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A Study on Futures and Option Strategies

Prof. Amrut Rumde, Prof. Bhavika Rumade, Rajesh Pogale
Assistant Professor and Research Scholar
Nirajana Majethia College, Kandivali, Mumbai, India
St. Rock's College of Commerce and Science, Borivali (W), Mumbai, India

Abstract*: This research paper explores the intricacies. Futures and Options are financial Derivatives that play very crucial role in the modern Financial Markets. This abstract provides a concise overview of the intricate world of Futures and Options, shedding light on their fundamental concepts, strategies, and the inherent risks. This research paper delve into the mechanics of these derivatives, discussing how they enable investors to manage risk, speculate on price movements, and enhance portfolio performance. Additionally, This research paper explore the dynamic of these markets, considering factors such as volatility, pricing models, and the regulatory framework. By understanding the intricacies of future and options, investors and financial professional can make informed decisions in a dynamic and ever-evolving financial landscape. This abstract serves as an entry point to a comprehensive exploration of these derivatives and their role in contemporary finance.*

Keywords: Futures and Options

I. INTRODUCTION

A future contract is an agreement made directly made between two parties to buy and sell an asset on a specific date inn futures, at the terms decided today. Futures are widely used in commodities, foreign exchange, equity and interest rate market.

Let us understands with the help of example. What is the basic difference between the cash markets and futures? Assume that on May 11, 2023 you want to purchase gold form goldsmith. The market price for gold on this day is Rs. 62,130 for 10 grams of gold. And the goldsmith agrees to sell you gold at this price. You pays him 62,130 for 10 grams of gold and take delivery of the gold. This is a cash market transaction as a price (in this case Rs. 32,130) referred to as spot price

Now suppose you do not want delivery of the gold on May 11, 2023, but only after 1 month. The goldsmith quotes you Rs.62, 337 for 10 grams of gold. You agree to the forward price for 10 grams of gold and go away. Here, in this example, you have ''bought a future contract'' or you are ''long forward'' whereas the goldsmith has sold a futures contract or he is short future. There is no exchange of money and gold at this point of time. After 1 month you came back to the goldsmith pays him Rs.62, 337 and take 10 grams of gold from him. This is future, where both the parties are obliged to go through with the contract irrespective of the value of the underlying asset (in this case gold) at the time of delivery

Essential features of a forward are:

• It is a contract between two parties (a bilateral contract)

• All terms of the contract like price, quantity, and quality of underlying, delivery terms like place, settlement procedure, etc. are fixed on the day of entering into the contract

In other words, future are bilateral over-the-counter (OTC) transaction where the terms of the contract, such as price, quantity, quality, time and place are negotiated between two parties of the contract. Any alteration in the terms of the contract is possible if both the parties agree to it. Corporations, traders and investing institution extensively use OTC transaction to meet their specific requirements. The essentials idea of entering into a future is to fix the price and thereby avoid the price risk. Thus, by entering into futures, one is assured of the price at which one can buy/sell and underlying asset.

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An option is a contract that gives the holder of the option the right, but not the obligation, to buy and sell the underlying asset on a before a stated date/day, at a predetermined price. The right can be bought known as the option premium. The party taking a long position i.e. buying the option is call buyer/holder of the option and the party taking a short position i.e. selling the option is called the seller/writer of the option. The option buyer pays the premium to the option seller upfront, i.e. at the time of buying the option

The option buyer or the holder has the rights but not an obligation with the regards to buying or selling the underlying assets, while the option writer has the obligation in the contract. Therefore, the option buyer will exercise his option only when the situation is favourable to him. On the other hand, the option writer is legally bound to honour the contract whenever the option buyer decides to exercise his option

Options may be categorized into two main types

• Call option
• Put option

An option, which gives the buyer/holder a right to buy the underlying asset, is called a call option; and an option which gives the buyer/holder a right to sell the underlying asset, is called put option.

II. REVIEW THE LITERATURE

1. Introduction to futures and options – Many reviews start by the explaining the basic concepts of the futures and options, highlighting their role in financial markets for the risk management, speculation, and hedging
2. Market Efficiency – This section often discusses the Efficient Market Hypothesis (EMH) and how it applies to future and option market. Researchers explorer whether these markets are truly efficient and whether arbitrage opportunities exists
3. Price Determinants – Understanding what factors influence futures and options price is crucial. Common determinants include underlying asset price, interest rates, dividends, and market sentiment
4. Option Pricing Models – The Black-Scholes-Merton model and its variations are often a central focus. Researchers explore the strengths and limitations of these models, including their assumptions
5. Hedging and Risk management – How futures and options are used for hedging various risks, such as price risk, interest rate risk, and foreign exchange risk, is a key area of study.
6. Speculations and Trading Strategies – Researchers examine different trading strategies involving options and futures, such as delta hedging, straddles, and spreads, and their profitability over time
7. Market Microstructure- This area delves into how futures and options markets operate, including trading mechanism, liquidity, and the impact of electronic trading.
8. Volatility and Implied Volatility – The concept of volatility, especially implied volatility in the options, is extensively analysed. The volatility smile and skew are the important topics in the context.
9. Risk Assessment – Risk assessment tools and models such as value at the Risk (VAR) and stress testing are explored to manage risk in futures and options portfolios
10. Regulatory and Legal Aspects – This section may discuss regulations surroundings futures and option markets including reporting requirements margin requirements and position limits
11. Empirical studies and Case Analyses – Researchers often provide empirical evidence and case studies to illustrate the application of futures and options in real-world scenarios
12. Behavioral Finance – Some reviews delve into how psychological factors and behavioural baises influence decision-making in future and options trading
13. Commodity and Energy Markets – Literature reviews may also focus on futures and option in specific markets such as commodities and energy exploring unique characteristics and challenges
14. Options in Non-Traditional Assets – This sections may cover options on assets beyond traditional equities such as cryptocurrencies environmental commodities and more.
15. Risk and Returns – Research examines the risk-return trade-off different futures and options strategies and portfolio.

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2.1 Objectives of the Research

1. To study the concept of derivatives markets.
2. To know the trading strategies of futures and options.

III. RESEARCH METHODOLOGY

Secondary data

This research paper is based on Secondary data collection from books, journal, internet, etc.

IV. CONCLUSION

If you're looking for some additional help with futures and options trading, we have many trading platforms and tools that can assist you and make planning and strategy building easier. Our options trading platform, Sensibull, is one such useful tool. With Sensibull, you get advanced tools for analysing your trades and have access to the strategy builder function, which creates and analyses option strategies. Check it out to make your derivative trading smoother.

REFERENCES

[1]. The Complete Guide to Options & Day Trading: This go to guide shows the advanced strategies and tactics you need to succeed to Day Trade Forex, Options, Futures, and Stocks:

[2]. David Hewitt • Andrew Peter (June 2021).