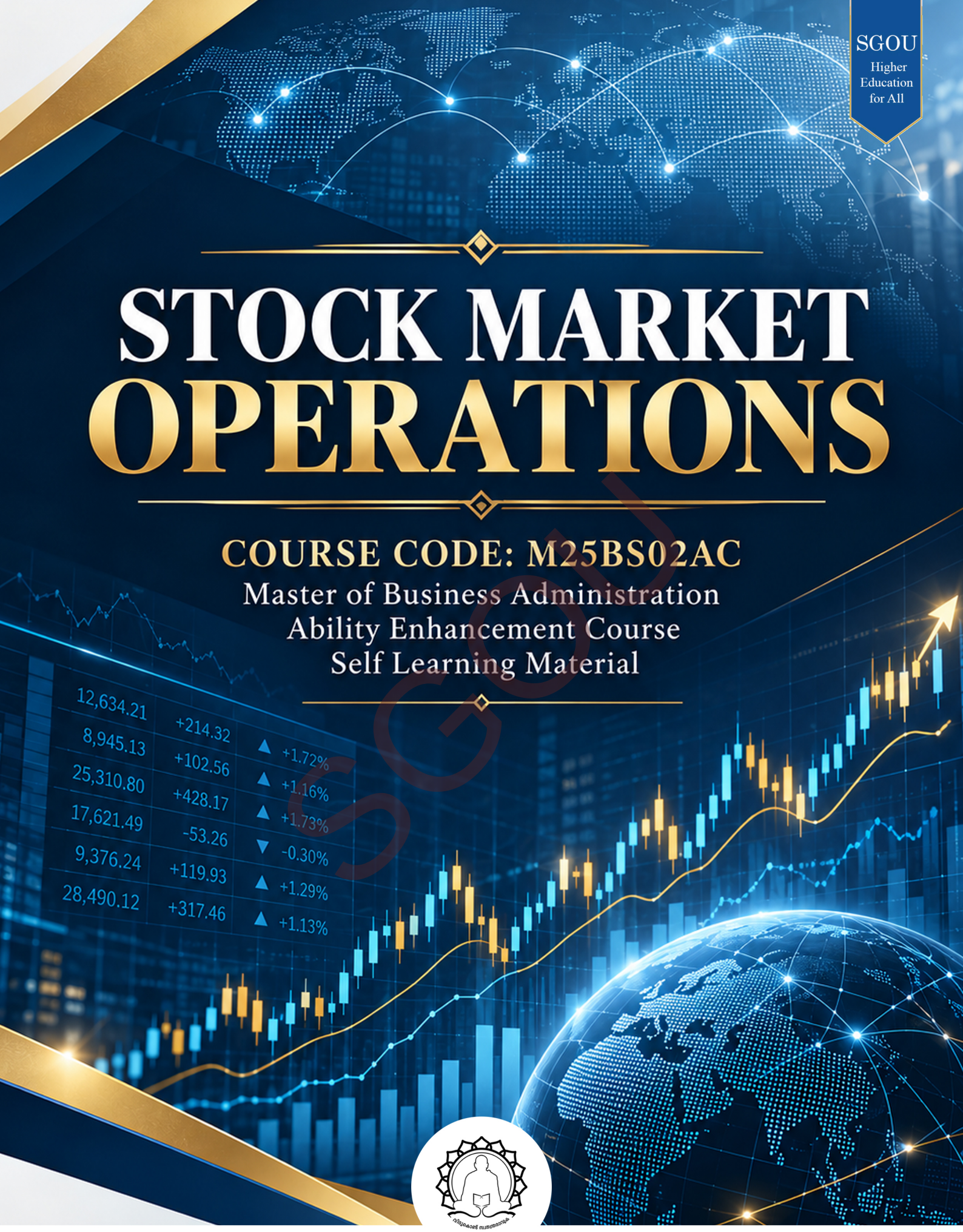
SGOU
Higher Education for All

STOCK MARKET OPERATIONS

COURSE CODE: M25BS02AC

Master of Business Administration
Ability Enhancement Course
Self Learning Material



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SREENARAYANAGURU OPEN UNIVERSITY

SREENARAYANAGURU OPEN UNIVERSITY

The State University for Education, Training and Research in Blended Format, Kerala

SREENARAYANAGURU OPEN UNIVERSITY

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Vision

To increase access of potential learners of all categories to higher education, research and training, and ensure equity through delivery of high quality processes and outcomes fostering inclusive educational empowerment for social advancement.

Mission

To be benchmarked as a model for conservation and dissemination of knowledge and skill on blended and virtual mode in education, training and research for normal, continuing, and adult learners.

Pathway

Access and Quality define Equity.

Stock Market Operations

Course Code: M25BS02AC

Semester - II

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Ability Enhancement Course
Master of Business Administration
2025-26 Admission
Self Learning Material

(With Model Question Paper Sets)

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STOCK MARKET OPERATIONS

Course Code: M25BS02AC
Semester- II
Ability Enhancement Course
Master of Business Administration

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Edition
October 2026

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ISBN 978-81-181797-3-3

9 788118 179733

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MESSAGE FROM VICE CHANCELLOR

Dear Learner,

It gives me immense pride and heartfelt satisfaction to welcome you to Sreenarayanaguru Open University—a transformative space where aspirations are nurtured, potential is unlocked, and futures are shaped with purpose.

Established in September 2020 as a pioneering state initiative, the University stands as a symbol of inclusive, accessible, and high-quality higher education. Anchored in our guiding philosophy—"access and quality define equity"—we are committed not merely to expanding educational opportunities, but to ensuring that every learner receives an education that is meaningful, relevant, and transformative.

Our journey is deeply inspired by the timeless vision of Sreenarayana Guru, whose ideals of knowledge, equality, and social empowerment continue to illuminate our path. His philosophy reminds us that education is not just a means to an end, but a powerful instrument for personal growth, societal progress, and human dignity.

In a rapidly evolving and digitally driven world, we recognize that learning must be flexible, dynamic, and future-ready. Our thoughtfully designed blended learning ecosystem—integrating Self-Learning Materials, Classroom Counselling, and Virtual Learning Platforms—ensures that you experience the best of both independence and guided academic engagement. This model empowers you to learn at your own pace while staying meaningfully connected to academic support systems.

The MBA programme at Sreenarayanaguru Open University is not just a degree—it is a gateway to leadership, innovation, and professional excellence. The curriculum is meticulously curated to reflect the realities of the contemporary global business landscape, seamlessly blending foundational management principles with cutting-edge developments in business and technology.
You will explore and engage with:

- Strategic management and entrepreneurial thinking
- Digital transformation, FinTech, and emerging technologies
- Logistics, supply chain, and global business ecosystems
- Consumer behaviour and evolving market intelligence
- Human resource management in the age of Artificial Intelligence
- Ethical leadership and sustainable decision-making

Designed with a multidisciplinary and future-oriented perspective, the programme offers diverse specializations, skill enhancement pathways, and exposure to innovative domains that align with industry expectations. It is structured to strengthen your employability, entrepreneurial mindset, and leadership capabilities—equipping you to excel in competitive and complex professional environments.

Our Self-Learning Materials are crafted with exceptional care, combining conceptual clarity with real-world relevance through case studies, contemporary examples, and practical insights. They are designed not only to inform but to inspire critical thinking, problem-solving, and adaptability—skills that are essential in today's disruptive and ever-changing business world.

At the heart of our mission lies an unwavering commitment to learner success. Our comprehensive learner support system is always within your reach, ensuring that your academic journey remains smooth, enriching, and fulfilling. We encourage you to actively engage, explore, question, and grow—because your success is the true measure of our purpose.

As you begin this important journey, I invite you to dream boldly, learn continuously, and lead responsibly. Let this programme be a stepping stone towards achieving your ambitions and making a meaningful impact in the world.

