INDIAN STOCK MARKET JOURNAL

EMPOWERING TRADERS AND INVESTORS

Cracking The Code Of Multibagger Investing: Spot Potential 100X Returns

Derivative Expiry And Its Impact On The Indian Market

First Republic Bank, The New Banking Crisis Victim

A Portfolio Or A Single Stock, Hedge Using Futures

Stock Market Outlook

Stocks To Bet On

BANNED

RBI Withdraws Rs 2,000 Notes From Circulation Should You Worry About Another Demonetisation?

From The CEO'S Desk

INDIAN STOCK MARKET JOURNAL

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Full efforts have been made to ensure the authenticity and accuracyof the contents of the Yearbook, but we do not accept any liabilityfor the errors if committed and the subsequent loss arising fromthe same, but we will make sure that the errors if occurred arerecited and minimized in future editions and also would welcomethe reader's feedback.

We welcome your comments and suggestions for our future editions to make it more helpful month after month.

Follow us on

Dear Readers,

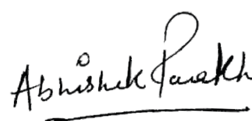
Among many things happening nationwide, the RBI's announcement of withdrawing Rs 2,000 denomination notes from circulation is the most interesting. Although, it is important to note that the notes will continue to be legal tender until declared otherwise. Readers need not worry about the situation being a demonetisation. It is just a routine clean-up procedure followed by central banks worldwide.

This edition of ISMJ has brought you the solution to getting 100X returns through Multibagger Investing. The edition also analyses the impact of Derivative Expiry on the Indian capital markets. Also, in the edition, we discussed how you could use Futures contracts to Hedge your portfolio. Finally, we address the crash of First Republic Bank amidst the US Banking crisis.

Along with all the topics deemed the future of markets, we also bring you Stock Market Outlook and how Nifty and Bank Nifty are expected to move in the upcoming months. Hope you learn and grow.

We would like to thank you for appreciating our previous editions with your kind words. We would love to have your continuous feedback to improve our work. Please feel free to write to us at support@equitypandit.com.

Happy Investing!



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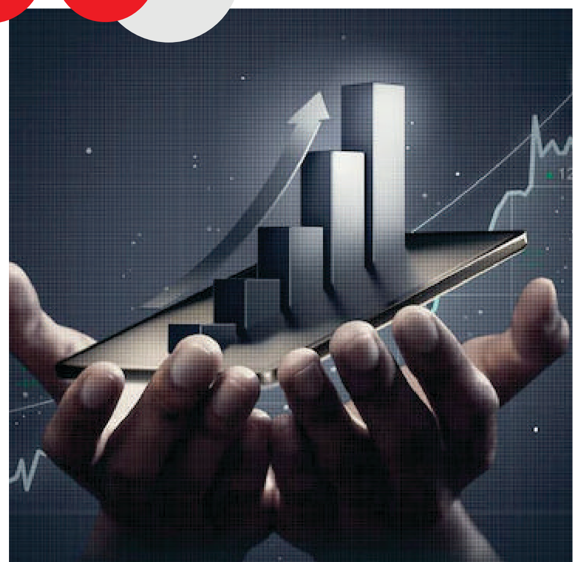


Stock Market Outlook

NIFTY

The nifty benchmark index saw a turnaround on April 23 Series, and the rally continued on May 23. From support levels of 16800 overall market has seen a tremendous rally on the upside, where it touched a high of 18473 (15-May).

However, now the market (Nifty Index) seems to pause before further rallying on the upside. In the May-23 Series, till Nifty Future holds levels 17950, we may not see any weakness in the market. Relatively outperformance has been witnessed in

Nifty Auto, Nifty FMCG and Nifty Private Banks; these 3 sectors seem to outperform in the market, which is holding up the index. Focus on frontline stocks TATAMOTORS, MARUTI, EICHERMOT, BRITANNIA, NESTLE, COLPAL, AXISBANK and ICICIBANK.

Nifty Future 18100- 18400 is a crucial zone on the Index front. If we look at the daily charts, the Index reacts on these levels. As the current short-term trend looks to be bullish, buying can be initiated, and stocks can accumulate at current levels.

Till Nifty sustains above 17950 levels, we can expect a rally till 18600- 18900 levels. On the other hand, a close below 17900 will indicate more weakness towards 17614.

BANK NIFTY

Bank Nifty Future Index witnessed clear outperformance in the overall market, and banking stocks are heading up and holding up the market.

Bank Nifty, especially Private sector banks, have performed better than PSU banking stocks. In the Private Bank Sector space, components like ICICIBANK and AXISBANK are the clear outperformer and keep a close eye on the stocks. We observed a rising wedge pattern formation on the Weekly charts of the Bank's nifty future.

In April 23 series, we saw a robust rally in the banking index, and Index may continue to hold up in the May 23 Series; it closed at 43967 (20-May); we expect outperformance in the banking stocks, and Bank Index Future can head towards wedge pattern resistance around 45500-45700. For the May 23 Series, the downside is protected until Bank Nifty is holding 43400- 43500. If Index closes below 43400, the levels need to be reviewed, and some correction will prevail in the banking stocks.

Upcoming Trading Holidays

Id-ul-adha (Bakri Id)

June 28, 2023	Wednesday

RBI Withdraws Rs 2,000 Notes From Circulation

Should You Worry About Another Demonetisation?

Reserve Bank of India (RBI), the Indian banking system regulator, announced on May 19 that it has decided to withdraw Rs 2,000 denomination notes from circulation. It also highlighted that these notes will continue to be legal tender.

Is this another Demonetisation? Why are these notes being withdrawn? Before you rush to your nearest bank, read till the end to find answers to such questions.

Rs 2,000 Notes Deposit Deadline And Limit

The central bank has requested the people deposit Rs 2,000 notes in their bank accounts or exchange them for notes of other denominations before September 30, 2023. Deposits into bank accounts can be made as normal, with no restrictions.

The exchange service for Rs 2,000 currency notes will begin

on May 23, 2023, to provide operational ease and minimise interruption of bank branch activities. The exchange of Rs 2,000 bank notes for banknotes of other denominations is limited to Rs 20,000 at a time.

The exchange service with issuing departments will be available at any bank branch or one of the 19 Regional Offices of the RBI. The notes can also be exchanged through Business Correspondents, but only for a maximum of Rs 4000/- each day for an account holder.

When Was The Note Introduced, And Why Is It Being Withdrawn?

