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# *"A Comparative Study of Equity and Derivative market"*

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***Abstract***

*The research paper is about the comparative study on derivative and equity market. The major study of the research paper is to compare trading in derivative with equity cash segment. The methodology of the study here is to analyze the scrips in Equity & Derivative market and analyze the performance based on its return, risk reward ratio and other factors.*

*The aim of the research paper is to analyze the investment opportunities available for the investors & study the returns & risk involved in various investment opportunities. The basic rule of investment is high risk, high return, but this is applicable only when one invests for a long term purpose in Equity market. While in derivative there is a high risk, high return in the short term, because derivative contract is for short time period of 1, 2 and 3 months only. So, this research paper aims in understanding which avenue is more beneficial for investors to trade in, either equity or derivate market considering the risk reward ratio and the returns earned.*

***Keywords:*** *Equity, Derivative, Investment, Risk, Return*

## INTRODUCTION

What is Equity Market?

A stock market or equity market is the aggregation of buyers and sellers (a loose network of economic transactions, not a physical facility or discrete entity) of stocks (also called shares); these may include securities listed on a stock exchange as well as those only traded privately


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**What is Derivative Market?**

The term 'Derivative' stands for contract whose price is derived from or is dependent upon an underlying asset. The underlying asset could be a financial asset such as currency, stock and market index, an interest bearing security or a physical commodity.

The derivatives market is the financial market for derivatives, financial instruments like futures contracts or options, which are derived from other forms of assets. The market can be divided into two, that for exchange-traded derivatives and that for over-the-counter derivatives. The legal nature of these products is very different, as well as the way they are traded, though many market participants are active in both.

***Steps to calculate Risk Reward Ratio-***

1. Set stop loss and take profit orders.
2. Calculate Risk Reward Ratio by using below formula.

Risk/Reward ratio = Profit distance/Stop loss distance

What is Swing trading? -Swing trading is a speculative activity in financial markets where a tradable asset is held for between one to several days in an effort to profit from price changes or 'swings'. A style of trading that attempts to capture gains in a stock within one to four days is called swing. Swing traders use technical analysis to look for stocks with short-term price momentum. These traders aren't interested in the fundamental or intrinsic value of stocks, but rather in their price trends and patterns.

**OBJECTIVES**

**1)** To study the concept of equity market and derivative market.
**2)** To study the risk and reward ratio while trading in equity and derivative market.
**3)** To study the various trading strategies in equity and derivative market.
**4)** To identify different types of investors and trading strategies applicable to them.

**RESEARCH METHODOLOGY**

The secondary data is available already, which has been collected and analyzed through different sources. The secondary data is helpful in understanding about best performing companies over the past years. The secondary information is mostly taken from Newspapers, Moneycontrol.com, Reuters and different stock market related Magazines.


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**DATA ANALYSIS AND INTERPRETATION**

To study the difference in trading in equity and derivative market 5 scrips has been selected for the same. The price with scrip above Rs. 500 has been selected considering the fact that higher the price higher is the returns. The trading of five scrips in the month of June 2015 and July 2015 were been carried out.

The market was bullish on the trading day. If a trader buys 50 shares of Aditya Birla Nova at Rs.2200 per share in equity market, then he has to pay Rs.110000 to buy the script. If the script is sold at price say Rs.2227 then the profit earned will be Rs.1350.

If a trader buys one lot of the same scrip in future market on same date at Rs.2200 with a margin of Rs.41250 (15%) and if it is sold at its nearest high price Rs.2224 then profit that he will earn will be Rs.3000.

***Intra Day trading in the month of July***

***1) Aditya Birla Nova***

| EQUITY MARKET | Date | open | High | low | Close | OC | HC |
|---|---|---|---|---|---|---|---|
| ABIRLANUVO | 30-Jul-15 | 2196 | 2232 | 2179.00 | 2204.95 | -0.4075 | 1.211918 |

| FUTURE MARKET | Date | Lot size | Open | high | Low | Close | OC | HC |
|---|---|---|---|---|---|---|---|---|
| ABIRLANUVO | 30-Jul-15 | 125 | 2195.05 | 2229 | 2176.15 | 2207.2 | 0.5535 | 0.9780 |

***Risk and Reward Ratio***

| Scrip | Equity | Derivative |
|---|---|---|
| ABIRLA NUVO | 1:2.7 | 1:4.8 |


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The above table shows the risk and reward ratio, while trading in equity and derivative market. For calculating the risk and reward the stop loss and target prices are considered. In the first case, the stop loss is 10 points below entry price i.e Rs. 2190. For calculating reward, it is the difference between entry price and selling price i.e 27 points. In case of future trading, the stop loss is of 5 points i.e Rs. 2195 and the reward is the difference between entry price and selling price which is 24 points i.e Rs.2224.

