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## **A Study on Derivatives, its Strategies and Step by Step Guide to Buy & Sell Shares Online.**

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### **ABSTRACT**

This project report explores the world of derivatives trading, focusing on strategies and methods for safe investment practices within the derivatives market. Utilizing secondary sources, the report aims to provide a comprehensive overview of derivatives, including their definitions and characteristics, as well as effective trading strategies. It emphasizes the importance of utilizing online trading applications and offers guidance on how to navigate the derivatives market securely. With shares as the chosen underlying asset, the report also includes practical suggestions for traders to enhance safety and effectiveness in their trading activities. This document serves as a valuable resource for individuals looking to deepen their understanding of derivatives and improve their trading practices.

Keywords: Derivatives, Derivative Strategies, Online Trading

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### **Introduction**

In this project, we will explore derivatives and various strategies related to them. The focus will be on understanding what derivatives are, how they are used in trading, the strategies associated with derivatives, and some suggestions for investing in them. Our discussion will centre on the underlying asset of company shares. Furthermore, the strategies and suggestions will specifically pertain to trading shares of a company as the underlying asset.

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### **OBJECTIVES:**

- 1.To learn about derivatives.
- 2.To learn step by step on how to buy and sell using an online platform.
- 3.To understand various strategies used to trade in derivative.
- 4.To give suggestions how you can select and implement the strategies in derivatives.

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### **Derivatives And Its Strategies**

#### **What are derivatives?**

The term "derivative" refers to "an expression that indicates the rate of change of a function in relation to an independent variable." In finance, derivatives are financial instruments—like futures, options, or warrants—whose value depends on and is contingent upon the value of an underlying asset, which can include commodities, currencies, or securities.

In the context of the stock market, the term "derivative" signifies a financial contract whose worth is tied to an underlying asset. These contracts are usually formed between parties involved in a transaction. Changes in the value of derivatives typically correspond to fluctuations in the price of the underlying asset. Derivatives serve two primary functions: they can be used to hedge against risk or to speculate on the risks related to a specific asset, allowing an asset's classification to shift between high-risk and low-risk

#### **Strategies for Derivatives:**

Hedging:

Hedging is a technique that investors utilize to safeguard their portfolios from unfavorable market changes by decreasing risk exposure. This method frequently includes various derivative instruments like futures, options, and swaps to counterbalance the possible losses in underlying assets.

Investors can employ futures contracts to mitigate their risk associated with a particular asset or market by taking an opposing position in the futures market. For instance, a commodity producer can sell futures contracts to secure a specific price for their goods, thereby shielding against possible price drops.

Options also provide a means to hedge against changes in an asset's value. By acquiring put options, an investor can defend against a decrease in the asset's worth. Conversely, call options can be utilized to protect against increasing asset costs. Options offer a more adaptable hedging strategy, enabling investors to maintain potential upside while limiting downside risk.

Swaps can be used to hedge against various risk types, including interest rate or currency risks. For example, an investor who is vulnerable to fluctuating interest rates can engage in an interest rate swap to convert floating-rate payments to fixed-rate payments, effectively hedging against possible increases in interest rates.

#### Arbitrage:

Arbitrage is a financial technique that involves the simultaneous buying and selling of associated instruments to take advantage of price differences, thus creating risk-free profits. Such changes often occur due to market inefficiencies or mis-valuations and are usually short-lived, as market actors quickly rectify these price discrepancies.

A well-known type of arbitrage is cash-and-carry arbitrage, which consists of purchasing an asset in the spot market while simultaneously selling a related futures contract. This method aims to profit from the gap between spot prices and futures prices, which are anticipated to align as the futures contract approaches its expiration.

Another variant is risk arbitrage, commonly known as merger arbitrage. This strategy concentrates on acquiring positions in the securities of firms involved in mergers or acquisitions, looking to gain from the price differences between the current stock price of the target company and the proposed acquisition price by the acquiring firm.

Covered interest arbitrage is a strategy that utilizes disparities in interest rates between two nations while minimizing currency risk. This is done by borrowing a currency with a lower interest rate, converting the borrowed amount into a currency with a higher interest rate, and then investing the resulting funds in an interest-earning instrument.