The Rs 2,000 notes were first introduced in November 2016, during the demonetisation of Rs 500 and Rs 1,000. The primary objective behind the circulation of the Rs 2,000 banknotes was to meet the currency requirements of the country efficiently after the demonetisation.

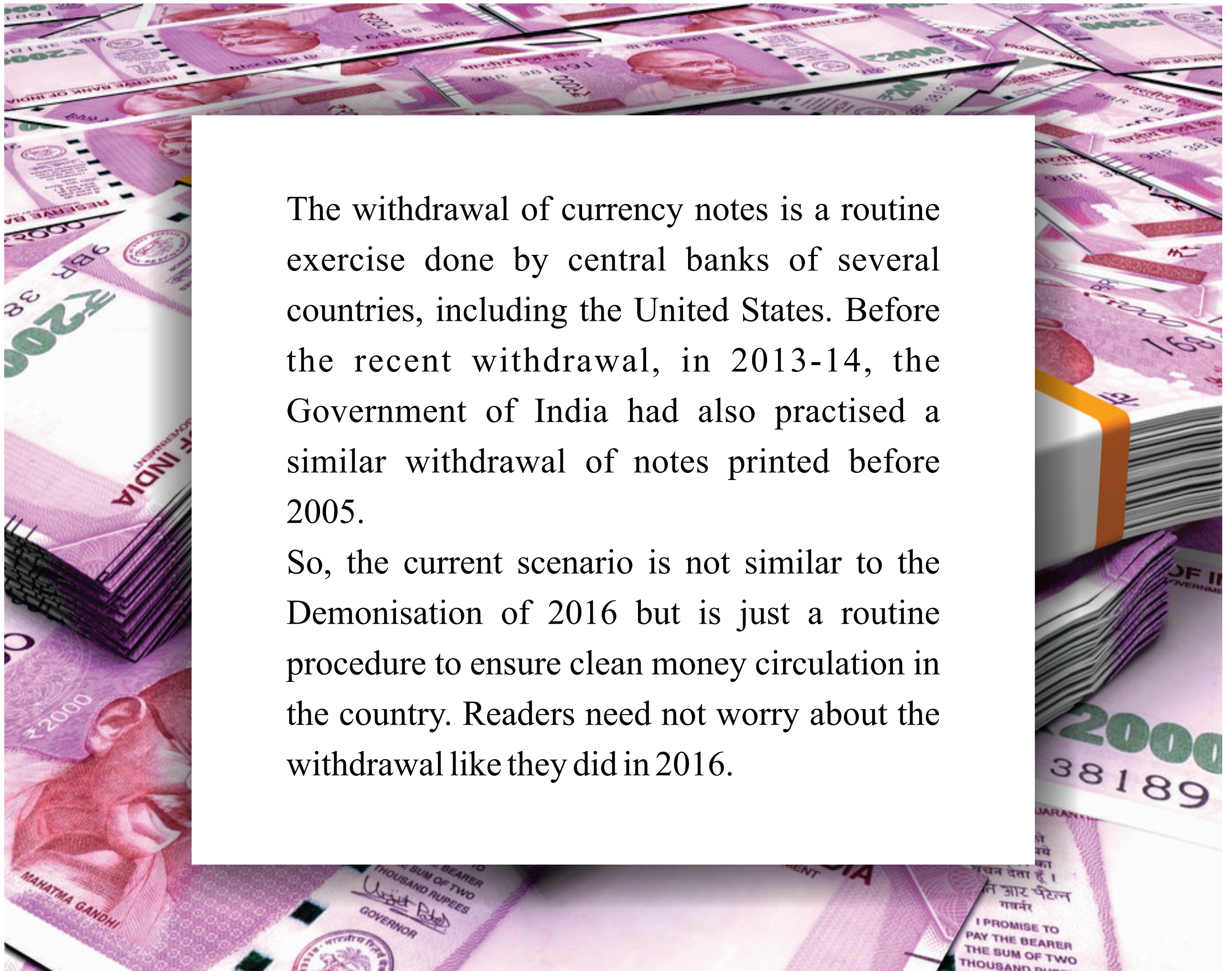
The printing of Rs 2,000 notes was already stopped in 2018-19 due to various reasons cited ahead.

Firstly, about 89% of these notes were issued before March 2017 and were reaching or were already at the end of their estimated lifespan of 4-5 years.

Moreover, using the Rs 2,000 notes in transactions drastically reduced from Rs 6.73 lakh crore at its peak to Rs 3.62 lakh crore on March 31, 2023, accounting for only 10.8% of all notes in circulation. The primary reason is the availability of banknotes in other denominations in adequate quantities.

Finally, the "Clean Note" Policy of the RBI is in motion to ensure that members of the public have access to high-quality banknotes. Therefore, the RBI withdrew the Rs 2000 denomination banknotes from circulation, given the above.

Demonetisation Or Just A Time To Time Clean Up?



The withdrawal of currency notes is a routine exercise done by central banks of several countries, including the United States. Before the recent withdrawal, in 2013-14, the Government of India had also practised a similar withdrawal of notes printed before 2005.

So, the current scenario is not similar to the Demonisation of 2016 but is just a routine procedure to ensure clean money circulation in the country. Readers need not worry about the withdrawal like they did in 2016.

FIRST REPUBLIC BANK, THE NEW BANKING CRISIS VICTIM

In March, the "Startup Darling" Silicon Valley Bank (SVB) and the lesser-known Signature Bank, with assets worth $200 billion and $100 billion, respectively, collapsed in less than a week, making them the second and the third largest bank failures in US history.

Recently, in the first week of May, First Republic Bank (FRCB), with $233 billion in assets, became the most recent and the biggest victim of the 2023 Banking Crisis, taking the SVB's position on the leaderboard.

All of these banks shared one thing – a business model that could not adapt to the rising interest rates. It was a problem obvious in hindsight, but FRCB, among others, thought they would survive the Fed's inflation-fighting just fine.