May your journey here be one of discovery, empowerment, and excellence.
With my best wishes for your success and lifelong learning,



Prof. (Dr.) Jagathy Raj V. P.
Vice Chancellor

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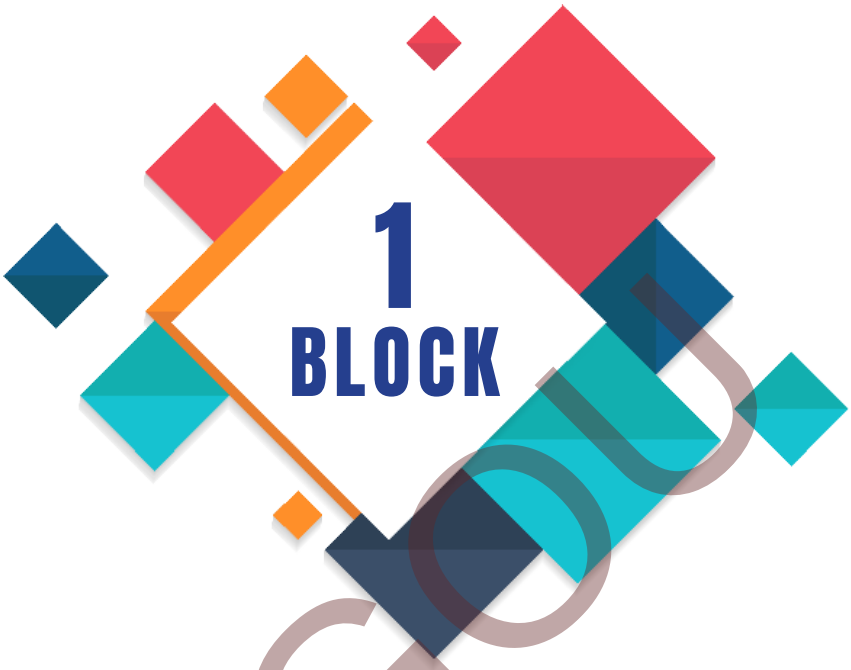
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Investing in Stock Market

Unit 1

Fundamentals of Stock Market Investment

Learning Outcomes

After the successful completion of the unit, the learners will be able to:

- ◊ explain the functioning of stock market
- ◊ examine the differences between primary and secondary markets
- ◊ understand the functioning of screen-based trading platforms
- ◊ evaluate investment opportunities using basic technical analysis tools
- ◊ apply basic technical indicators such as Moving Averages, RSI and MACD

Background

The stock market plays an important role in the financial system by providing an organised mechanism for the issuance and trading of securities and facilitating the flow of capital between investors and entities seeking finance. It enables investors to participate in the securities market, provides liquidity through secondary market trading and supports the mobilisation and allocation of capital within the economy.

The functioning and performance of the stock market are influenced by a wide range of factors, including macroeconomic conditions, corporate financial performance, interest rates, market expectations, government policies, regulatory developments and investor behaviour.

The evolution of stock markets from traditional floor-based trading to screen-based and technology-enabled trading systems has significantly transformed the investment process. Electronic trading has improved the speed and efficiency of transactions while enhancing market transparency, accessibility and information

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dissemination. Investors can now monitor real-time market information, analyse securities using digital tools and execute transactions electronically from virtually any location.

The growing participation of retail investors, institutional investors and other market participants has increased the importance of understanding the stock market. A sound understanding of market structure, trading mechanisms, investment strategies, derivatives and risk management helps investors evaluate investment opportunities and risks systematically. Such knowledge supports informed investment decisions, effective financial risk management and a better understanding of the role of securities markets in the broader financial system.



Keywords

Secondary Markets, Equity Shares, stock Exchanges, Intraday, Candle sticks, MACD, Support and Resistance, Online trading platforms



Discussion

1.1.1 Introduction to the Stock Market

Have you ever wondered how an individual can acquire an ownership interest in a large company without purchasing the entire business? This is made possible through shares, which represent units of ownership in a company. When a company raises capital by issuing shares, its ownership is divided into units, allowing individuals and institutions to acquire an ownership interest by purchasing these shares. After the shares are listed on a stock exchange, they can be bought and sold among investors in the secondary market.

The stock market refers broadly to the organised system through which shares and other equity securities are issued and traded. It encompasses the exchanges, market intermediaries, trading mechanisms, supporting infrastructure and regulatory arrangements involved in securities transactions.

According to Securities Contracts (Regulation) Act 1956, stock exchange is defined as any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating, or controlling the business of buying, selling, or dealing in securities.

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A defining characteristic of the stock market is the continuous movement of security prices, which reflects the changing interaction between demand and supply. When investors place buy and sell orders, the resulting demand for and supply of securities contribute to price determination. These market forces are influenced by various factors, including a company's financial performance and future prospects, industry conditions, interest rates, economic developments, government policies, regulatory measures, global market conditions and investor expectations. As new information becomes available or expectations about future conditions change, investors reassess the value of securities, leading to corresponding changes in market prices.

These price movements directly influence the returns and risks associated with investment in shares. Investors may earn returns through capital appreciation when the market price of a share increases and through dividends distributed by the company. However, neither form of return is guaranteed, and investors may experience losses when the market value of their investments declines. The extent of such risk varies with factors such as the financial performance of the company, industry and market conditions, as well as the investor's investment objectives and time horizon. Investment decisions therefore require an assessment of the expected return in relation to the level of risk undertaken, taking into account the investor's objectives and risk tolerance.

The process of participating in the stock market has also been transformed by technological developments. The transition from traditional trading practices to screen-based and electronic trading systems has enabled investors to access market information, place orders and execute transactions more quickly and efficiently. Real-time price information and electronic trading platforms have increased the accessibility and convenience of securities trading for a wider range of market participants. Consequently, effective participation in the stock market today requires not only an understanding of price formation, returns and risks, but also familiarity with the mechanisms and technologies through which securities are analysed and traded.

1.1.2 Primary and Secondary Markets

1.1.2.1 Primary Market

The primary market is the segment of the capital market in which new securities are issued and allotted to investors for the first time. It acts as a bridge between companies seeking capital and investors willing to invest their funds. The funds raised may be used for different purposes including business expansion, new projects, capital expenditure, repayment of existing obligations and other activities specified by the issuer.

Initial Public Offering (IPO) is an important primary-market mechanism through which a company offers its shares to the public for the first time and seeks listing on a stock exchange. Once the shares are listed, they can subsequently be traded among investors in the secondary market. Thus, the IPO connects the process of capital raising in the primary market with liquidity and trading in the secondary market.

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Companies that are already listed may raise additional equity capital through mechanisms such as a Follow-on Public Offer (FPO) or a Rights Issue. In an FPO, additional securities are offered to the public by an already listed company, whereas a Rights Issue gives existing eligible shareholders an opportunity to subscribe to additional shares, generally in proportion to their existing holdings. The primary market is significant because it facilitates capital formation by enabling issuers to obtain funds from investors.

1.1.2.2 Functions of the Primary Market

i. **Mobilisation of Savings :** The primary market mobilises savings from individuals and institutions by providing opportunities to invest in newly issued securities. It channels surplus funds from investors towards productive economic activities.

ii. **Raising New Capital :** It enables companies, governments and other eligible entities to raise fresh funds by issuing securities such as equity shares, preference shares and debt securities. The funds raised can be used for expansion, diversification, modernisation and other financial requirements.

iii. **Facilitating Capital Formation :** By directing savings towards productive investments, the primary market contributes to capital formation. It enables businesses to obtain long-term funds required for creating and expanding productive assets.

iv. **Providing Investment Opportunities :** The primary market offers investors opportunities to invest in newly issued securities according to their return expectations, investment objectives and risk tolerance.

v. **Supporting Business Expansion and Development :** Funds raised through new issues can be utilised for establishing new projects, expanding existing operations, acquiring assets, undertaking research and development, and meeting other strategic financial requirements.

1.1.2.3 Secondary Market

The secondary market is the segment of the securities market where securities that have already been issued are subsequently bought and sold among investors. The transactions in the secondary market take place between existing holders of securities and prospective investors.

