delivery of the harvest.) - Time often far apart and contractors is always the accounting office of the Exchange, the commitments made by an offsetting transaction can in the meantime discard again. Experience has shown that even make almost all market participants from the "Closing" mentioned process use. This requires a seller (buyer) prior to maturity contracts according to the number of its open positions to buy (sell) and thus solves its market positions.

86. What does the term Open Interest (OI = Open Interest or Open Positions = OP) mean?

The Open Interest the number of open futures positions is called. If a contract is traded, the trading volume is 1 and the number of open positions is also 1 (a buy and a sell position so together yield the open interest of 1 Represents the seller's position plain, in which he buys and other market participants sold , sales increased to 2, while the open interest remains the same, for now is only one other market participants holder of the short position. since the number of open long positions always corresponds to the open short positions, be either purchased or contracts sold counted.

87. Which obligations have to be fulfilled after the last trading day?

If after the last trading still positions open, so do not close out to date, the holders of open short positions (long) positions in futures must provide with physical settlement a precisely defined quantity and quality of a particular base material of the / those provided for in the specifications place / places (remove and pay). In contrast, are settled (usually price index) for futures with cash settlement (cash settlement) any items that are still open after the last trading day, against a reference price. Since the income balance by this time already held daily, now only the credit or debit of the last day difference occurs at the index to the accounts of participants. The physical so actual delivery is excluded in this process, as satisfying the performance obligation.

88. Which functions do commodity futures exchanges fulfill?

On commodity futures exchanges in the world by numerous market participants and proven capabilities can benefit. These are based on the previously outlined features of commodity futures trading and can be divided into individual companies and macroeconomic functions.

Functions of single operational point of view:

- Information improvement (price transparency / -leitfunktion)
- Risk reduction (price and reliable costing)
- Help raise capital (improving quality)
- Investment opportunity (speculation)

Functions from a macroeconomic point of view:

- Compensation of temporal or spatial imbalances
- promoting competition

89. What do commodity futures exchanges contribute to improve information and what is meant in this context by the price control function?

On stock exchanges the market assessments of many market participants come together in a concise form. The available information is priced into the individual contracts / futures prices. Since these are published by data provider, the Internet and in print media, commodity futures exchanges are suitable to increase market transparency and to homogenize the information level. From a price guide function is called in this context, because the contract prices ideally reflect future market conditions reliably, so that they can be used by companies in the agri-food sector as the basis of their production and marketing decisions. Also, the Future prices can as a reference price for spot or forward transactions in the cash market (EFP - see below: point 24) are used. Anyone can benefit from the advantages of information improvement, without engaging yourself in the stock market. The price transparency thus makes a significant contribution to promoting competition.

90. Which market participants are there in the commodity futures exchange environment and which goals do they pursue?

The market participants in commodity futures markets are generally divided into four groups (hedgers, speculators, arbitrageurs and spread traders). All of them, transactions can be traced back to the motives of risk management and profit, with their weighting of participants is different participants.

91. Hedger: The Hedger market participants are called, opening the stock market positions to hedge against price changes in the goods they want to buy or sell on the spot market in the future. The items are usually resolved at the time the goods flow again. Therefore, such as hedge () business called price protection as a temporary substitution of the existing or expected cash transaction be considered: Someone who continue to sell goods (purchase) would like to

sell (buy) this early on in the stock market and later liquidated its first incoming performance obligation. Consequently, a hedger always acts both on the spot market and the commodity futures market. Have hedge transactions to the target that caused the cash market losses are largely offset by increases in value of the stock market positions due to price changes and the hedger thus early pricing and costing accuracy attained (barter).

92.Speculators: Speculators are market participants who take the price / price change risk consciously accepted, because they expect them to profit opportunities. Speculators sell (buy) futures, when they expect falling (rising) prices and speculate on being able to close out this later at a lower (higher) price. Accordingly, they usually have no interest in the possession of the goods and are active almost exclusively in the stock market. Speculators are among the group of people who take the risk of hedgers. With the liquidity provided you provide them thus make an important contribution to the functionality of the market.