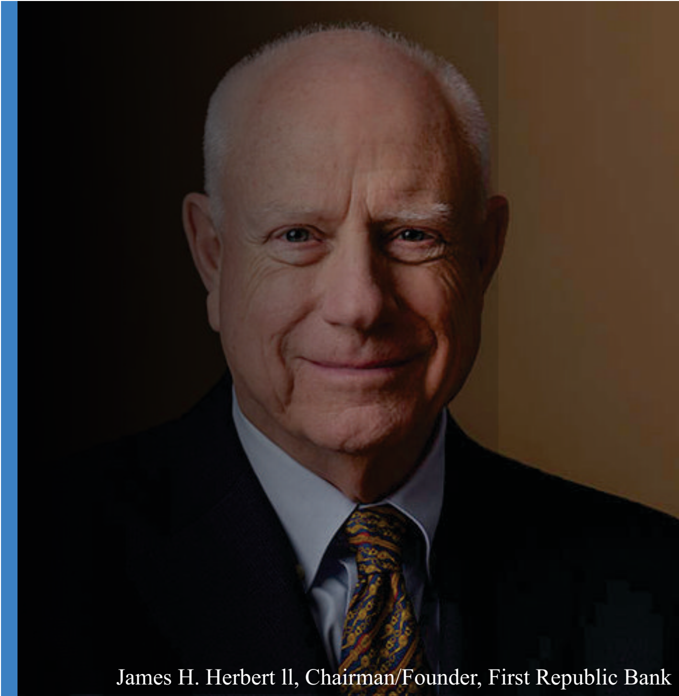
However, although SVB's main concern was its holding of mortgage bonds and Treasuries, First Republic's troubles were mainly focused on its lending business.

In March 2023, FRCB's stock was trading for $122.5 per share. It's now at about $0.4, a more than 99% decline. The shares tanked more than 40% in a single day five times.

Fleeing Depositors and Loss-making Asset Portfolio – the double attack that led to First Republic's demise.

JPMorgan Chase bought the carcass of FRCB after the Federal Deposit Insurance Corporation (FDIC) took control, making it the buyer in the two largest bank collapses in US history. The FDIC's expenditures will be limited to $13 billion if First Republic's loan losses are shared with JPMorgan.

THE TIMELINE


James H. Herbert ll, Chairman/Founder, First Republic Bank

Founded in 1985 by James H. Herbert ll, First Republic Bank operated in San Francisco, specialising in CDs, savings accounts and jumbo mortgages.

FRCB became a full-service bank in the late 1990s, adding new services and markets on the West and East Coasts.

The ownership shifted many hands during the long life of the bank– Merrill Lynch in 1998, Bank of America in 2007, and back to its founder, along with a group of private equity investors in 2010.

In January, FRCB delivered seemingly solid financial results from the last quarter of 2022, and its shareholder returns were compounding at 19.5% annually. Meanwhile, its loan book and investment portfolio grew less valuable as the Federal Reserve Bank of the United States hiked interest rates, and its interest expenses increased by 2,040% yearly.

In February 2023, the bank's wealthy customers started withdrawing their deposits from their accounts, and the bank's capital was on the brink of being eaten away by its realised loss.

Silvergate Capital announced it would cease operations in March, and SVB revealed the sale of $2 billion in debt

securities. SVB saw its stock collapse by 60% and was later closed by the FDIC on March 10. FRCB began experiencing the ripple effects of "unprecedented deposit outflows." Shares of First Republic slid 29% between March 8 and March 10.

On March 12, The FDIC closed Signature Bank. HSBC acquired the UK subsidiary of SVB for just 1 pound the next day. First Republic's rating was reduced by many

credit rating organisations, indicating a lack of trust in the bank.

After shares of FRCB fell a further 62% from March 10, a consortium of the 11 largest American banks injected the bank with a total of $30 billion in uninsured deposits.

Bank failures go abroad as Troubled Swiss giant Credit Suisse says it will strengthen its liquidity by borrowing up to 50 billion Swiss francs ($54 billion) from the Swiss National Bank.

On March 19, the Swiss government orchestrated UBS' takeover of its troubled rival Credit Suisse, while the bank's rescue efforts made little headway as its stock plummeted over 50% on March 20.

As a relatively peaceful month, First Republic shares fell over 25% to $8 as their deposits fell by more than $100 billion in a matter of days during the March bank run.

Over the last weekend of April, US regulators attempted to close a sale of FRCB Bank, with around a half-dozen banks bidding, including JPMorgan Chase, Bank of America, and PNC. The FDIC seized First Republic Bank on May 1, and JPMorgan bought most of the bank's assets. FRCB was properly laid to rest at the age of 38.

WHY DID THE BANK FAIL?

First Republic Bank stocks failed for many of the same reasons as the earlier crashed Silicon Valley Bank and Signature Bank, with one other being the failure of these banks. When the Federal Reserve began raising interest rates in the United States to combat inflation last year, First Republic began amassing paper losses. According to First Republic's annual report, gross unrealised losses in the company's held-to-maturity investment portfolio, primarily government-backed debt, increased to $4.8 billion at the end of December from $53 million the year before. Analysts and investors estimated its March paper losses to be between $9.4 billion and $13.5 billion.

Mortgages, Uninsured Deposits And A Bank Run

First Republic Bank attracted deposits by offering minimal interest and used the funds to fund mortgages, charging higher interest rates to borrowers than it paid to depositors. The bank's primary source of income was net interest income from loans and investment securities, with a significant portion of investments in real estate loans and municipal securities.

Its wealthy customer base had many uninsured deposits, making a bank run possible if investors panicked.

In February 2023, customers began withdrawing their money, and the bank lost over $100 billion in just a few days during the March bank run, triggering its collapse. More than half of First Republic Bank's deposits exceeded the Federal Deposit Insurance Corp.'s insurance limit, making it difficult for customers to get their money back. A high number of uninsured deposits contributed to the bank's failure.

Fed Rate Hikes

The Federal Reserve's rapid interest-rate hikes initiated the bank's downfall. When a central bank raises interest rates, banks usually pass the additional cost of the rate hike on to their customers. This makes it more expensive for customers to apply for or repay existing loans. When interest rates increased, the bank saw a decline in demand for new loans, which reduced the value of its total assets and hindered its ability to raise funds in the future. As a result, it was challenging for the bank to attract deposits, and depositors went to look for better returns elsewhere. Additionally, the bank's dependence on uninsured deposits made it vulnerable to sudden withdrawals.

The bank had to pay more to keep deposits just when rising rates were damaging the value of its mortgage portfolio. While this problem was not anticipated, First Republic and other banks believed it would weather the Fed's inflation-fighting without issue.

IS INDIA GOING TO BE A VICTIM?

Despite this recent financial instability in US and Europe, the Indian banking system has demonstrated resilience and has not been drastically impacted. The RBI Governor, Shaktikanta Das, recently provided reassurances regarding the strength and durability of the Indian banking sector. The RBI has established various prudential regulatory frameworks, such as capital adequacy requirements, asset classification and provisioning requirements, dividend distribution framework, and liquidity management framework, to address system-wide risks.

IS THE BANKING CRISIS OVER YET?