An investor who purchases shares of a company through the primary market may subsequently decide to sell those shares. The investor does not normally return the shares to the issuing company for repayment. Instead, the shares are sold to another investor through the secondary market. Thus, the secondary market enables securities to change ownership after their initial issuance.

The secondary market performs the important function of price discovery. Security prices are continuously determined through the interaction of buy and sell orders placed

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by market participants. These prices incorporate investors' assessments of factors such as corporate performance, economic conditions, industry prospects, available information and expectations about the future.

In India, recognised stock exchanges such as the BSE Ltd. (BSE) and the National Stock Exchange of India Ltd. (NSE) provide electronic platforms for trading securities admitted to trading on their respective exchanges. Transactions executed through these platforms are followed by clearing and settlement through the relevant market infrastructure, involving clearing corporations, depositories and other authorised intermediaries. This infrastructure facilitates the orderly transfer of securities and funds between the parties to a transaction.

1.1.2.4 Functions of the Secondary Market

i. **Facilitating Price Discovery:** The secondary market facilitates the continuous determination of security prices through the interaction of demand and supply. Prices reflect the information, expectations and assessments of market participants regarding the value and future prospects of securities.

ii. **Enabling Transfer of Ownership:** It facilitates the transfer of securities from one investor to another through organised trading mechanisms. This allows securities to change ownership without requiring the involvement of the issuing company in each transaction.

iii. **Providing Liquidity:** The secondary market enables investors to convert their securities into cash by selling them to other investors. This provides investors with flexibility to enter or exit investments according to their financial needs and investment objectives.

iv. **Supporting Portfolio Management:** Investors can buy, sell or adjust their holdings in response to changes in financial objectives, risk preferences and market conditions. The secondary market therefore provides an important mechanism for portfolio rebalancing and risk management.

1.1.3 Basics of Equity Share

What does it mean when someone says, "I own shares in a company"? It means that the person has acquired an ownership interest in the company. This ownership is represented by equity shares, which are units into which the company's equity share capital is divided.

An equity share represents a proportionate ownership interest in a company. A person who holds equity shares is known as an equity shareholder and has certain rights and interests in the company, subject to applicable laws. The extent of an investor's ownership interest generally depends on the number of equity shares held relative to the company's total outstanding equity shares.

For example, suppose a company has 10 lakh equity shares outstanding and an investor holds 10,000 shares. The investor's proportionate ownership interest is:

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Ownership Interest = (10,000 / 10,00,000) × 100 = 1%

Thus, the investor holds a 1% ownership interest in the company's equity share capital.

Equity shareholders generally have voting rights on certain matters of the company, subject to applicable laws and the rights attached to their shares. These rights enable shareholders to participate in important corporate decisions, particularly through voting at general meetings.

The return on equity shares is not fixed or guaranteed. Equity shareholders may receive dividends when the company declares them, but the payment and amount of dividend depend on factors such as the company's profits, financial position, dividend policy and applicable legal requirements.

In addition to dividends, shareholders may earn a capital gain if the market price of their shares increases and they sell the shares at a price higher than their purchase price. However, the market price may also decline, resulting in a capital loss. Share prices are influenced by the company's financial performance, business prospects, economic conditions, market sentiment, investor expectations and other factors. Therefore, equity shares provide investors with ownership, potential dividend income and potential capital appreciation, but these returns are uncertain and involve market risk.

1.1.4 Stock Exchanges

A stock exchange is an organised and regulated marketplace where securities such as equity shares, bonds and certain derivative instruments are bought and sold according to established rules and procedures. It provides the infrastructure through which buyers and sellers can transact in securities in a systematic and transparent manner.

When a company issues shares to raise capital, investors can acquire those shares through the primary market. Once the shares are listed on a stock exchange, investors can subsequently buy and sell them among themselves in the secondary market Thus, a stock exchange facilitates both the listing of newly issued securities and their subsequent trading, providing an organised and transparent marketplace for securities transactions.

Modern stock exchanges primarily use electronic, order-driven trading systems. Investors place buy and sell orders through trading platforms, and these orders are transmitted to the exchange for matching according to established trading rules. This technology-driven mechanism allows a large number of transactions to be processed efficiently and promotes transparency in the trading process.

Stock exchanges also operate within a regulatory and risk-management framework. They establish trading rules and procedures, while regulatory authorities oversee the securities market to promote fair, orderly and transparent trading and protect investor interests.

In India, the two major stock exchanges are the National Stock Exchange of India Limited (NSE) and BSE Limited (BSE). Both play an important role in the development and functioning of India's capital market.

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1.1.4.1 National Stock Exchange (NSE)

The National Stock Exchange of India Limited (NSE) is one of India's major stock exchanges and has played a significant role in modernising the country's securities market. NSE was incorporated in 1992, recognised as a stock exchange by the Securities and Exchange Board of India (SEBI) in April 1993, and commenced operations in 1994.

NSE was established with the objective of providing investors across India with a nationwide, technology-driven platform for securities trading. Its introduction of electronic, screen-based trading reduced dependence on traditional floor-based trading and enabled investors from different geographical locations to participate in a common market. This contributed to greater transparency, efficiency and accessibility in securities trading.

NSE operates an electronic, order-driven trading system in which investors' buy and sell orders are entered into the trading system and matched according to established trading rules. Orders are generally matched based on price and time priority, facilitating systematic execution and transparent price discovery.

Over the years, NSE has expanded beyond the equity market and developed a broad market infrastructure covering various segments, including equity derivatives, currency derivatives and fixed-income securities, along with indices and other market-related services.

The Nifty 50 is the flagship index of NSE. It comprises 50 large and liquid companies listed on the exchange across various sectors and is widely used as a benchmark for assessing the performance and general direction of the Indian equity market.

NSE operates within the regulatory framework established by SEBI and follows established systems for trading, clearing, settlement and risk management. Through its technology-driven infrastructure, NSE has contributed significantly to the development of an efficient, transparent and accessible securities market in India.

1.1.4.2 BSE

The BSE Limited (BSE) is one of India's major stock exchanges and has a long history in the development of the country's securities market. Its origins can be traced to 1875, making it one of the oldest stock exchanges in Asia. Over the years, BSE has evolved from a traditional trading environment into a technology-driven and regulated marketplace for a wide range of financial securities.

BSE provides an organised platform for trading various securities and financial instruments, including equity shares, debt securities, equity derivatives, mutual fund units and other eligible securities. It facilitates the interaction of buyers and sellers, supports liquidity and price discovery, and provides investors with access to securities across different companies and sectors.

The principal benchmark index associated with BSE is the S&P BSE SENSEX, commonly known as the Sensex. It consists of 30 large and liquid companies selected according to the index's methodology.

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BSE operates within India's securities-market regulatory framework and is subject to the oversight of SEBI. Its operations are supported by established mechanisms for trading, clearing, settlement and risk management, which are designed to promote fair, orderly and transparent markets and support investor protection.

1.1.5 Overview of Trading

Trading refers to the buying and selling of financial securities in a market through an organised mechanism. In the stock market, trading enables investors and other market participants to transfer ownership of securities and respond to changes in prices, information and market expectations. Although trading may be undertaken with the objective of earning a return from favourable price movements, not all market participants trade solely for short-term profit; trading may also be undertaken for investment, portfolio management, hedging, liquidity management, or other financial objectives.

Nowadays, trading is predominantly conducted through electronic and screen-based trading systems. A market participant places a buy or sell order through an authorised trading interface, specifying relevant details such as the security, quantity, price and order type. The order is transmitted to the appropriate stock exchange, where the trading system processes it according to established rules and matching mechanisms. When compatible buy and sell orders are matched, the trade is executed and recorded. The executed transaction subsequently moves through the applicable clearing and settlement process.

Trading activities can be classified in different ways, intraday trading involves opening and closing a position during the same trading day, whereas delivery-based trading involves taking delivery of the securities and holding them beyond the trading day.

1.1.5.1 Intraday Trading

Intraday trading involves buying and selling securities within the same trading day. Traders aim to profit from short-term price fluctuations without taking ownership of the shares. All positions opened during the trading session must be closed before the market closes.