#### Income Generation:

Income generation is a strategy involving derivatives aimed at producing steady cash flows from investments in different financial instruments, such as options. Investors frequently implement income-generating strategies to enhance their regular income or take a more cautious approach to their investments.

A widely used method is covered call writing, which entails maintaining a long position in an underlying asset while simultaneously selling call options on that same asset. This strategy produces income from the premiums earned by selling the call options and offers some level of downside protection if the asset's price decreases.

Another approach is cash-secured put writing, where an investor sells put options on an underlying asset while retaining cash equivalent to the potential obligation to purchase the asset at the strike price of the option. This method generates income from the premiums received for selling the put options and also enables the investor to buy the underlying asset at a more favorable price if the option gets exercised.

In addition, the dividend capture strategy using options consists of purchasing shares of stock before its ex-dividend date and selling call options on those shares to generate income from the option premiums. This strategy aims to benefit from both the dividend payment and the option premiums while reducing the risk of holding the stock for a prolonged period.

#### Portfolio Management:

Portfolio management is a strategy that uses derivatives to improve the risk-return profile of an investment portfolio. This can be achieved through various financial instruments, including futures, options, and swaps. Effective portfolio management techniques enable investors to meet specific goals, such as diversification, risk reduction, and enhanced returns, while also aligning with their risk appetite and financial objectives.

Derivatives allow for adjustments in asset allocation and portfolio rebalancing without the need to buy or sell the underlying assets. For instance, investors can use futures contracts to change their exposure to particular asset classes, like stocks or bonds, or to hedge against possible market declines.

Tail risk hedging is a focused portfolio management approach intended to protect against rare but extreme market occurrences, often referred to as "black swan" events, which can result in substantial losses. Investors can employ options, such as out-of-the-money put options, to guard against tail risk and lessen the potential impacts of severe market shifts on their portfolios.

Volatility management is another approach within the derivatives framework that entails using financial instruments, such as options or volatility derivatives, to mitigate the effect of market volatility on an investment portfolio. By reducing the portfolio's sensitivity to market fluctuations, investors can achieve more consistent returns and decrease the chances of significant losses during periods of increased volatility.

## Diversification the best strategy for Shares trading And long Term Investment.

“Diversification is the only free lunch in investing.” ----- Harry Markowitz, Nobel Prize Laureate

Any type of investment carries a number of inherent risks. Even those that are often thought of as risk-free may expose investors to inflation-driven declines in their purchasing power. Although risks cannot be totally eliminated, their detrimental effects on an investment portfolio can be lessened with good management.

The first crucial step is to thoroughly research the investment and comprehend the dangers involved; this information cannot be replaced. It would be wise to get expert assistance if you are unable to complete this investigation on your own.

The second step is to diversify your investments across a range of options, with the emphasis on “diverse.” Diversification can be achieved through:

1. Companies
2. Industries or sectors
3. Asset categories
4. Geographies or currencies

Within each asset class, diversification is also essential. Diversification and high-quality assets work together to shield your portfolio from the majority of dangers. Diversification, however, cannot completely eliminate all hazards, such as market-wide price volatility. The price of individual securities is likely to decline in tandem with a slump in the market as a whole.

Aligning the type of investments you make with your investment horizon is essential to reducing the negative consequences of such risks. For instance, if you have a short- or medium-term time horizon, investing in stocks may be risky. Long-term portfolios, on the other hand, ought to be protected from inflation. Investing in securities that are anticipated to outperform inflation over time would be a wise course of action in this situation. Additionally, if your goals are short-term or near-term, it is advisable to avoid assets that are extremely volatile or illiquid.

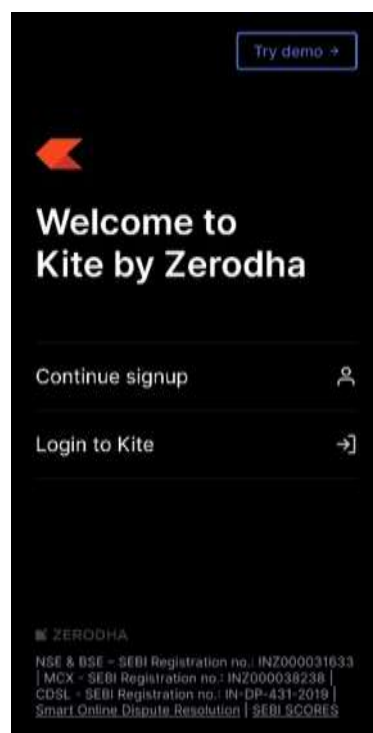
## How to trade in an online platform?