The recent failure of First Republic Bank, despite being quickly taken over by JPMorgan, serves as a reminder that the banking crisis may not be over yet. The collapse of SVB and FRCB also demonstrates how risky decisions at one bank can spread rapidly to the broader financial system.

The business model of banks like First Republic Bank, Silicon Valley Bank, and

Signature Bank did not adapt well to rising interest rates, emphasising the need to review liquidity requirements and more rigorous stress testing. These challenges facing the banking sector suggest that the crisis is ongoing and uncertain when it will be resolved. In addition, other banks in the US hold significant unrealised losses on investments, and the banking sector is flush with the same kind of paper losses. Although regulators have taken steps to protect all uninsured depositors, banks could still face significant losses in the event of a bank run or market selloff. Policymakers and regulators must address incentive structures that encourage excessive risk-taking and reconsider liquidity requirements and stress testing rules. The fractional banking system can only work if people have confidence and trust that their money will be there when needed.

Cracking The Code Of Multibagger Investing: Spot Potential 100X Returns

Almost all of us might have seen articles with clickbaity titles like "Make Rs 42,000 to Rs 1,00,00,000 in just 2 years". But these "get rich quick" schemes are just not legitimate and should be avoided. Many new investors get attracted to these schemes and lose money.

But there is a "legal" way to make multi-fold investment returns. It is not a sure-shot method and often takes a long period to turn fruitful. These investments require patience, commitment and tedious research. These are Multibagger Stocks.

"When we own portions of outstanding businesses with outstanding managements, our favourite holding period is forever" - Warren Buffett.

Simple yet powerful advice, especially when one wants to pick stocks that could turn into multi-baggers in future.

Whether you are a seasoned investor or a newbie in the stock market, understanding multibagger stocks and how to find them can help you make informed investment decisions and increase your chances of generating high returns. This article will enlighten you about multibagger stocks and everything you need to know before investing. You will learn how to identify multibagger stocks and the risk and rewards involved. We will also discuss the key characteristics of companies that have the potential to become multi-baggers. We'll start with the basics and then delve deeper, so continue reading.

What Are Multibagger Stocks?

Multibagger stocks can generate returns several times the amount invested in them. The term was first introduced in 1988 by Peter Lynch in his book, One Up on Wall Street. Multibagger stocks do not refer to a separate category of shares but describe the characteristic feature of the shares.

Multibagger stocks are undervalued, with high growth potential and strong fundamentals waiting to be discovered by investors. These shares are of companies with unique characteristics like strong performance, capable management, and continuous free cash flows. These stocks may check all necessary quantitative and qualitative aspects but may remain undervalued.

Notably, these businesses were not established overnight, but it took them decades to become respected names in their respective fields. Investors who spotted them and remained invested reaped the rewards.

But the catch is a multibagger is a multibagger only in hindsight. Initially, it may look like a risky investment in an abnormal market environment. These may also take a considerably long time to show high values; therefore, investors need to be patient. They might not give explosive returns initially, but they hold the potential to be a big mover in the long term.

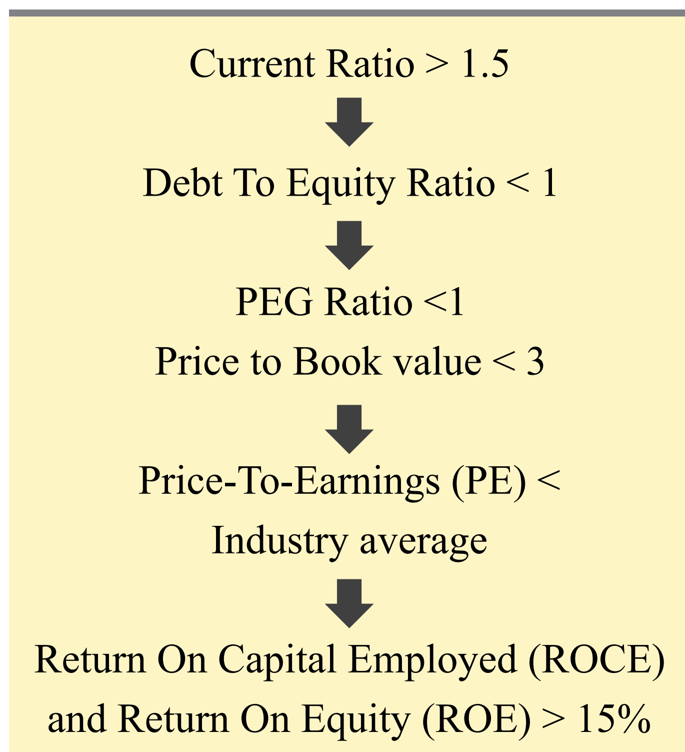
A set of criteria determines the potential to become a multibagger stock. Some vital signs can help you pick a multibagger, but there is no guarantee of high returns when buying such stocks.

How To Identify Multibaggers?

To identify multibagger stocks, investors need to consider several factors. There is no particular framework to pick multi-baggers in all market conditions. Even experienced investors and fund managers might miss such opportunities. Finding multibagger stocks is not an easy task, and it is crucial to understand that such high returns don't happen overnight; it requires patience and perseverance.

1 Initial Screening

When identifying multibagger stocks, the first step is to conduct an initial screening to shortlist potential stocks. The sheer number of listed public companies can make it challenging to sift through each one, making an initial screening a vital part of the process. You can use a few simple financial ratios to streamline this initial screening process.



These ratios are just examples to demonstrate the screening process. However, it is important to note that this initial screening is just the first step in a rigorous process. Thorough research, analysis, and due diligence are necessary to ensure that investing in a potential multibagger stock is wise.

2 Quantitative Analysis

Quantitative analysis of multibagger stocks involves examining financial data to identify companies with the potential to deliver significant returns over a long period.

Here are some crucial points to check when conducting a quantitative analysis of multibagger stocks:

- Are the company's revenue, profit and margins growing?
- Is the company in Huge Debt?
- Does the company have increasing free cash flow?
- Has the ROE of the company been consistently high?
- Does the company have a strong promoter holding?
- Are the Earnings per Share constantly growing?

We have listed down a few of the essential points to keep in mind, but the list does not end here.

Investors can identify companies that may deliver significant returns over time by analysing key metrics.

3 Qualitative Analysis

Qualitative analysis is a key factor in determining the potential of multi-bagger stocks. It involves evaluating the company's underlying strengths and competitive advantages. Here are some of the essential elements to consider when performing a qualitative analysis of multi-bagger stocks:

- Do you understand the business of the company?
- Does the company have a Diversified Product Portfolio?
- Is the company part of a Growing and Perennial Industry?
- Does the company have Strong and Capable Management?
- Is the company in a position of Competitive Advantage?
- Is the business model of the company scalable?