Intraday trading requires close attention to market movements because prices can change significantly within a short period. They may use technical analysis, such as price charts, trading volume, trends and technical indicators, to assess short-term price movements and identify possible entry and exit points. However, technical analysis cannot guarantee the accuracy of price predictions or profitable trading outcomes. Intraday trading requires disciplined execution, timely decision-making and effective risk management, as even a small adverse movement in price can result in a significant loss.

For example, suppose a trader buys 100 shares at ₹200 per share in the morning. If the price rises to ₹205 during the same trading session, the trader may sell the shares and earn a gain of ₹5 per share, before considering applicable brokerage, taxes and

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other charges. If the price falls to ₹195 and the trader closes the position, a loss of ₹5 per share would arise.

Traders may also use leverage provided by brokers. Leverage allows a trader to take a market position that may be larger than the trader's own available capital. While this can increase the potential return from a favourable price movement, it can also magnify losses when the market moves against the trader.

1.1.5.2 Delivery Trading

Not every investor buys shares with the intention of selling them on the same day. Sometimes, an investor purchases shares with the intention of holding them for several days, months, or even years. This form of trading is commonly referred to as delivery trading.

Delivery trading refers to the buying of securities with the intention of holding them beyond the trading day. In a delivery transaction, the securities are transferred to the investor's demat account after the completion of the applicable settlement process. The investor can then hold the securities for as long as desired and may sell them at a later date.

For example, suppose an investor purchases 100 shares of a company at ₹200 per share. Instead of selling them on the same day, the investor chooses to hold the shares for several months because of confidence in the company's future prospects. If the market price later increases to ₹250, the investor may sell the shares and realise a capital gain, before applicable costs and taxes.

Delivery trading is generally associated with an investment-oriented approach rather than attempting to benefit from very short-term price movements. Investors may consider factors such as the company's financial performance, growth prospects, industry conditions and overall economic environment when deciding to buy a security. However, holding securities for a longer period does not eliminate market risk. The market price of the security may rise or fall during the holding period. Therefore, investors should consider the risk, expected return, financial objectives and investment horizon before purchasing securities.

1.1.6 Screen-Based Trading

The development of electronic trading has fundamentally changed the way securities are bought and sold in financial markets. Earlier, trading on stock exchanges was largely conducted through physical trading floors using the open-outcry system, where traders communicated buy and sell orders verbally. With the introduction of screen-based trading, these activities were gradually shifted to computerised systems, allowing orders to be entered, displayed, transmitted and matched electronically.

Investors and trading members can enter orders electronically without being physically present on the exchange trading floor. The orders generally contain details such as the security, quantity, price and order type. The exchange's trading system then

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matches compatible buy and sell orders according to predefined rules, particularly price. Once the orders are matched, the trade is executed electronically and the transaction details are recorded for subsequent clearing and settlement.

Screen-based trading offers several important advantages in the functioning of securities markets. The electronic processing of orders allows trades to be executed quickly, making it possible to handle a large number of orders within a short period. Transparency is enhanced because orders and relevant market information are processed through a structured and rule-based trading system. The electronic nature of the system also provides greater scalability, allowing stock exchanges to accommodate high trading volumes without the physical limitations associated with traditional trading floors. In addition, electronic records of orders and transactions support systematic market monitoring, clearing, settlement, and other post-trade processes.

The development of online trading platforms, such as Zerodha kite, Grow, Upstox, Angel one and ICICI Direct, has made financial markets more accessible to investors by enabling them to access real-time market information, place buy and sell orders, monitor their investments and receive transaction updates through internet - based platforms.

Advantages

- Faster and more efficient trading compared to traditional methods
- Lower transaction costs
- Easy access from any location
- Reduced human errors
- Better information availability for decision-making

Limitations

- Dependence on Internet connectivity
- Risk of technical glitches.
- Security concerns like hacking if not properly protected
- Requires basic knowledge of technology and trading systems

1.1.7 Candlestick Charts and Their Usage

A stock's price can change many times during a single trading session. But how can an investor understand all these price movements at a glance? One of the most widely used tools for this purpose is the candlestick chart. Instead of presenting price movements as a long list of numbers, a candlestick chart converts them into a simple visual form that helps traders study how prices have moved over a particular period.

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A candlestick chart is a graphical representation of the price movement of a security during a specific period. Each candlestick generally provides four important pieces of price information: the opening price, highest price, lowest price and closing price. Depending on the time interval selected, a single candlestick may represent one minute, one hour, one day, one week or another specified period.

A candlestick consists mainly of a body and wicks. The body shows the relationship between the opening and closing prices, while the upper and lower wicks indicate the highest and lowest prices reached during the selected period. Different charting platforms may use different colours, but green/red is a commonly used combination.

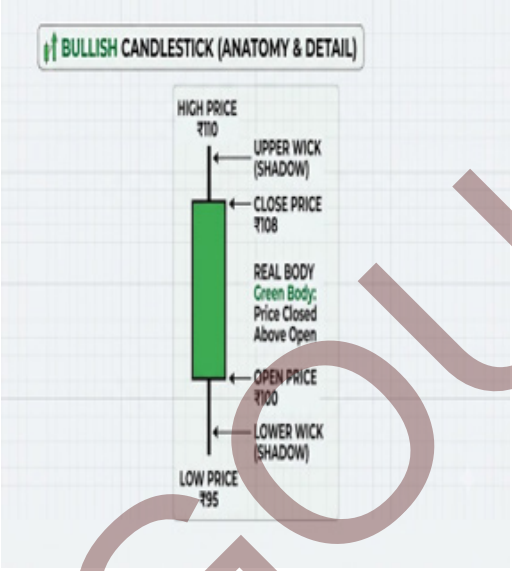


Fig. 1.1.1 Candlestick

For example, suppose a share opens at ₹100, reaches a high of ₹110, falls to a low of ₹95 and closes at ₹108. The candlestick for that period will represent all four prices in a single visual form. A trader can therefore understand not only where the price started and ended, but also the highest and lowest levels reached during that period.

1.1.6.1 Pattern and Usage in Chart Reading

Candlestick charts are widely used in technical analysis which is a study of stock price behaviour. Traders study individual candlesticks as well as combinations of several candlesticks to identify possible patterns and understand market sentiment. The usefulness of candlestick charts comes from their ability to present a large amount of price information in a compact visual format. By studying the relationship between opening, closing, high and low prices, traders can assess whether buying or selling pressure appeared stronger during a particular period.

A bullish candlestick is formed when the closing price is higher than the opening price, indicating buying pressure in the market. Conversely, a bearish candlestick occurs when the closing price is lower than the opening price, indicating selling pressure. Candlestick charts help traders identify trends, reversals, and continuation patterns.

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Key Uses of Candlesticks

- Identifying market trends, such as bullish and bearish movements.
- Recognising potential trend reversals through specific candlestick patterns.
- Identifying continuation patterns that indicate the possible continuation of an existing trend.
- Determining potential entry and exit points for trading decisions.
- Candlesticks can be combined with RSI, MACD and moving averages to confirm trading signals.

Chart patterns are recognisable formations created by the movement of security prices on a price chart over a period of time. Traders study these formations to understand price behaviour, identify existing market trends and assess possible changes in price movements. Based on their purpose and interpretation, chart patterns can broadly be discussed under support and resistance patterns, reversal patterns and continuation patterns.

1. Support and resistance Patterns

Support and resistance Patterns help traders identify price levels or zones were buying or selling pressure may become stronger. Support is a price level or zone where a falling security may find increased buying interest, causing the decline to slow down or temporarily stop. For example, if a share repeatedly falls towards ₹500 and then moves upward, ₹500 may be considered a support level. In contrast, resistance is a price level or zone where a rising security may face increased selling pressure, causing the price increase to slow down or temporarily stop. For example, if a share repeatedly rises towards ₹600 but then declines, ₹600 may be considered a resistance level. If strong selling pressure causes the price to move below a support level, it may indicate a possible downward movement. Similarly, if strong buying pressure pushes the price above a resistance level, it may indicate a possible upward movement.