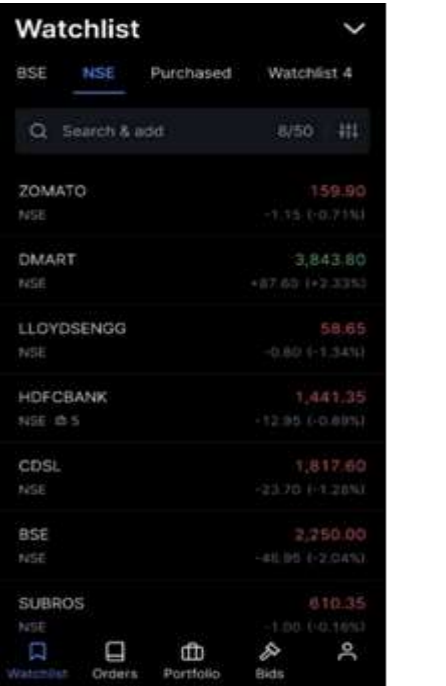
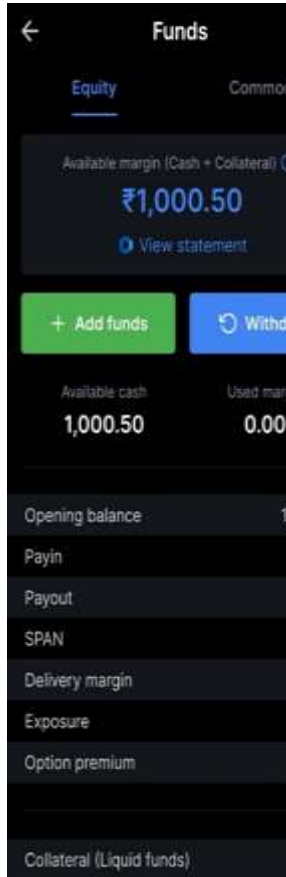
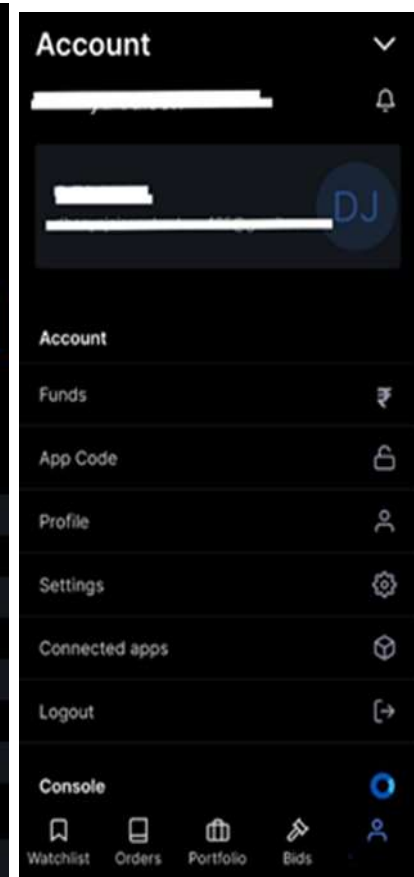
We are going to discuss how to trade on an online platform, specifically using Zerodha’s KITE app for trading shares. This app is developed by Zerodha, one of the company's flagship products. The app is popular because it charges a very low brokerage rate compared to others in the same category. Additionally, the KITE app is user-friendly, making it accessible for people of all age groups. Navigation within the app is straightforward and easy to follow, so even someone aged 50 or older can learn to use it with ease. Now, let's go over the steps to trade using the KITE app:

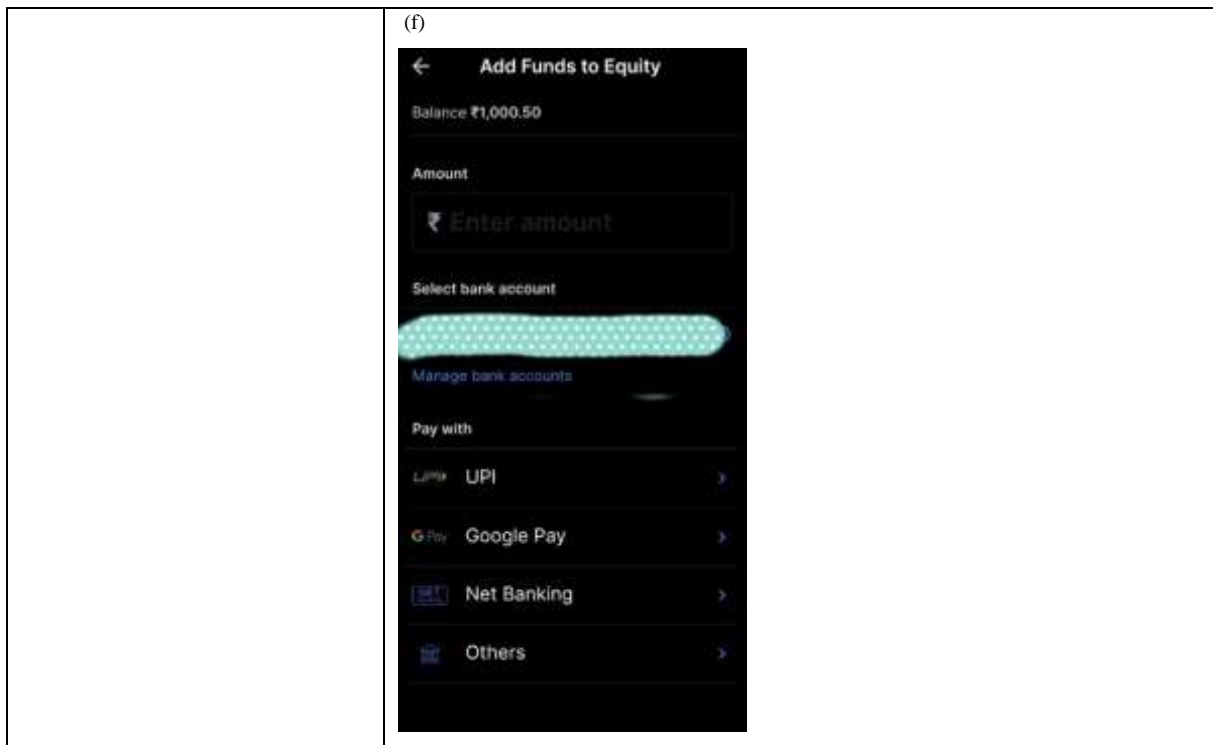
### Step 1: Create a KITE app account.

When you launch the application, (a) is the page that shows up. Press "Continue signup" to establish an account on Zerodha. After you complete the remaining steps of the enrollment process, Zerodha will open a demat account for you. It will request access to your Digi-locker in order to open the demat account. To obtain your Aadhar and PAN cards for E-KYC, Digi-locker access is required. Additionally, you will be required to supply your signature and photo for the same. Your account will be established within three business days of fulfilling the conditions. After that, you can begin trading.

(a)