There is a lot more on which the quality of a company is judged. By considering these factors, investors can better evaluate the potential of a company to generate long-term returns.

4 Valuation

Valuation is a critical aspect of investing in stocks, and investors need to have a reasonable understanding of a company's intrinsic value to identify potential multibagger stocks. While the cheap valuation may not be bad, high valuations do not necessarily guarantee wealth generation. Investors must use various valuation techniques, such as discounted cash flow, relative, and absolute valuation, and examine multiple ratios and metrics to determine a company's true standing.

Companies can inflate valuations to attract investors, and favourable market conditions can lead to misconceptions that all companies are performing well. Therefore, investors must be cautious and examine all factors before investing in a company. Finally, investors should look for undervalued companies with good fundamentals, which have the potential to become multibagger stocks.

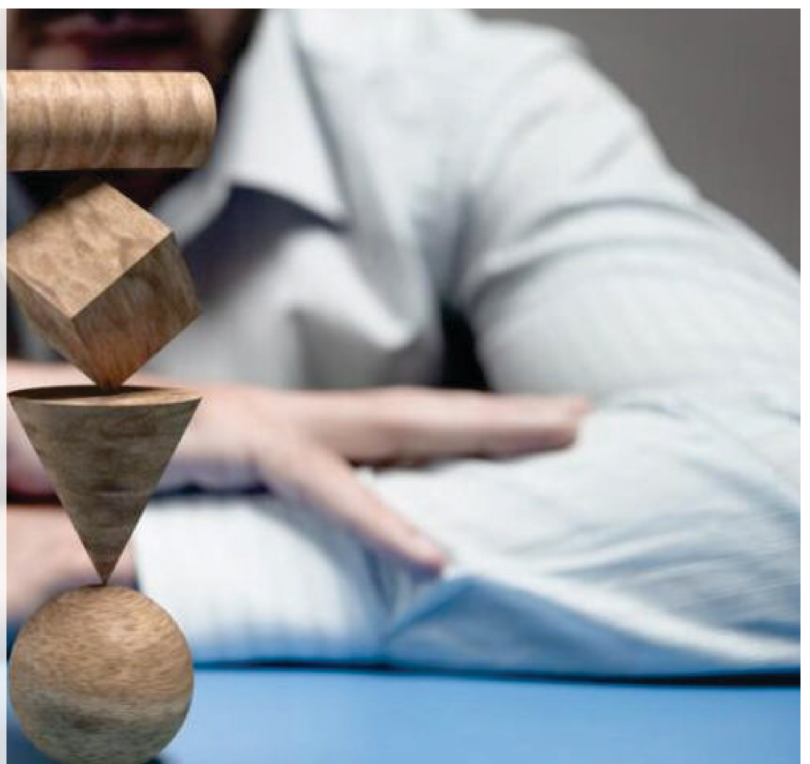
5 Patience

Investing in multibagger stocks can be lucrative, but it requires patience and a long-term investment approach. Spot trades on multi-baggers, even at a reasonable price, may not yield higher returns and can waste investment potential. Investors may be tempted to sell their shares in a multibagger stock while it is still rising, but this can result in missed opportunities for greater returns in the future. Therefore, patience is essential for maximising the benefits of investing in multibagger stocks.

Do Multibagger Stocks Make For Profitable Investments? Aren't They Risky?

Multibaggers can be both a boon and a bane. It is a medley of deep research and luck to land a multibagger stock.

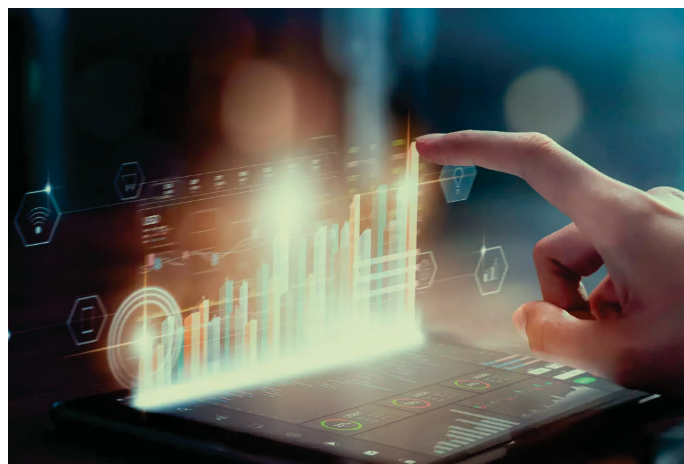
Multibagger stocks can provide investors with high returns but can also be risky. Only if an investor has a high-risk appetite and can digest the ups and downs of the market can multi-baggers turn out to be a good investment.



Can I Rely On Online Sources To Pick Multi-Bagger Stocks?

Numerous websites, stock screeners, social media channels, stock market influencers, and videos provide information on potential multi-bagger stocks that promise high returns. With all this available online, investing in multi-bagger stocks "seems" like an easy task.

But, there is no guarantee of its accuracy. Blindly relying on any information online can be risky. It's important to not follow buying and selling recommendations from untrusted sources. When it comes to multi-bagger stocks, traditional methods and thorough fundamental analysis can be your best bet. This process, though essential, can be tedious and time-consuming.



Why Is Finding Multibaggers So Challenging?

Finding multi-baggers is a tedious process requiring much patience and commitment. Most investors are focused on making quick profits. Moreover, investors often miss obvious signs of trouble with their investments. Another common mistake is that investors tend to book profits too soon. Investors may also misunderstand basic math and invest in stocks already reaching their potential.

To reap the maximum profits from multibagger stocks, investors need to make informed and reasonable bets while having the patience to allow the bigger picture to play out and potentially earn significant returns.

DERIVATIVE EXPIRY AND ITS IMPACT ON THE INDIAN MARKET

Trading has recently become a popular career path, especially in Derivatives. It is such a massive chunk of the Stock Investment Arena that sometimes changes in the derivative market can also impact the Equity Market. This is where the expiry date comes into play. For those new to trading, the concept of contract expiry might be confusing.
In this article, we will discuss the basics of Derivatives, futures and options expiry in India and the impact of expiry on the Indian stock market.

WHAT ARE DERIVATIVES?