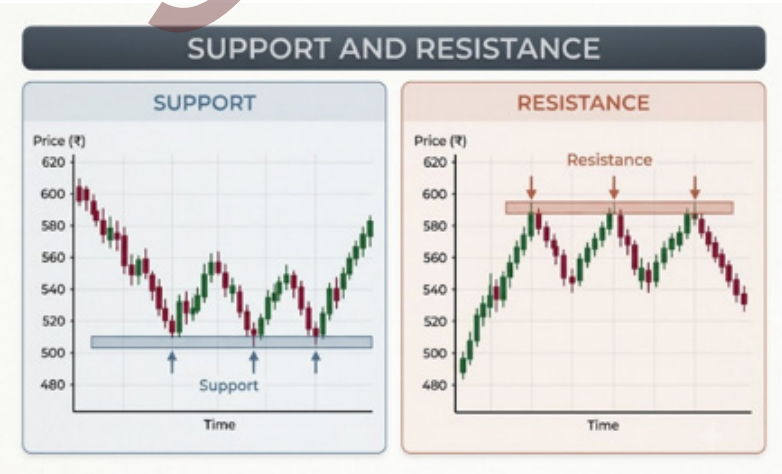


Fig.1.1.2 Support and Resistance

2. Reversal patterns

These are chart formations that may indicate a possible change in the direction of an existing trend. They are particularly useful when an established upward or downward trend begins to lose strength. Common reversal patterns include Head and Shoulders, Inverse Head and Shoulders, Double Top and Double Bottom.

A Head and Shoulders pattern generally develops after an upward trend and may indicate a possible bearish reversal. It consists of three peaks, where the middle peak, known as the head, is higher than the two surrounding peaks, known as the shoulders. A line connecting the lows between these peaks is called the neckline, and a break below the neckline may provide confirmation of the potential reversal.

The Inverse Head and Shoulders pattern is the opposite formation and generally develops after a downward trend. It consists of three troughs, with the middle trough being the deepest and a break above the neckline may indicate a possible bullish reversal. A Double Top is another bearish reversal pattern in which the price reaches a high, declines and then rises again towards a similar high before declining. The two peaks create an appearance similar to the letter "M". A break below the support level between the two peaks may confirm the potential bearish reversal. A Double Bottom is the opposite formation and may indicate a possible bullish reversal after a downward trend. The price reaches a low, rises and then falls again towards a similar low before moving upward, creating a pattern similar to the letter "W". A break above the resistance level between the two lows may provide confirmation of the potential upward reversal.

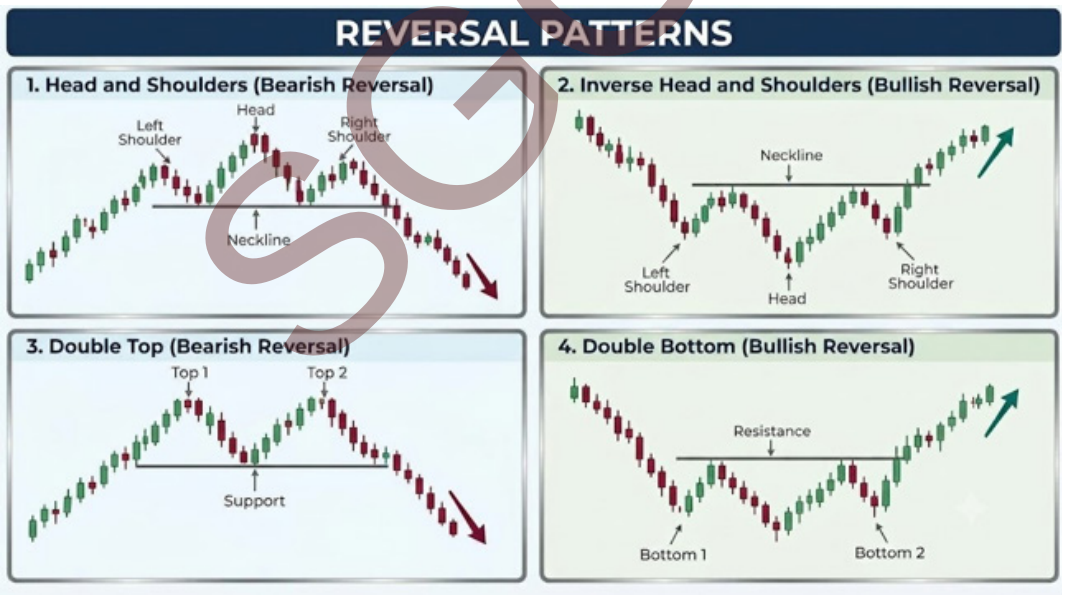


Fig. 1.1.3 Reversal Patterns

3. Continuation patterns

Continuation patterns are formations that occur during an existing trend and may indicate that the trend could continue after a temporary pause or period of consolidation. Prices do not always move continuously in one direction; during a strong trend, they

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may temporarily move sideways or make a small movement against the prevailing trend before resuming the original direction. Common continuation patterns include Triangles, Flags, Pennants and Rectangles.

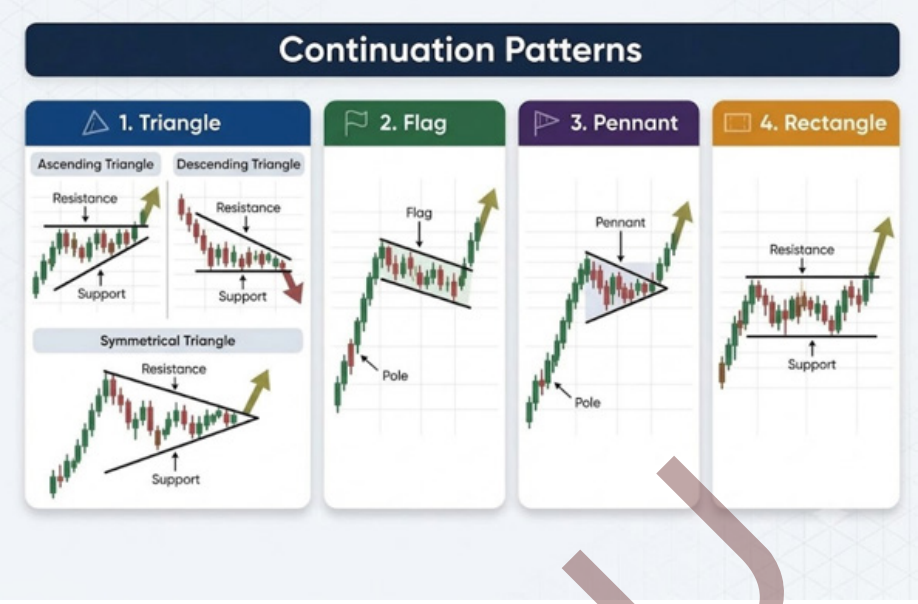


Fig. 1.1.4 Continuation Patterns

A Triangle develops when the price moves within a progressively narrowing range, with the highs and lows moving closer together. An Ascending Triangle generally has a relatively stable resistance level and rising support, and an upward breakout may indicate possible continuation of a bullish movement.

A Descending Triangle generally has relatively stable support and declining resistance, and a downward breakout may indicate possible continuation of a bearish movement. A Symmetrical Triangle forms when both the highs and lows converge, and the price may break out in either direction.

A Flag is a short-term continuation pattern that usually appears after a strong price movement, followed by a brief period of consolidation within a relatively narrow range. A Pennant is similar to a flag but generally forms within a small triangular consolidation area after a strong price movement.

A Rectangle is a continuation pattern that usually appears after a price movement, followed by a period of consolidation in which the price fluctuates between approximately horizontal support and resistance levels. The pattern indicates a temporary balance between buying and selling pressure before the price potentially resumes the preceding trend.