***2) ACC***

| EQUITY MARKET | Date | open | High | low | close | OC | HC |
|---|---|---|---|---|---|---|---|
| ACC | 30-Jul-15 | 1379.7 | 1381.1 | 1360.15 | 1371.15 | 0.6197 | 0.72044 |

| FUTURE MARKET | Date | Lot size | open | High | low | close | OC | HC |
|---|---|---|---|---|---|---|---|---|
| ACC | 30-Jul-15 | 125 | 1383 | 1383 | 1360 | 1370.5 | 0.903832 | 0.90383 |

The market was bullish but the script was bearish.

If a trader short sells 50 shares of ACC at price of Rs.1384 per share in equity market then he has to pay Rs. 69200. If the script is bought nearest high price Rs.1377 then the profit earned will be Rs. 350.

If a trader short sells one lot of same scrip in future market at Rs.1384 and buys at the price Rs.1377 then profit that he will earn will be Rs.875.

***Risk and Reward Ratio***

| Scrip | Equity | Derivative |
|---|---|---|
| ACC | 1:0.7 | 1:1.4 |

The above table shows the risk and reward ratio while trading in equity and derivative market. For calculating the risk and reward the stop loss and target prices are considered. In


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the first case the stop loss is 10 points above entry price i.e. Rs. 1394. For calculating reward, it is the difference between entry price and buying price i.e.7 points. In case of future trading the stop loss is of 5 points i.e. Rs. 1389 and the reward is the difference between entry price and buying which is 7 points i.e. Rs. 1377.

### *3) Indiabulls Housing Finance*

| EQUITY MARKET | Date | open | high | Low | Close | OC | HC |
|---|---|---|---|---|---|---|---|
| IBULHSGFIN | 30-Jul-15 | 736.3 | 745.95 | 726.15 | 730.55 | 0.780932 | 2.064482 |

| FUTURE MARKET | Date | lot size | Open | High | Low | Close | OC | HC |
|---|---|---|---|---|---|---|---|---|
| IBULHSGFIN | 30-Jul-15 | 500 | 735.1 | 746 | 728 | 731.3 | 0.516936 | 1.9705 |

The market was bullish but the script was bearish.

If a trader short sells 50 shares of India Bulls Housing Finance at price of Rs.741 per share in equity market then he has to pay Rs.37050. If the scrip is bought at nearest high price Rs.730 then the profit earned will be Rs. 550.

If a trader short sells one lot of the same script in future market at Rs.740 and buys at the price Rs.730 then profit that he will earn will be Rs.5000.

### *Risk and Reward Ratio*

| Scrip | Equity | Derivative |
|---|---|---|
| IBULHSGFIN | 1:1.1 | 1:2 |

The above table shows the risk and reward ratio while trading in equity and derivative market. For calculating the risk and reward the stop loss and target prices are considered. In first case the stop loss is 10 points above entry price i.e. Rs. 751. For calculating reward, it is the difference between entry price and buying price i.e 11 points. In case of future trading the stop loss is of 5 points i.e. Rs. 745 and the reward is the difference between entry price and buying which is 10 points i.e. Rs. 730.


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***4) Wock pharma***

| EQUITY MARKET | Date | open | High | Low | close | OC | HC |
|---|---|---|---|---|---|---|---|
| WOCKPHARMA | 25-Jun-15 | 1438 | 1452.3 | 1414.00 | 1419.65 | 1.276078 | 2.248158 |

| FUTURE MARKET | Date | Lot size | open | high | low | Close | OC | HC |
|---|---|---|---|---|---|---|---|---|
| WOCKPHARMA | 25-Jun-15 | 125 | 1435.5 | 1451.75 | 1413.2 | 1419.4 | 1.12156 | 2.22834 |

The market was bullish but the script was bearish.