93.Arbitrageurs: arbitrageurs seek to exploit temporal or spatial price differences between futures and cash commodity between Future and the simultaneous taking opposing positions in various markets profitably. Taking z. B. a potato dealer arbitrage between two potato futures of different specification front, he sells processing potatoes with the higher price and buy potatoes at the lower rate. The same applies to the arbitrage between futures and cash commodity: you buy eg the cheap goods and sell the more expensive Future. The arbitrage is dissolved from him by into two contracts he makes a compensating counter business later. Is the price difference shrunk over time or omitted, he has made a profit. Arbitrage transactions are less risky in which are used as purely speculative transactions on rising or falling prices. Through their transactions arbitrageurs same temporal and spatial imbalances and thus inevitably bring about a largely uniform pricing.

94.Spread Trader: A spread-trader has to use the target, one expected him to change a price difference between two futures (expansion or convergence) for a profit. Spread traders build offsetting positions on (buying and selling either in the same futures have different terms or in similar futures) and solve this at a later time again. Thus, there are similarities between spread betting and arbitrage. Since Spread traders but usually have no interest in the possession of the goods and their transactions are associated with a higher risk of spread trading can also be regarded as a special form of speculation.

95.Stock options

Stock options can be offered by companies as management incentives. These options give you the right (but not the obligation) to buy your employer’s stock at a pre-set price within a specified time period.

For example, if a manager helps boost the value of the company’s stock above the price of his or her option, the manager can buy the stock at the lower price and pocket the gain if they sell. But all shareholders benefit from the increased value of the stock.

96. Asset allocation

Spreading your investments between asset categories (stocks, bonds, cash or cash equivalents) may help minimize risk. That’s because investment categories respond to changing economic and political conditions in different ways. Just keep in mind that the use of asset allocation does not guarantee returns or insulate you from potential losses.

97. Balanced fund

A fund with an investment objective of both long-term growth and income, through investment in both stocks and bonds.

98. Collective investment fund (CIF)

Investments created by a bank or trust company for employee benefit plans, such as 401(k) plans. Also referred to as collective or commingled trusts, CIFs pool the assets of retirement plans for investment purposes. CIFs are governed by rules and regulations that apply to banks and trust companies instead of being registered with the SEC.

99. Company stock fund
A fund that invests primarily in employer securities that may also maintain a cash position for liquidity purposes.

UNIT-5

100. Credit risk
The risk that a bond issuer will default. In other words, not repay principal or interest to the investor, as promised. This is also known as default risk.

101. Who is BSE?
BSE has been highly responsible for the growth and development of Indian economy and the corporate sector as it has duly access to mechanism for fund raising.

102. Expand OTCEI
Over the Counter Exchange of India. The listing on an OTC markets confers the same rights to a corporation as they get from listing on any other regular stock exchange. The OTC market in India is known as OTCEI.

103. What is SEBI?
The Securities and Exchange Board of India was established by the government of India through an executive resolution and was subsequently upgraded as a fully autonomous body.

104. Who are brokers?
They transact the transactions for their clients and for other members. The brokers, who work for their clients are called 'commission brokers'.

105. Broker
A broker is a person who buys and sells investment on your behalf and, in exchange, takes a certain amount of money called commission or fee.

106. Sensex
Sensex is a figure that indicates all the relative share prices that are listed on the Bombay Stock Exchange.

107. Nifty
The Nifty 50 Index, called the National Stock Exchange of India, is the primary and brad based stock market index for the equity market of India.
The Nifty 50 consists of 50 Indian company stocks in 12 different sectors, and it is one out of two stock indices that are mainly used in the stock market

108. Absolute Returns
Absolute Return is simply the rate of return on an investment attained over a specific period. It basically measures the gain earned, and loss suffered expressed as a percentage over the initial investment over a particular period.

109. Internal Rate of Return
Internal Rate of Return is the rate at which the future cash flows are discounted to arrive at the net present value of 0. The Internal rate of returns assumes that the cash flows are periodic increments to an investment. It is an important metric to estimate the profitability of potential investments.

110. Index
Stock Market Index typically tracks the aggregated movement in the prices of all the shares listed in the stock market as compared to the previous day prices to determine the market performance. It may also track the cumulative movement in the prices compared to the past prices of a hypothetical portfolio of a basket of securities belonging to a particular industry or collated and grouped based on market capitalisation. It serves as an indicator of changes in the

stock market. The index serves as a benchmark for evaluating the active returns of a portfolio. It serves as a reference against which to assess the performance of a portfolio.