Chart patterns are useful because they provide traders with a structured way to interpret price movements. They can help identify market trends, support and resistance levels, potential reversal points and possible continuation of existing trends. Traders may also use pattern breakouts and breakdowns to plan potential entry and exit points and to determine appropriate levels for managing risk. However, chart patterns should

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not be treated as certain predictors of future price movements. A pattern may fail to produce the expected outcome and its interpretation can vary depending on the market conditions, time frame, trading volume, liquidity and security being analysed. False breakouts may also occur when the price briefly moves beyond a support or resistance level before returning to its previous range. Therefore, traders generally combine chart pattern analysis with volume analysis, trend analysis and other technical indicators before making trading decisions.

1.1.7 Technical Indicators

Technical indicators are mathematical tools used in technical analysis to interpret market data and assist traders in making better decisions. They are derived mainly from historical price, volume, or open interest data and are plotted on charts to provide additional insights beyond simple price movements. These indicators help simplify complex market information by converting it into signals that indicate trends and possible future price behavior. By analyzing these signals, traders can understand whether a market is in overbought or oversold zone or whether a trend is gaining or losing momentum. Their usefulness depends on appropriate selection, interpretation and market context. A signal generated by an indicator can be false under certain market conditions.

Key Functions of Technical Indicators:

- Identify the direction of the market trend
- Indicate overbought or oversold conditions
- Help detect potential reversal points in the market
- Analyze market volatility
- Confirm trading signals generated by price patterns
- Assist in setting entry and exit points for trades
- Reduce emotional decision-making by providing objective data

1.1.7.1 Moving Averages

Moving averages are widely used mathematical indicators that smooth short-term fluctuations in security prices and help identify the underlying direction of a price trend. A moving average is calculated by taking the average price over a specified number of periods and continuously updating the calculation as new observations become available. Although closing prices are commonly used, the calculation can also be based on other price measures depending on the analytical approach.

The two commonly used forms are the Simple Moving Average (SMA) and the Exponential Moving Average (EMA). The SMA assigns equal weight to each observation within the selected period, whereas the EMA assigns greater weight to more recent observations. Consequently, the EMA generally reacts more quickly to recent price changes than the SMA.

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For example, a 5-day Simple Moving Average (SMA) based on closing prices is calculated by adding the closing prices of the latest five trading days and dividing the total by five. When a new trading day is added, the oldest observation is removed and the latest observation is incorporated. The calculation therefore moves forward over time, which gives the indicator its name.

Moving averages are primarily used to identify trends and assess changes in price direction. When the price of a security remains above a moving average, it may indicate relatively stronger price performance over the period represented by that average; conversely, sustained movement below the moving average may indicate relatively weaker price performance. Traders may also compare moving averages calculated over different periods. For instance, when a shorter-period moving average crosses above a longer-period moving average, it may be interpreted as a potential bullish signal, while a downward crossover may be interpreted as a potential bearish signal. Such crossover signals are not conclusive predictions and are generally evaluated in conjunction with other market information.

The main limitation of moving averages is that they are lagging indicators because they are calculated from historical price data. A moving average may therefore react slowly to sudden changes in price direction. Moving averages can also produce misleading signals in sideways or highly volatile markets. They should therefore be used as decision-support tools alongside other forms of technical analysis and appropriate risk-management practices, rather than as standalone indicators of future price movements.

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Fig. 1.1.5 Moving Averages

1.1.7.2 Relative Strength Index (RSI)

A stock may rise sharply for several days, but does that mean it will continue rising? Or has the price moved too far, too quickly? The Relative Strength Index is a technical

indicator that helps traders examine the strength and momentum of price movements and identify whether a security may be in an overbought or oversold condition.

The Relative Strength Index (RSI) is a momentum oscillator developed by J. Welles Wilder Jr. It measures the speed and magnitude of recent price changes and expresses the result on a scale ranging from 0 to 100. The RSI is commonly calculated using a 14-period setting, although traders may use different periods depending on their trading strategy and time frame.

An RSI value above 70 is traditionally considered an indication that a security may be overbought, while a value below 30 may indicate an oversold condition. An overbought reading suggests that the price has experienced strong upward momentum and may be vulnerable to a correction, whereas an oversold reading suggests strong downward momentum and the possibility of a price recovery. However, these levels should not be interpreted as automatic buy or sell signals.

The RSI is calculated using the formula RSI = 100 − [100 ÷ (1 + RS)],

where RS = Average Gain ÷ Average Loss.

For example, suppose the average gain in a stock over the relevant 14-period calculation is ₹6, while the average loss is ₹3. The Relative Strength (RS) would therefore be ₹6 ÷ ₹3 = 2.

Applying the RSI formula, RSI = 100 − [100 ÷ (1 + 2)] = 100 − 33.33 = 66.67.

An RSI of 66.67 indicates that upward price movements have been stronger than downward price movements during the period considered. Since the RSI is approaching the commonly used overbought level of 70, the reading suggests a potential near-overbought condition.



Fig. 1.1.6 RSI

An important point to remember is that an overbought market does not necessarily mean that the price will immediately fall, and an oversold market does not necessarily mean that the price will immediately rise. In a strong upward or downward trend, the RSI can remain in these zones for an extended period.

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1.1.7.3 Moving Average Convergence and Divergence (MACD)

Moving Average Convergence Divergence (MACD) is a trend-following momentum indicator used to assess the direction and strength of price movements. It compares a short-term EMA with a long-term EMA to identify changes in momentum.

The MACD value is calculated separately for each trading day using the difference between the 12-period EMA and the 26-period EMA. These daily values are then plotted on the graph and connected to form the MACD Line, where the X-axis represents time and the Y-axis represents the MACD value.

A crossover of the MACD Line above or below the Zero Line may indicate a change in momentum. A MACD value above zero indicates that the 12-period EMA is higher than the 26-period EMA, suggesting relatively stronger upward price momentum, while a value below zero indicates the opposite. MACD can also help identify divergence between price and momentum.

MACD is useful for analysing trends and momentum but may generate false signals in sideways markets. Therefore, it should be used with other technical analysis tools rather than as a standalone indicator

1.1.7.4 Support and Resistance

Have you noticed that a share price sometimes falls to a particular level and then starts moving upward, while at another level it struggles to move higher? These price levels can provide useful clues about the behaviour of buyers and sellers. In technical analysis, such levels are commonly referred to as support and resistance.

Support is a price level or zone at which buying interest is strong enough to prevent or slow down a further decline in price. When the price approaches a support level, buyers may become more willing to purchase the security, while some sellers may become less willing to sell at lower prices. As a result, the price may stop falling and move upward. However, support is not a guaranteed level, if selling pressure becomes sufficiently strong, the price may break below the support level.

Resistance is a price level or zone at which selling pressure is strong enough to prevent or slow down a further rise in price. When the price approaches a resistance level, some investors may choose to sell, while buyers may become less willing to purchase at higher prices. As a result, the upward movement may slow down or reverse. Like support, resistance is not a permanent ceiling and can be broken when buying pressure becomes strong enough.

Support and resistance can be identified by studying previous price movements, highs and lows, chart patterns, trend lines and trading activity. They help traders understand where buying and selling pressure may become stronger and can therefore be useful when planning potential entry and exit points.

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An interesting feature of support and resistance is that their roles can sometimes reverse. When a resistance level is decisively broken and the price moves higher, that previous resistance level may later act as support. Similarly, when an important support level is broken, it may later become a resistance level. Support and resistance are not always exact prices. In many situations, they are better understood as zones or ranges within which buying or selling pressure becomes noticeable. Their significance may also vary depending on the time frame being analysed.

Case Study: Tata Motors – Business Restructuring and Stock Market Response

In March 2024, Tata Motors announced a significant restructuring of its business. The company proposed to separate its Commercial Vehicles (CV) business from its Passenger Vehicles (PV) business, including EVs and Jaguar Land Rover (JLR) into two separately listed companies. Under the proposed arrangement, existing Tata Motors shareholders would receive shares in both companies in the same proportion as their existing shareholding. The restructuring was intended to provide greater strategic focus and flexibility to the two business groups.