If a trader short sells 50 shares of Wockpharma at price of Rs.1442 per share in equity market then he has to pay Rs.72100. If the script is bought nearest price Rs.1420 then the profit earned will be Rs. 1100.

If a trader short sells one lot of same script in future market at Rs.1440 and buys at the price Rs.1420 then profit that he will earn will be Rs.2500.

***Risk and Reward Ratio***

| Scrip | Equity | Derivative |
|---|---|---|
| WOCKPHARMA | 1:2.2 | 1:4 |

The above table shows the risk and reward ratio while trading in equity and derivative market. For calculating the risk and reward the stop loss and target prices are considered. In first case the stop loss is 10 points above entry price i.e. Rs. 1452. For calculating reward, it's the difference between entry price and buying price i.e 22 points. In case of future trading the stop loss is of 5 points i.e. Rs. 1445 and the reward is the difference between entry price and buying which is 20 points i.e. Rs. 1420.

***Analysis of Risk and Reward for the Month of July***

| **Script** | **Equity** | **Derivative** | **Profit Earned In Equity** | **Profit Earned In Derivative** |
|---|---|---|---|---|
| ABIRLANUVO | 1:2.7 | 1:4.8 | 1350 | 3000 |
| ACC | 1:0.7 | 1:1.4 | 350 | 875 |
| IBULHSFIN | 1: 1.1 | 1:1.2 | 550 | 5000 |


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| | | | | |
|---|---|---|---|---|
| WOCKPHARMA | 1:2.2 | 1:4 | 1100 | 2500 |

The above table shows the risk and reward analysis between different stocks in equity and derivative trading. It can be seen that the risk taken through stop loss is same i.e. 10 points in case of equity. The ratio which is above 1:2 is said to be worth trading. It can be seen that almost three scripts in equity have not given profits as expected.

In case of derivative trading almost all the scripts except two have higher rewards with same risks. The profits earned are much higher as compared to equity trading.

It can be observed from the above that a trader if trades in futures will earn more profits due to lot size of each script. It can be seen that in derivative market a trader can even earn Rs.10, 200 in a day through one trade as against Rs. 950 in equity. Considering the brokerage and taxes on each trade the profit in equity will further reduce.

## SWING TRADING AS STRATEGY

In swing trading strategy a stock is held for few days up to a month and later squared off. For the purpose of study the same scrips have been considered but trading is done during the month of June 2015. In each of the examples, the holding period is of 8 days and then profit has been calculated.

**Example 1**

| EQUITY MARKET | Date | Buy price | Holding period | Sell price | Profit |
|---|---|---|---|---|---|
| ABIRLANUVO | 25-Jun-15 | Rs.1728 | 8 days | Rs.1927.05 | Rs.9952.5 |

| FUTURE MARKET | Date | Buy price | Holding period | Lot size | Sell price | Profit |
|---|---|---|---|---|---|---|
| ABIRLANUVO | 25-Jun-15 | Rs.1731 | 8 days | 125 | Rs.1926.90 | Rs.24487.5 |

**Example 2**

| EQUITY MARKET | Date | Buy price | Holding period | Sell price | Profit |
|---|---|---|---|---|---|
| ACC | 25-Jun-15 | Rs.1410 | 8 days | Rs. 1500.10 | Rs. 4505 |


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| FUTURE MARKET | Date | Buy price | Holding period | Lot size | Sell price | Profit |
|---|---|---|---|---|---|---|
| ACC | 25-Jun-15 | Rs.1410 | 8 days | 125 | Rs. 1500 | Rs. 11250 |

**Example 3**

| EQUITY MARKET | Date | Buy price | Holding period | Sell price | Profit |
|---|---|---|---|---|---|
| IBULHSFIN | 25-Jun-15 | Rs.605 | 8 days | Rs.654.25 | Rs.3462.5 |

| FUTURE MARKET | Date | Buy price | Holding period | Lot size | Sell price | Profit |
|---|---|---|---|---|---|---|
| IBULHSFIN | 25-Jun-15 | Rs.604 | 8 days | 500 | Rs.654.05 | Rs.25025 |