A Derivative contract is a contract wherein two parties agree to buy and sell a financial instrument at an agreed-upon price on a future date. The value of the contract is determined by the underlying asset such as stocks, currencies, commodities, etc. These contracts are usually used for hedging against any current investments.
The two most common types of derivative contracts are – Futures and Options (F&O). Both of these contracts carry a promise to buy or sell at the pre-fixed price and date. However, under a Futures contract, both parties are obligated to fulfil the promise irrespective of the loss or profit they incur. The contract has to be fulfilled on or before the date of expiry. Whereas there is no such compulsion under an Options contract, the buyer has the right to fulfil the contract without any obligation. But if the buyer wishes to buy, the seller has to sell the contract, for which they will receive a premium in addition to the contract price. This is a major differentiator between the two derivative contracts.

HOW DO FUTURES AND OPTIONS WORK?

Futures and options trading are quite different from trading stocks. With futures contracts, traders have to fulfil their obligation before the contract expires, regardless of the price at the expiration time. In contrast, options traders can choose to participate or not participate in the trade before expiration, but they have to pay a premium for this privilege.

Futures are leveraged products, i.e. the total cost of trading is not paid upfront but rather financed by a broker, provided a minimum amount is maintained by an investor in the investor's trading account. It is crucial to remember that the impact of leverage through margins works both ways: in the case of profits and losses.

Margins on futures can increase sharply in volatile times, so traders must always be aware of this risk.

Buying options means limited risk, but the chances of profit-making are low. The buyer's loss is limited to the premium, but the seller's loss is potentially unlimited, and therefore, they make money more often compared to option buyers. It is important to remember that the prospects of making profits are limited when buying options.

Options can be used to profit in volatile and lacklustre markets and combined with futures to adopt a non-directional strategy. Options can also be used to hedge against potential losses in the futures market.

EXPIRATION AND SETTLEMENT OF F&O CONTRACTS

Futures and options contracts are agreements to buy or sell underlying securities, commodities, currencies, or any other asset for a particular period.

However, these contracts have an expiration date upon which they must be exercised. It's important to note that the contract's expiration date is not the asset's expiration date.

Expiry date indicates the last day the contract is valid, and it's when the derivative contract- futures or options- expires. It is essential to settle the contract before the expiration date.

The Indian stock exchange has a fixed standard expiry date for the F&O market to avoid confusion and ambiguity among traders. Monthly futures and options contracts in the Indian stock market expire on the last Thursday of every month. So, this month the contracts will expire on 25 May.

Nowadays, Index Contracts also have a weekly expiry, i.e. every Thursday. Active traders can benefit from this weekly contract expiry. In the case of the market's closure on a Thursday, the expiry day will be the previous trading day.

The Securities and Exchange Board of India (SEBI) also regulates the F&O market, and traders must follow the rules and regulations set by SEBI.

Settlement of F&O contracts can be done either through cash settlement or physical delivery settlement. Cash settlement involves settling the difference between the spot price and the price of the derivative through the exchange of cash. Derivatives in the Indian Markets are

currently settled on Cash Basis only. Physical delivery settlement is common in commodity contracts, where the seller delivers the underlying asset to the purchaser, and the purchaser pays the price for it. Settlement of a futures contract can be done by either settling in cash or through physical delivery. On the other hand, option contracts can also be cancelled, making them more flexible for the buyer. If the contract is not acted upon before the expiration date, it simply expires, and the seller forfeits the premium paid by the buyer.

EFFECT OF F&O EXPIRY ON STOCK PRICES

The expiry date of Futures and Options contracts is an important date that affects the stock market significantly. It refers to the settlement date of these contracts and marks the end of the contract's validity. The stock market undergoes considerable volatility close to the expiry date as traders execute trades to maximize profitability.

Arbitrage trading is one factor that impacts stock prices close to the expiry date. Before the contracts' expiration date, F&O traders that engage in arbitrage trading assess the performance of the contracts' underlying assets. They trade on the secondary markets to maximize profitability, which causes price fluctuations and impacts the overall stock

market. However, this effect is temporary because the stock market will correct itself after the expiration date.

Derivatives contracts derive their value from underlying assets, and the value of the contract varies with the underlying asset's price fluctuations. For instance, in an equity options contract, the value of a call option increases when the equity price increases and decreases when the equity price drops.

But it can work the other way too. Any positive sentiment in the derivatives market can increase the demand for buy contracts compared to sell contracts. This can lead to an influx of investors buying

the given stock in anticipation of increasing price in the future and begin to push demand higher for the same scrip, which can push the price of the stock higher. On the other hand, when the markets are bearish, investors may see more sell contracts than buy contracts, leading to a decrease in stock prices.

WRAPPING UP

To sum up, the expiry and settlement of F&O contracts play a crucial role in the Indian derivatives market. As the market moves towards increased digitization and trading volumes, traders need to be aware of the expiry date and its impact on the market. Understanding SEBI's rules and regulations, the standard expiry date, and the settlement procedures can help traders make informed decisions and avoid any penalties.

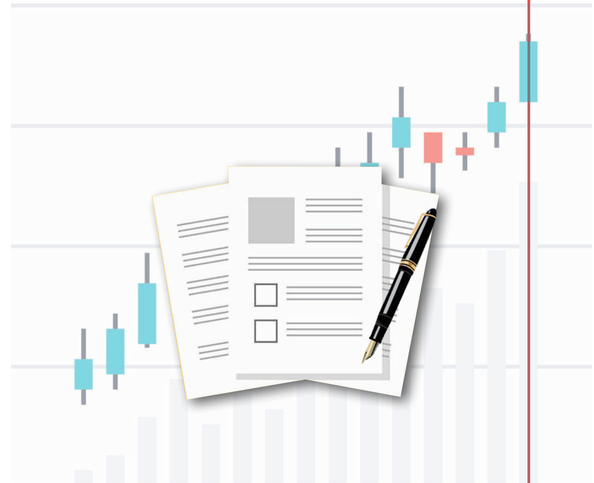
Whether you are a seasoned trader or a novice, keeping track of the expiry date of derivative contracts is vital for successful trading. With the proper knowledge and strategy, traders can navigate the market's mood near the expiry date and make informed trading decisions. Ultimately, it is essential to approach F&O trading with a well-informed and researched approach to achieve financial success.

A Portfolio Or A Single Stock, Hedge Using Futures

We are exposed to risks in the stock market from internal and external factors. We can do nothing to predict and safeguard ourselves from external factors. But we can try to protect our portfolio from some risks. Let us discuss in detail how we can do the same.