The announcement presented investors with a new perspective on Tata Motors. Although the company was already listed on the stock exchange, its businesses operated across different segments with distinct market conditions, growth opportunities and investment requirements. Investors therefore had to consider how separating these businesses might affect the future performance and value of their investment. Following the announcement, Tata Motors' share price recorded a significant upward movement. The development attracted considerable attention in the stock market as investors assessed the proposed restructuring and its possible implications for the company's future.

The case illustrates how corporate restructuring announcements can influence investor expectations and share-price movements in the secondary market. It also highlights the importance of distinguishing between short-term market reactions and the long-term creation of shareholder value. Investors must evaluate the strategic rationale, financial implications and associated risks of a restructuring before making investment decisions.

Questions

1. How could differences in the growth prospects of the Commercial Vehicles and Passenger Vehicles businesses influence investor interest after the demerger?
2. As an investment analyst, what information would you examine before assessing whether Tata Motors' restructuring could create value for shareholders?

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Summarised Overview

The stock market provides an organised mechanism for the issuance, trading and settlement of securities and plays an important role in facilitating investment and capital formation. The primary market enables companies to raise funds through new securities, while the secondary market facilitates the trading of existing securities among investors. Equity shares represent ownership interests in companies and offer the potential for dividends and capital appreciation, while also exposing investors to market risk.

Screen-based trading has transformed securities trading by enabling electronic order entry, processing and matching based on predefined rules. Trades are subsequently cleared and settled through established settlement mechanisms. Intraday trading involves opening and closing positions within the same trading day, whereas delivery trading involves taking or giving delivery of securities subject to the applicable settlement process.

Technical analysis helps investors interpret market data and price movements. Moving averages smooth price fluctuations and assist in identifying trends. The Relative Strength Index (RSI) measures the strength of recent price movements and helps identify potential overbought or oversold conditions.

Self-Assessment Questions

1. Explain the structure of the stock market.
2. Discuss the differences between primary and secondary markets.
3. Explain the features, advantages, and risks of equity shares.
4. Describe NSE.
5. Discuss intraday trading and delivery trading.
6. Explain the role of technical indicators in technical analysis and discuss how they assist traders in analysing market trends and momentum.
7. Explain Simple Moving Average (SMA). Discuss its use in identifying market trends.
8. Explain the Relative Strength Index (RSI), including its interpretation and use in identifying overbought and oversold conditions.
9. Explain support and resistance concepts in technical analysis.
10. Analyze the role of online trading platforms in investing.
11. Discuss the impact of technology on stock market trading

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Assignment Questions

1. Select a recent IPO listed on the Indian stock market and critically analyze the company's background, issue size, subscription details, listing performance, and overall investor response.
2. Compare any three online trading platforms based on their account opening process, brokerage charges, user interface, research tools, and customer support services and recommend the most suitable platform for different categories of investors.
3. Construct a hypothetical stock portfolio worth ₹5,00,000 by selecting five stocks from different sectors and evaluate the investment rationale, risk-return profile, expected performance, and diversification benefits of the portfolio.

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Suggested Reading

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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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Unit 2

Trading Mechanism and Investment decisions

Learning Outcomes

After the successful completion of the unit, the learner will be able to:

- ◊ explain the trading mechanism and order execution process in stock markets.
- ◊ distinguish between different order types
- ◊ understand different types of Share Issues
- ◊ describe Corporate actions relating to equity shares
- ◊ identify common behavioural biases that affect investor decision-making

Background

The stock market is an important component of the financial system, facilitating the buying and selling of securities among market participants. Although stock trading is now largely conducted through electronic systems, organised securities markets have a long history, with the Amsterdam Stock Exchange, established in the seventeenth century, often regarded as one of the earliest formal stock exchanges. Over time, stock markets have evolved from physical trading environments to highly automated systems capable of processing large volumes of transactions within very short periods.

Investors participate in the stock market with different objectives, investment horizons, return expectations and levels of risk tolerance. While some investors seek to build wealth over the long term, others attempt to benefit from short-term changes in security prices. The interaction of these diverse objectives and expectations contributes to continuous buying and selling activity in stock markets. Interestingly, the same security can attract buyers and sellers at the

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same time because market participants may interpret the available information differently or have different expectations about its future value.

Participation in the stock market, however, involves several considerations beyond the decision to buy or sell a security. Investors operate within an organised market environment where prices, information, and trading activity can change continuously. Their decisions may therefore be influenced by perceptions, expectations and behavioural tendencies. Understanding these aspects provides a foundation for examining how stock market function and how investors make decisions within them. This unit explores the practical aspects of stock market trading, capital-raising methods, corporate actions and behavioral biases that affect investor decision-making.



Keywords

Trading mechanism, Order types, Momentum trading, Swing trading, Value investing, IPO, FPO, Rights Issue, dividend, Bonus issue, Buyback, Loss aversion, Herd mentality



Discussion

1.2.1 Trading Mechanism

A trading mechanism refers to the system and procedures through which securities are traded in financial markets. In contemporary stock markets, trading is conducted through electronic platforms that automatically match buy and sell orders based on predetermined rules. Investors place their orders through brokers or online trading platforms and these orders are transmitted to stock exchanges where they are executed. The computerized trading system ensures transparency and efficiency in the execution of transactions. The trading mechanism contributes significantly to liquidity, enabling investors to buy or sell securities quickly without causing major price fluctuations. It also facilitates price discovery, where market prices are determined by the interaction of demand and supply forces. The introduction of electronic trading systems has revolutionized financial markets by reducing transaction costs, eliminating geographical barriers and increasing market participation.

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1.2.2 Order Types

Investors use different types of orders to execute trades according to their investment objectives and risk preferences. The choice of order type affects both the execution price and the level of risk associated with a trade.

The types are as follows:

1. Market Order

A market order instructs the broker to buy or sell a security immediately at the best available market price. Market orders prioritize execution speed over price certainty. Although they ensure that the transaction is completed quickly, investors may not receive the exact price they expected, particularly in highly volatile markets. Market orders are generally suitable when investors are more concerned about completing a transaction than obtaining a specific price.

2. Limit Order

A limit order allows investors to specify the maximum price they are willing to pay when purchasing a security or the minimum price they are willing to accept when selling it. This type of order gives investors greater control over the execution price but does not guarantee that the transaction will occur. If the market price does not reach the specified limit, the order may remain unexecuted. Limit orders are particularly useful for investors who seek to buy securities at attractive prices or sell them at predetermined profit levels.

3. Stop-Loss Order

A stop-loss order is a risk management tool designed to limit potential losses. Investors specify a trigger price, and when the market price reaches that level, the order is automatically converted into a market order. Stop-loss orders help investors protect their capital during adverse market movements and reduce the emotional stress associated with monitoring investments continuously. Effective use of stop-loss orders is considered an important component of disciplined trading and portfolio management.

1.2.3 Bid-Ask Spread

The bid-ask spread represents the difference between the highest price a buyer is willing to pay for a security (bid price) and the lowest price a seller is willing to accept (ask price). This spread reflects the transaction cost incurred by investors when trading securities.

The size of the bid-ask spread serves as an important indicator of market liquidity. Securities that are actively traded generally have narrow spreads because there are many buyers and sellers participating in the market. Conversely, securities with low trading volumes often exhibit wider spreads due to lower liquidity and higher uncertainty. Investors and traders carefully monitor bid-ask spreads because they directly influence profitability, especially in short-term trading strategies.

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1.2.4 Clearing and Settlement Process

After a trade is executed, several post-trade activities are required to complete the transaction. Clearing and settlement are the processes through which the obligations arising from a trade are determined and subsequently fulfilled by the transfer of securities and funds between the relevant parties. Clearing involves determining the obligations arising from executed trades, including the securities and funds that each participant is required to deliver or receive. Clearing corporations facilitate this process and support the orderly completion of transactions.

Settlement is the process through which these obligations are finally discharged by the transfer of securities and funds. The buyer receives the securities, while the seller receives the corresponding funds through the prescribed settlement mechanisms. In India, the standard settlement cycle for equity-market transactions is generally T+1, where T represents the trade date and T+1 represents the next business day. Thus, a trade executed on Monday would ordinarily be settled on Tuesday, subject to applicable market holidays and settlement rules.