**Example 4**

| EQUITY MARKET | Date | Buy price | Holding period | Sell price | Profit |
|---|---|---|---|---|---|
| WOCKPHARMA | 25-Jun-15 | Rs.1440 | 8 days | Rs.1496.85 | Rs.2842.5 |

| FUTURE MARKET | Date | Buy price | Holding period | Lot size | Sell price | Profit |
|---|---|---|---|---|---|---|
| WOCKPHARMA | 25-Jun-15 | Rs.1440 | 8 days | 125 | Rs1496.95 | Rs.7118.75 |

***Trading Strategy for Different Types of Investors/Traders- Equity***

| Type of Investor | Initial Investment | Trading Strategy | | |
|---|---|---|---|---|
| | | Intra-day | Swing | Investment |
| Student | 5000-10000 | ✓ | ✓ | ✓ |
| Servicemen/women | 5000 to 50000 | ✓ | ✓ | ✓ |
| Servicemen/women | 50,000 to 100000 & above | ✓ | ✓ | ✓ |
| Businessmen/women | 5000 to 50000 | ✓ | ✓ | ✓ |
| Businessmen/women | 50,000 to 100000 & above | ✓ | ✓ | ✓ |


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It can be observed from the above table that there are different types of investors with different financial capacity to invest. Here 6 categories of investors are been identified along with the investment range in which they can invest considering their financial soundness. It can be observed that in equity market one any type of investor can do intraday, swing or investment in the market. Here the minimum investment required is Rs.5000 and maximum can be in lakhs. Here, there is no problem of margin money and lot size. Investors can even buy one share or even hundreds of share only if the margin balance prohibits it.

It can be observed from the above table that there are different types of investors with different financial capacity to invest. Here 6 categories of investors are been identified along with the investment range in which they can invest considering their financial soundness.

Here it is to be noted that the first kind of investor cannot trade in future market due to insufficient funds. The investor should trade only in equity market.

The second category of investor to some extent can do intraday trading but cannot trade in more than 1 lot that too with a margin amount less than Rs. 50,000. Here the investor should not do swing trading as it will block the amount for a week. Investment too is also not a good option for this investor.

***Future Trading (Derivative Market)***

| **Type of Investor** | **Initial Investment** | **Trading Strategy** | | |
|---|---|---|---|---|
| | | **Intra-day** | **Swing** | **Investment** |
| Student | 5000-10000 | × | × | × |
| Servicemen/women | 5000 to 50000 | ✓ | × | × |
| Servicemen/women | 50,000 to 100000 & above | ✓ | ✓ | ✓ |
| Businessmen/women | 5000 to 50000 | ✓ | × | × |
| Businessmen/women | 50,000 to 100000 & above | ✓ | ✓ | ✓ |


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The third category of investor has an ideal amount of money to invest. The investor can do intraday, swing as well as investment in future trading.

The fourth category of investor to some extent can do intraday trading,but cannot trade in more than 1 lot that too with margin amount less than Rs. 50,000. Here the investor should not do swing trading as it will block the amount for a week. Investment too is also not a good option for this investor.

The fifth category of investor has enough amount of money to invest. The investors can do intraday, swing as well as investment in future trading.

## CONCLUSION

The Indian stock market is one of the oldest exchanges in the continent, but still the knowledge among the investors regarding the market in the country is not satisfactory. The people in the country have stereotyped the market as gambling and even today are hesitant to invest in it. The liquidity in the stock markets in recent years indicates a change in mindset of the people towards the stock market. The optimism to earn higher returns from the idle savings, industrial growth and foreign institutional investors have made the Indian stock market as an attractive destination for investments and trading. It is high time that the investors know the different trading options available and the amount required to be invested. The study highlights that trading in future market is riskier compared to traditional equity market, but the returns are much higher. It is to be understood that swing trading is the best option for every trader to trade in the future market. There are six different types of investors participating in the market. The research provides information on strategies to be followed by the investors or traders considering their investment capacity. An investor or trader can opt for swing trading, intra day trading or investments in either equity or derivative market but, it depends upon the funds available. A trader should trade in derivative market for earning high returns, but it involves high risk compared to the equity market. Like every field requires in depth study to excel it, so does an investor or trader should have a sound knowledge about the stock market before investing and trading.

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