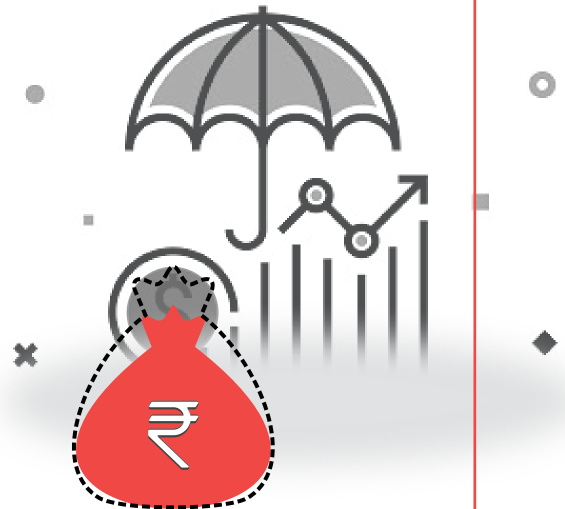
Futures

Futures Contracts are derivative instruments where a party is obligated to buy or sell a stock at a predetermined future date at a fixed price. A derivative's price depends on the movements in the price of the related stock. Hedging is one of the essential functions of Futures Contracts.



Hedging

In layman's terms, hedging is covering your risks. A hedge is an investment to cover the risks of an adverse market. It is a strategy used to reduce the risk of adverse price movements by taking a position in the opposite direction of the original trade.



Why Hedge?

Without a hedging strategy, they can either sell their assets and buy back the same when the price falls or just sit back and wait for the prices to bounce back up.

Both of these strategies do not guarantee loss reduction or profit. That is why hedging in these situations is the best option to safeguard your positions in the market.

When To Hedge?

There are a few situations when a trader decides to hedge. It could be that the trader suspects that a particular stock's price will fall. This prediction may be based on negative news, inside information, or pure speculation.

How Much To Hedge?

The next question that comes to mind is what amount to hedge with. This depends on the value of the stock or portfolio and the beta of the same. The hedge value is simply the product of the two. The value of the stock or the portfolio is clearly visible on any trading platform. Let us see what beta means and how it is useful.

Risks

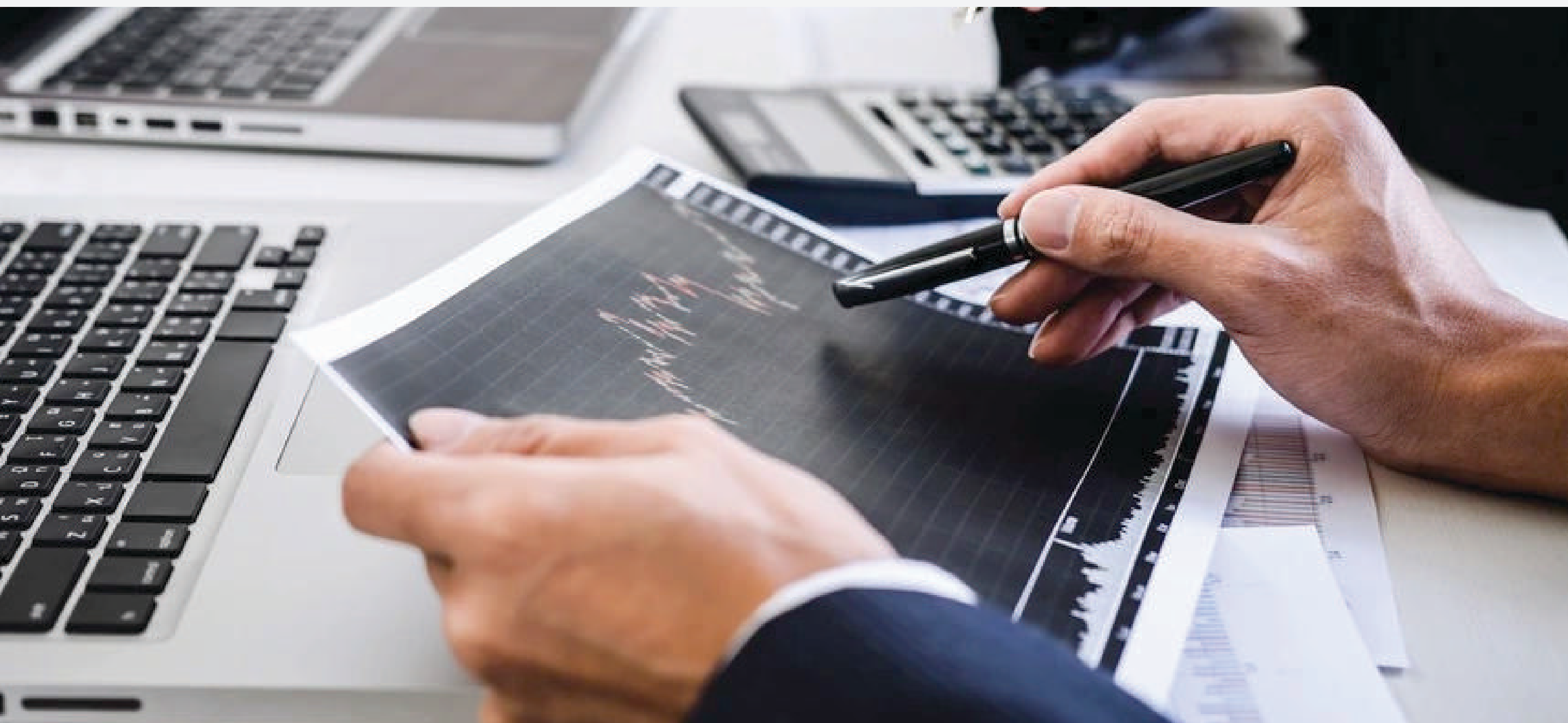
Risk is the chance that the outcome of a trade will be different from what is expected and may lead to a loss of invested capital. Broadly, risks in the stock market are of two types- Systematic and Unsystematic.

Systematic or Market risks are risks that affect the overall market or a large percentage of it. Factors such as political shifts, changes in interest rates, or inflation are included under Market risk. Unsystematic risk is losing your investments due to a particular company or industry. These risks could be a change in management, a new competitor, or poor financial reports. Investors are exposed to both these types of risks in general. Unsystematic risks can be easily prevented by diversifying your portfolio.

Beta

Beta is one of the most used indicators and a crucial concept in the financial market. It helps in assessing a stock's volatility concerning the market. It is denoted by the Greek alphabet β. The beta of a stock is the form of a number. Since we are determining the beta concerning the market, the beta of the particular index is +1. The following table will help us understand how we can interpret a stock's beta.

