

# Businessworld

## STOCKMARKETS

# High Stakes For Options

**In a first, options trading is playing a prominent role in equity derivatives**

THE RISK APPETITE OF INVESTORS IN DOMESTIC and global equity markets might have gone up. But the unprecedented intra-day volatility in the domestic equity market is causing investors and traders — who play the equity derivatives market on an intra-day or inter-day weekly basis — tweak their investing style.

Investors are increasingly dabbling in options trades on the National Stock Exchange (NSE), particularly options on the S&P CNX Nifty. From 1 July to 18 August, the traded value (notional) of options crossed that of the futures on NSE's derivatives trading segment.

current financial year's aggregate figures so far, (till 17 August), has seen options' contribution total become even healthier at 42.2 per cent.

Day traders, ultra short-term investors and foreign institutional investors (FIIs) are driving the change from futures to options. "Earlier, a typical day trader client of ours would trade in 20 Nifty futures contracts in the derivatives segment, but now the same guy is trading in 15 Nifty options contracts and just five Nifty futures contracts," says Mrugank Sanghvi, a dealer in Jagvin Investments, an NSE broker.

The FIIs who, unlike domestic institutional investors, are allowed to speculate freely in equity derivatives, are doing alike. In recent months, of the total trades in equity derivatives, FIIs' trades make up for between 10 and 20 per cent on an average. As per FIIs' derivatives trading data released by the Securities and Exchange Board of India, FIIs' aggregate trades (sum of purchases and sales) in options up to 17 August were more than their trades in futures, amounting to 56 per cent of FIIs' total derivatives trading. In June and July, FIIs' options trade was 41 per cent and 49 per cent, respectively.

More than 90 per cent of options trades are taking place in index options, primarily in Nifty, and the rest in stock options. In futures trades, the spoils are shared roughly equally by index and stock futures. "The high liquidity in Nifty options is a major attraction for traders," says Sanghvi. "This was earlier limited only to Nifty futures and futures in select stocks."

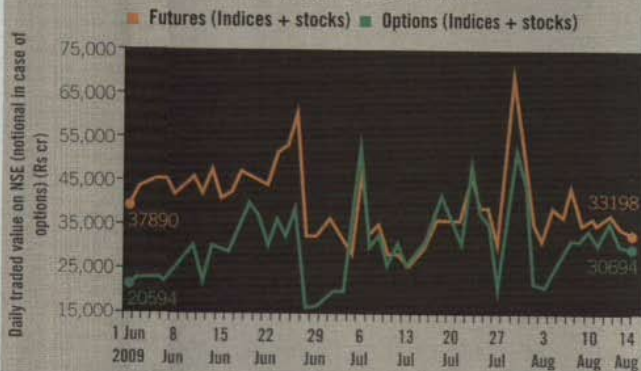
The shift in trader preferences from futures to options is because of convenient trading strategies in options and synthetic stop loss trades through a combination of options and futures, says Kotak's Nayak. The high volatility in Nifty was resulting in top loss trades in naked Nifty futures positions getting triggered too often. The stops do not get triggered when done through a synthetic stop using options.

"When it comes to FIIs, we are seeing some of them sell call or put options of various strike prices and buy or sell futures to make it a delta hedge (risk-free) position," says Nayak. Traders, including FIIs, with views are getting hit by new information more often in the recent weeks' dynamically shifting undercurrents in the stockmarket. Options contracts, therefore, acts as a refuge for such times. Whether the new trend will sustain or not is not certain, given the propensity of most brokerage firms to give to their retail investor clients recommendations on derivatives strategies involving only stock and Nifty futures. "But the phenomenon of high options trading volume is here to stay," says Nayak. Investors will be glad if Nayak is right.

Rajesh Gajra

## FUTURE FOR OPTIONS

The gap between futures and options has narrowed, indicating rising maturity of traders



Source: NSE, B/W research

Indian equity derivatives market's trading trends typically deviate from those in developed derivatives markets where options trading dominates. Futures on Nifty and stocks used to trade much more than options on Nifty and stocks. "But this began changing, and trading volume in options rose rapidly, especially after the markets crashed during 2008 and investors' risk appetite came down sharply," says Sandeep Nayak, senior vice-president and head of private client group at Kotak Securities.

Aggregated for financial year 2008-09, options trades contributed a healthy 35.9 per cent of all equity derivatives trades on the NSE. The