F & O trading

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What is F&O?

Futures and Options are financial derivatives, meaning their value is derived from an underlying asset such as stocks, commodities, currencies, or indices.

Futures

- *Futures give you the right to buy shares of a defined lot size at little premium to cash price.*
- *Futures are hedge transactions.*
- *Futures contracts are marked to market daily, meaning gains and losses are settled at the end of each trading day.*
- *Future positions can be closed before the contract's expiration date. If you hold the contract until expiration, it will be settled either through physical delivery of the underlying asset or cash settlement.*

Options

- *Options means calls and puts.*
- *When you buy call or put, you have to pay a premium.*
- *You buy a call when you want to go long and you buy put when you want to go short.*
- *The other way round means writing the position which will attract margin equivalent to futures and hence, retail generally don't write.*
- *Also, the risk for buying call and put is limited to the premium but if you write call or put the risk is unlimited and open.*
- ***Premium lapses with time and hence, option trades are suggested only when you are 100% sure of the price direction.***

What is F&O?

Hedging

Advanced risk management strategy that involves buying or selling an investment to potentially help reduce the risk of loss of an existing position. This works through physical settlement.

- *This is not effective in India and hence, here hedging means buying in cash and selling in futures and vice versa.*
- *It is called arbitrage and there are several arbitrage funds active that are creating volatility and liquidity.*

Do you know why oil traded at $-39 in 2020?

Types of hedge contracts

Forwards | **Futures** | **Derivatives** | **Swaps**

F & O is always a zero-sum game. So, for every long, there is a short. The open interest is always net of short.

F&O trading involves significant leverage and risk, and it is typically undertaken by investors and traders who have a good understanding of the markets and are willing to accept the associated risks.

Rollover process - a pain

The rollover process involves extending the expiration date of an open position by closing the current contract nearing expiration and simultaneously opening a new contract with a later expiration date.

For example: Suppose you hold a long position in Reliance futures expiring in June, and you want to maintain this position. Here's how you might perform the rollover:

Close the June Contract*: Sell the June futures contract, effectively closing your current position.*

Open the July Contract: *Buy the July futures, establishing a new long position with a later expiration date.*

- ***Ordinary traders rollover their positions from one settlement to next by paying a premium.***
- ***Market drivers take reverse badla.***
- ***Market drivers keep reducing cost by eating call/put premium.***
- ***Traders cannot beat market drivers.***
- ***There is always a false breakout near expiry***

How would you rollover if you had, say, 5 million shares?

Success mantra for F&O trades

Never cross limits. You should not exceed more than 3 long positions in F & O.

Never buy desired quantity in one go. Due to volatility the prices are expected to remain volatile which gives further opportunity to buy at lower price.

All Future trades have to be positional, may be for months, like your investments in cash. Flash trades are nothing but gambling.

Calculate the cost of carry.

Use F & O trades as investment with limited money through margin mechanism.

Apply the same financial acumen which you apply for investments, largely.

Success mantra for F&O trades

Stock prices always move in accordance with fundamentals.

Keep in mind that same principles of market operators and controls apply even in F & O.

Beware of false break out.

Be prepared for 20% downside.

Try to add second position at stop loss level instead of triggering stop loss.

Constantly monitor call put built up.

Your F & O bets should be 10% of your portfolio value.

Success mantra for F&O trades

Excess exposure will expose the risk of mark to market in case of market fall (for eg, the sudden 6000 point fall on 4th June killed all positions).

In case of ban, use cash markets for adding positions and when ban is removed convert to F & O again.

Ban is used effectively to control the prices that in fact, allow you to enter at discount in cash market.

Avoid trades that are extremely event based.

Use sharp declines and dips to enter F & O trades.

Avoid relying on social media and fake reels claiming profits for taking your trades

***No one can guarantee profits in F & O** and hence, ignore fake claims /extremely affirmative claims.*

Why investors and traders love to trade in F & O?

Liquidity

Low investments

High returns on investments

No exchange or brokers regulations

Easy app-based trading

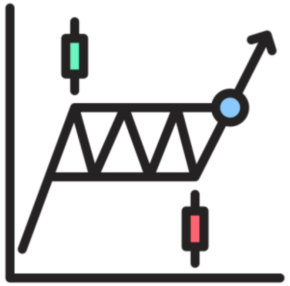
Why is F & O considered risky?

Over exposure

Price volatility

Heavy mark to market

Price decay and eventual 100% loss in options



Option controls keep stocks range bound

F&O stock picking

- *Examples of stock picking with regard to valuation:*
  a. BHEL
  b. SAIL
  c. BPCL
- The fundamentals of these stocks are explained here to determine the destination.

New orders of 1 lac crores and orders of another 1 lac crores expected

EV/EBITDA is Rs 1200 per tonne as compared to Rs 10000 per tonne for other companies

Capex of 1.75 lac crores

Disclaimer:
- ***The companies mentioned in the slide are for educational purposes only and not recommendations to buy***
- ***The author may have investments in some or all the companies discussed in the presentation.***

Conclusion

- *F&O trading involves deep understanding of market dynamics, risk management techniques, and disciplined execution.*
- *F&O can be powerful tools in your investment arsenal, providing opportunities for hedging, speculation, and diversifying your portfolio.*
- *This is not only theoretical, but it has been practically implemented by our company for the last 14 years earning an almost 100% success rate. There were nil returns in F & O only in 4 out of 168 months.*
- *All said and done, F&O trading can be both rewarding and challenging.*
- *Always be mindful of the risks involved in financial markets, including F&O trading. Understanding and managing risk is essential for long-term success.*

THANK YOU!

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