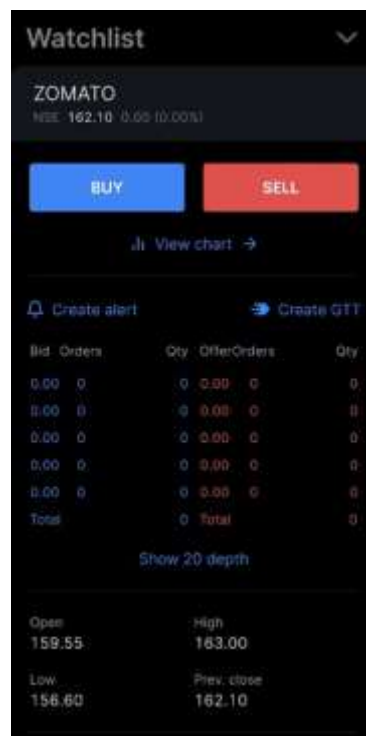
<p>Step 2: Create Watchlist.</p> <p>You can see an example of a watchlist in the image in (b) &amp; (c). You can classify the shares you are interested in using a watchlist. I divided the shares I'm interested in into three categories—BSE, NSE, and Purchased—in the graphic above. Only shares trading on the BSE are eligible for the BSE category. The NSE category was created specifically for NSE share trading. The purchased category is for keeping an eye on the shares I've bought. There are no rules for categorizing shares, so you can do as you choose.</p>	<div style="display: flex; justify-content: space-around;"> <div data-bbox="574 190 925 952"> <p>(b)</p>  </div> <div data-bbox="925 190 1410 952"> <p>(c)</p>  </div> </div>
<p>Step 3: Fund your Zerodha account. You can add money using Net banking, UPI Payment, and other methods.</p> <p>Visit your account page or profile. Decide on funds. There are two options in the Funds window: "Add funds" and "Withdraw." Click "Add funds." As shown in the (f) photo, a new window will open. Enter your amount, select a payment method, and your money will be added. You can take your funds in the same way.</p>	<div style="display: flex; justify-content: space-around;"> <div data-bbox="574 952 925 2027"> <p>(d)</p>  </div> <div data-bbox="925 952 1410 2027"> <p>(e)</p>  </div> </div>



Step 4: To purchase, choose a share and swipe.

From the watchlist, pick any company you like. From below a box will emerge. This box will display the company's information, including the share price at which it is trading, the prices of bids and offers. See the chart, Purchase Blue Button Additionally, sell blue buttons. Since we intend to buy the chosen share, we will first choose the view chart and use technical analysis, or candlestick chart analysis, to determine the share's trading position. Following analysis, we will return and choose the "buy" (blue) option.

(g)



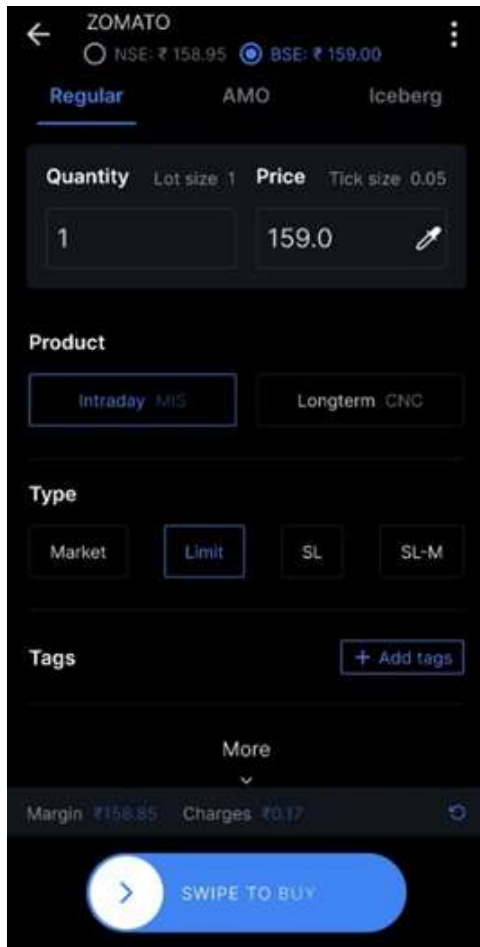
We have two options for purchasing shares within this app.

The first method is intraday trading, which means you should purchase and sell shares during trading hours. Two images below demonstrate your option for intraday trading. You can purchase shares at two different intraday prices, i.e. The price at which the share is traded and when you buy it is known as the market price. The second is the limit price, which is the amount you choose to pay for the share. In this instance, the purchase won't happen until your limit price and the going rate are equal.