111.Which are the indicators of weak form of market?

- Simulation test
- Filter test
- Serial correlation test
- Runs test
- Spectral analysis

112.What is efficient market theory?

This theory attempts to explain the changes in security prices according to this hypothesis , the stock price reflects the impact of all the information available. It also suggests that the financial markets are efficient

113. Diversifiable Risk : This risk is Company Specific or Non Systematic and is connected with the random events of respective company whose stocks are being purchased. Diversification can reduce diversifiable risk. The good random events influencing one stock will be cancel out by the bad random events that influence another stock of the portfolio.

114. Inflation risk : Stocks, bonds and cash are all subject to the risk that one's investment will not keep pace with inflation. This risk can be mitigated by investing in inflationprotected Treasury bonds.

115. Difference between Systematic and Unsystematic Risk No. Basis Systematic Risk Unsystematic Risk 1. Meaning Systematic risk refers to the hazard which is associated with the market or market segment as a whole. Unsystematic risk refers to the risk associated with a particular security, company or industry. 2. Nature Uncontrollable Controllable 3. Factors External Factors Internal Factors 4. Affects Large number of securities in the Only particular company.

116.Modern Portfolio Management : There are differences between Traditional and Modern Security Analysis. In traditional form of security analysis greater emphasis is placed on analyzing risk return relationship and in modern security analysis the intrinsic (Central) value is given more significance. Another point of difference is the effect of personal needs, desires and wants forming the basis of portfolio selection but in modern security analysis, greater emphasis is laid on scientific approach to security analysis in terms of estimating risk and return of portfolio and the risk return trade off estimated by the investors

117. What do you meant by Beta?

The beta is used to measure the non-diversifiable risk which is also known as systematic risk. It explains the way in which the security price will be affected due to the change in market price.

118. Define the term mutual funds.

Corporations which accept dollars from savers and then use this dollars to by stock,
long term bonds, short term debt instrument issued by business units, these corporations pool funds and thus reduce risk by diversification.

119.Write the benefits of the mutual funds.

- Transparency
- Diversification
- Research
- Stability
- Tax benefits

120.Define CAPM

- The capital asset pricing model, or CAPM, is a special model that's used in finance to calculate

the relationship between expected dividends as well as the risk of investing in specific equity. The CAPM model is used to determine the expected returns for a security. This can be compared with the risk-free returns and the addition of a beta.
To properly assess the capital asset pricing model, it is necessary to understand both systematic and unsystematic risk. Systematic risks are all general dangers that are involved in the investment of any type. There are many risks that could occur, such as inflation, wars, and recessions. These are just a few examples of systematic risk.
On the other hand, unsystematic risks refer to specific risks associated with investing in particular stocks or equity. Unsystematic risks, on the other hand, are not considered to be threats and are generally shared by the market.
CAPM focuses on systematic risks in securities and can thus predict whether certain investments will fail.

121. Consumer Price Index (CPI)

A measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

122. Credit Report

A summary of your credit activity and current credit situation such as loan paying history and the status of your credit accounts. Lenders use these reports to help them decide if they will loan you money and what interest rates they will offer you. Other businesses might use your credit reports to determine whether to offer you insurance; rent a house or apartment to you; or provide you with cable TV, Internet, utility, or cell phone service. If you agree to let an employer look at your credit report, it may also be used to make employment decisions about you.

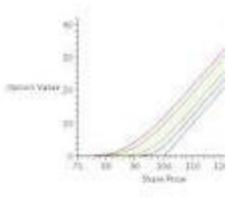
123. Unearned income

Income people receive even if they don’t work for pay. Can include things like children’s allowances, stock dividends paid by corporations, and financial gifts.

124. Unsecured loan

A loan (such as most types of credit cards) that does not use property as collateral. Lenders consider these loans to be more risky than secured loans, so they may charge a higher rate of interest for them. If the loan is not paid back as agreed, the lender can also start debt collection, file negative information on your credit report, and might sue you.

125.How do you solve Black-Scholes model?



$V(S, t) = K v(x, \tau)$. Remember, σ is the volatility, r is the interest rate on a risk-free bond, and K is the strike price. In the changes of variables above, the choice for t reverses the sense of time, changing the problem from backward parabolic to forward parabolic.