Beta	Interpretation	Example
$\beta < 0$	The stock price will move in the opposite direction of the market	$\beta = -0.3$ A 10% increase in the market will lead to a 3% decrease in the stock
$\beta = 0$	Any movement in the market will not affect the price of the stock	$\beta = 0$ Any change in the market will not affect the stock
$0 < \beta < 1$	The stock price will move in the same direction as the market but by less magnitude	$\beta = +0.8$ A 10% increase in the market will lead to an 8% increase in the stock
$\beta > 1$	The stock price will move in the same direction as the market but by more magnitude	$\beta = +1.4$ A 10% increase in the market will lead to a 14% increase in the stock



Hedging Using Futures

Futures contracts have a limited lifespan and are obligatory. Investors use futures contracts for hedging to reduce the risk of loss caused by an unfavourable market value of the underlying asset. By obtaining a futures contract on a futures exchange, investors offset their price risk and secure a predetermined price for their product. When the underlying asset's value is highly volatile, investors are more likely to purchase futures contracts for hedging.

Hedging A Single Stock

Let's look into how we can hedge a single stock and how that will benefit us.

Imagine you have bought 100 shares of XYZ at Rs 200/- each, a total of Rs 20,000/-. After a few days, there was a downfall in the stock prices. Since you are long on XYZ in the spot market, to hedge your position in XYZ, you can use short positions in XYZ futures to offset your potential losses.

Assuming the current XYZ futures price is Rs 205/- per share, you can sell 100 shares of XYZ futures at this price, which would give you a total of Rs 20,500/- (100 x Rs 205/-) in the futures market.

Share Price (Rs.)	Spot Market Profit/(Loss) (Rs.)	Futures Profit/(Loss) (Rs.)	Total Profit/(Loss) (Rs.)
180	(180-200)*100=(-2000)	(205-180)*100=2500	(-2000)+2500=500
220	(220-200)*100=2000	(205-220)*100=(-1500)	2000+(-1500)=500

If the XYZ stock price were to drop, your futures contract would gain in value, offsetting the losses in your spot market investment.

On the other hand, if the XYZ stock price were to rise, your futures contract would decline in value. However, you would still profit from your investment since you are long in the spot market. By hedging, you have reduced risk exposure and protected yourself from potential losses. However, it's essential to carefully consider the transaction costs and other fees before making any trades. You might now have questions like What if a stock that does not have a futures contract or how to hedge an entire portfolio? There is a simple answer to both of these questions - Indices.

Hedging With Indices

Indices like Nifty and Sensex have futures contracts in the derivative market and can be traded similarly to stock futures. So, hedging using indices becomes an obvious choice when a stock does not have a futures contract or a diversified portfolio needs to be hedged.

Index Futures are a popular choice as they provide exposure to the broad market index and are highly liquid, making them easy to trade. They are an efficient tool to hedge against systematic risk and are a natural choice for investors looking to protect their portfolios.

Let us first create a diversified portfolio in a hypothetical market and then go through the step-by-step hedging process.

	Stock Name	Beta	Investment Value
1.	A Bank	0.6	Rs.80,000/-
2.	B Services	1.3	Rs.90,000/-
3.	C Meds	1.1	Rs.1,20,000/-
4.	D Tech	0.9	Rs.60,000/-
5.	E Cement	1.4	Rs.1,50,000/-
	Total		Rs.5,00,000/-

Step 1:- Portfolio Beta

It is the sum of the weighted beta of each stock. Firstly, we calculate the weightage of each stock in the portfolio by dividing the sum invested in each stock by the total portfolio value.

Then we multiply the individual stock beta by its respective weightage in the portfolio. Adding the weighted beta of each stock in the portfolio will give us the Portfolio Beta.

Let us calculate the beta of our hypothetical portfolio.

Stock Name	Weight	Weighted Beta
A Bank	16%	0.096
B Services	18%	0.234
C Meds	24%	0.264
D Tech	12%	0.108
E Cement	30%	0.420
	Portfolio Beta	**1.122**

In our hypothetical market, our portfolio beta is 1.122. This means if the index goes up by 10%, our portfolio will increase by 11.22%.

Step 2:- Calculate The Hedge Value

It is simply the product of the beta and value of the portfolio.
In our case, the hedge value would be

Hedge Value = Rs. 5,00,000 * 1.122
= Rs. 5,61,000/-

Since hedging uses indices, we need to short these indices in the futures market totalling the hedge value. These are usually traded in lots. Let the index in our scenario be XYZ with a lot size of 25 and trading at 1010.

Hence, the value of one lot would be
= Rs. 1010* 25
= Rs. 25,250/-

The number of lots required to short XYZ
= 5,61,000/ 25,250
= Approx. 22.21 lots

The calculation above shows that we must short 22.21 lots of XYZ futures. However, since fractional lot sizes are not available. This would result in either an under-hedged or over-hedged position. This illustrates that we cannot always perfectly hedge a portfolio and that the effectiveness of the hedge will depend on the chosen number of lots and the degree of correlation between the portfolio and the market index. We will short 23 lots.

Step 3:- Results

XYZ fell by 75 points (about 7.5%) after employing the hedge.

Our XYZ Position

Short initiated at - 1010
Decline in Value - 75 points

XYZ current value - 965

Number of lots - 23

Profit/(Loss) = No. of lots * Lot size * Change in index

= 23 * 25 * 75

= Rs. 43,125

The short position has gained Rs. 43,125/-. We will look into what could have happened to the portfolio.

Portfolio Position

Portfolio Value	= Rs.500,000/-
Portfolio Beta	= 1.122
Decline in Market	= 7.5%
Expected Decline in Portfolio	= 7.5% * 1.122 = 8.415%
	= 8.415% * 5,00,000
	= Rs. 42,075

As you can see, the market position has a gain of Rs. 1050/-. The gain from the XYZ futures position has more than compensated for the portfolio's loss.

We hope you now have a basic idea of what hedging is and how important it is. Hedging is an important strategy to reduce risk in the stock market, which can help protect against both systematic and unsystematic risks and is especially useful when a trader suspects that a particular stock's price will fall. Hedging can be a useful tool for traders and investors to mitigate risk and protect against unpredictable market movements.

Stock To Bet On

Nestle India Ltd

ITC Ltd

ICICI Bank Ltd

Axis Bank Ltd

Tata Motors Ltd

Exclusive Recommendation By:

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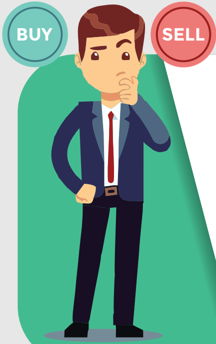

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