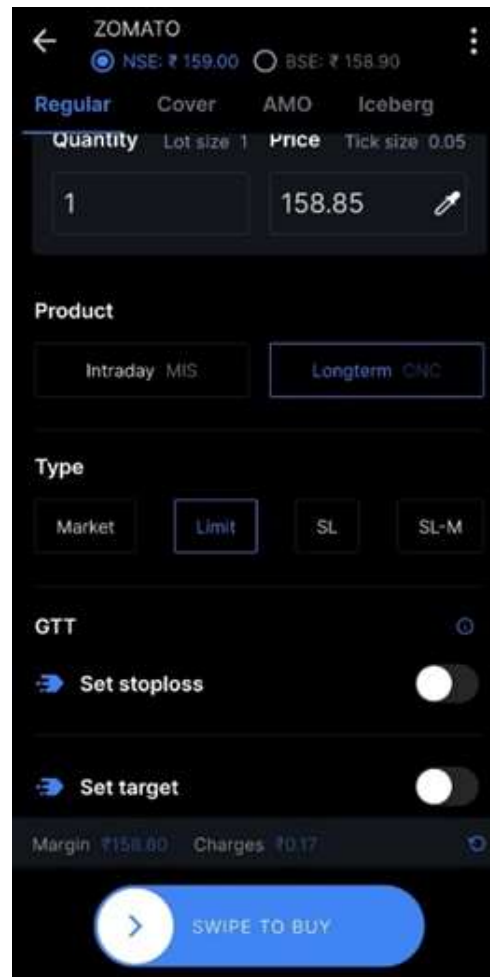
The second approach is long-term. Buy, meaning you buy shares for a long time and don't plan to sell very soon. Long-term share purchases are the default method of purchase in this app. If you're new to the market and a newbie, it's best to buy shares for a long time. Two possibilities for prices are available in long-term trading. Limit price and market price.

A stop-loss target setting is provided for both purchasing methods, which is a useful feature. Doing this will help you control your losses in the event that the share market declines. To buy, swipe.

(h)

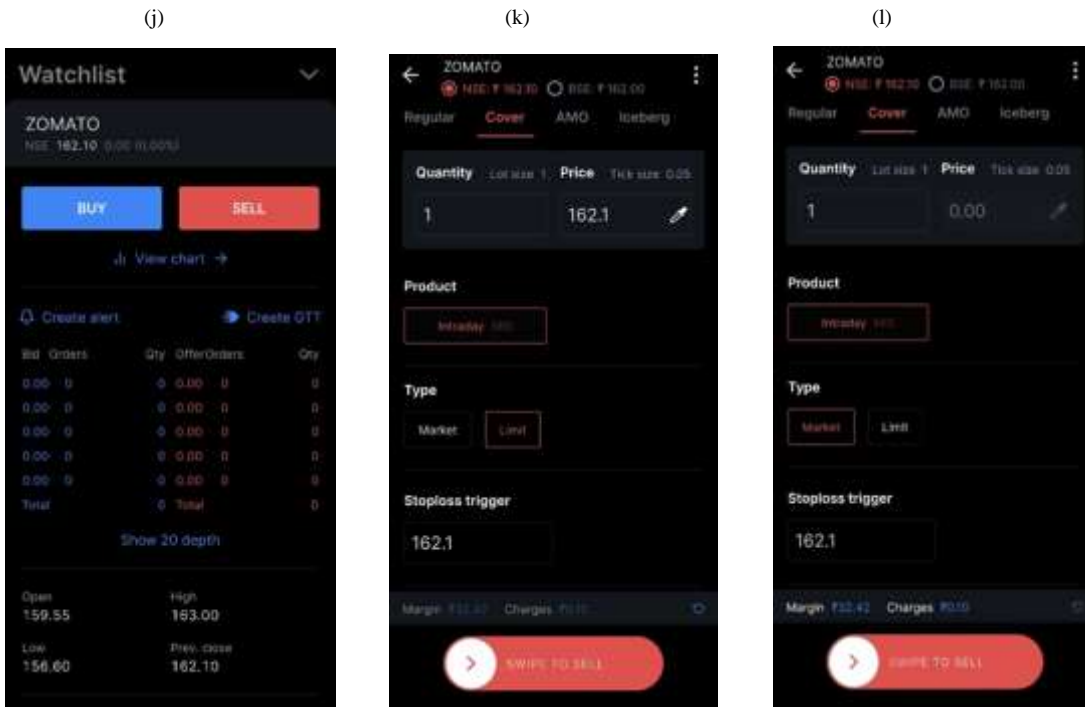


(i)



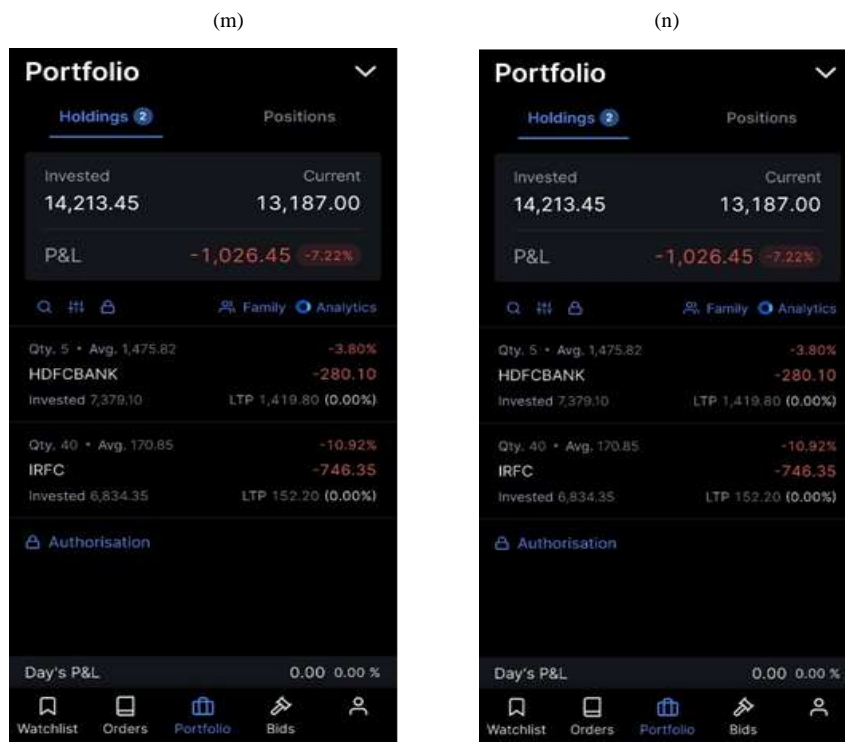
Step5: Pick the share and book profit

You are free to sell the share at any time. Choose which share you wish to sell. A window is open, as seen in the first image. The Red Sell Button should be selected. A new window will then open, similar to the second image. As you can see, the only selling option available here is intraday trading; it makes no difference if you sell the share on the day you purchased it or later. To sell, swipe.



Step 6: The app itself displays your portfolio.

Choose the Portfolio icon from the four icons with names at the bottom of the window. The amount you invested and the current state of your investment will be displayed in a new window. Additionally, it will display the amount of your investment's profit and loss. When you click the portfolio's downward arrow, an overview window will reveal your fund balance as well as the Nifty 50 and Nifty Bank amounts.



#### 4. Conclusion

An in-depth knowledge of derivatives strategies is a great advantage for investors who want to use these potent financial tools to achieve their investment objectives. Investors can improve the chances of successful implementation and efficient risk management by being knowledgeable about the workings, dangers, and possible benefits of different techniques.

Numerous benefits, including risk control, income generation, and enhanced overall investment performance, can be obtained through derivative techniques. Even though it's critical to acknowledge the inherent risks—like counterparty risk, market risk, and complexity—using these tactics thoughtfully can have beneficial effects. Investors are better able to make wise judgments when they balance the risks and possible rewards.

Attaining the best possible risk-return balance requires constant assessment and proactive derivatives strategy management. Investors can respond to changes in their investing goals or the overall market environment by remaining alert and keeping an eye on their positions and market conditions.

In order to achieve their financial goals, investors who are keen to investigate derivatives methods may find that using professional wealth management services is a great first step. By making sure investors understand the feasibility of derivatives strategies for certain objectives and offering helpful advice on implementation and risk management, an experienced wealth manager can make sense of the complicated methods.

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