1.2.4.1 Settlement Process

The post-trade process can be understood through the following stages:

i. **Trade Execution:** The process begins when compatible buy and sell orders are matched through the stock exchange's trading system. The matched transaction establishes the obligations of the buyer and seller.

ii. **Trade Confirmation:** The details of the executed trade, including the security, quantity, price and trade date, are recorded and made available through the relevant trading and clearing systems. These details form the basis for subsequent clearing and settlement.

iii. **Clearing:** The clearing process determines the securities and funds that each participant is required to deliver or receive. The clearing corporation performs the necessary calculations and facilitates the management of obligations arising from the trades.

iv. **Settlement:** The obligations determined during clearing are fulfilled through the transfer of securities and funds. The buyer receives the securities through the applicable depository mechanism, while the seller receives the corresponding funds through the prescribed settlement process.

v. **Completion of Settlement:** Once the required securities and funds have been transferred, the obligations arising from the trade are discharged and the transaction is considered settled. Example: If an equity trade is executed on Monday (T), the corresponding settlement would ordinarily take place on Tuesday (T+1), provided Tuesday is a business day. If Tuesday is a market holiday, settlement occurs on the next eligible settlement day.

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1.2.5 Common Trading Strategies

Financial markets offer various trading and investment strategies designed to suit different risk profiles, investment horizons and market conditions. Some commonly used trading strategies are as follows:

1. Momentum Trading

Momentum trading is a trading strategy based on the expectation that a security experiencing a strong upward or downward price movement may continue to move in the same direction for a period of time. Traders seek to benefit from an existing price trend rather than attempting to predict a reversal. For example, a trader may consider buying a security showing sustained upward price movement or taking a short position in a security showing strong downward momentum , that is, selling a stock first hoping to buy it later at a lower price when the stock price falls.

Traders may use price trends, trading volume, moving averages, RSI and other momentum indicators to assess the strength of price movements. Market news and investor sentiment may also contribute to the development or continuation of momentum. The strategy can provide opportunities for relatively short-term gains when momentum persists; however, a sudden reversal in price can result in significant losses. Therefore, appropriate risk-management measures are important when using momentum trading.

Advantages of Momentum Trading

- Price trends, trading volume, and momentum indicators can help traders identify securities with strong momentum.
- The strategy can be useful when markets exhibit strong and sustained price trends.
- When momentum continues as expected, traders may achieve returns within a relatively short period.

Limitations of Momentum Trading

- A security showing strong momentum can reverse direction quickly, resulting in losses.
- Temporary price movements may appear to indicate momentum but fail to develop into a sustained trend.
- Traders often need to monitor price movements and market information closely to respond to changing conditions.

2. Swing Trading

Swing trading is a trading strategy that focuses on capturing short to medium-term price movements that occur over a few days to several weeks. Instead of holding investments for the long term or trading within a single day, swing traders aim to benefit from temporary fluctuations within broader market trends. They analyze price charts to

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identify “swings” or price movements between highs and lows and use technical tools such as moving averages, trend lines, support and resistance levels and momentum indicators to decide when to enter and exit trades. This approach allows traders to take advantage of market opportunities without the need for constant monitoring, making it more flexible than intraday trading. However, it still requires discipline, analysis and risk management, as price movements can be unpredictable.

Advantages of Swing Trading

- Swing trading allows traders to seek gains from price movements that develop over several days or weeks.
- Positions are generally held longer, so continuous monitoring throughout the trading day may not be necessary.
- Stop-loss orders and predetermined profit targets can be used to manage potential losses.
- Traders can seek opportunities from both upward and downward price movements, depending on the strategy and market conditions.

Limitations of Swing Trading

- Positions remain open beyond the trading day and may be affected by unexpected news or price gaps.
- Market volatility and unpredictable price movements can result in losses.
- Identifying suitable entry and exit points often requires knowledge of charts, price patterns, and technical indicators.

3. Breakout Trading

Breakout trading involves taking a position when the price moves beyond an established support or resistance level, with the expectation that the price may continue in the direction of the breakout. A trader may consider a buy position when the price breaks above a significant resistance level, particularly when supported by increased trading volume. Conversely, a break below support may be considered a potential selling signal. However, false breakouts can occur when the price temporarily moves beyond a level and then reverses.

Advantages of Breakout Trading

- A breakout provides a relatively identifiable price level for initiating a trade.
- Breakouts can signal the beginning or continuation of a significant price movement.
- Traders can often place a stop-loss near the breakout level to limit potential losses.

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Limitations of Breakout Trading

- Prices may briefly move beyond support or resistance and then reverse, resulting in a losing trade.
- Breakouts may be accompanied by sharp price fluctuations, increasing the risk of adverse movements.
- The strategy may perform poorly when prices remain range-bound or lack sufficient momentum.

4. Mean Reversion Strategy

Mean reversion trading is based on the expectation that a security's price may move back towards its historical or perceived average after deviating significantly from it. Traders may look for securities that have moved unusually far from a reference level and assess whether conditions support a return toward that level. The strategy can perform poorly when a strong new trend causes prices to remain away from the historical average.

Advantages of Mean Reversion Trading

- Significant deviations from an established average may help traders identify potential entry and exit points.
- Traders can use statistical measures, moving averages and price bands to identify deviations from the reference level.
- The strategy attempts to capture gains when prices move back towards their historical or estimated average.

Limitations of Mean Reversion Trading

- The historical average used as the reference point may change over time. Therefore, assuming that the past average will continue to represent the security's normal price can lead to incorrect trading decisions.
- Temporary price movements can appear to indicate a deviation from the mean even when the movement reflects a genuine change in the underlying value of the security.
- A security may remain significantly above or below its perceived mean for a considerable period before reverting. Traders may therefore face losses while waiting for the expected price adjustment.

5. News-Based Trading

News-based trading is a short-term trading approach in which traders make buying or selling decisions in response to new information that may materially affect the price of a security. Such information may include corporate earnings announcements, mergers and acquisitions, regulatory decisions, economic data releases, changes in interest rates, or significant industry developments. Traders assess the likely impact of the news on market expectations and may take positions as prices adjust.

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The effectiveness of news-based trading depends largely on the market's expectations before the announcement and the speed and accuracy with which traders interpret and respond to it. A positive announcement does not necessarily result in a price increase if the information was anticipated or does not meet market expectations. Similarly, negative news may have a limited effect if it was already reflected in the price. Therefore, news-based trading involves significant uncertainty and requires careful assessment of both the information and the prevailing market context.

Advantages of News-Based Trading

- Corporate announcements and major economic developments can create clear trading situations.
- Large price movements following major news may provide opportunities for short-term gains.
- The strategy can be particularly relevant when specific events are expected to influence market expectations and security prices.

Limitations of News-Based Trading

- Prices can change sharply within seconds or minutes, increasing the risk of losses.
- The same news may produce different price responses depending on market expectations and prevailing conditions.
- If market participants anticipated the announcement, much of its effect may already be reflected in the security's price.

1.2.6 Value Investing

Value investing is an investment strategy that involves identifying and purchasing shares of companies whose market prices are below their estimated intrinsic values. Intrinsic value refers to the estimated worth of a company's share based on factors such as its financial performance, earnings, assets, cash flows and future growth prospects. Value investors believe that market prices do not always reflect the actual worth of a company, creating opportunities to invest in fundamentally sound businesses at relatively low prices.

Value investors use fundamental analysis to evaluate a company's financial statements, profitability, debt levels, cash flows and competitive position. They may also consider financial indicators to identify potentially undervalued shares.

For example, suppose an investor estimates that a company's share has an intrinsic value of ₹500 but is currently trading at ₹350. If the company's financial fundamentals remain sound, the investor may consider purchasing the share because it is available at a price below its estimated worth.

Value investing typically adopts a long-term investment horizon, as the market may take considerable time to recognise a company's intrinsic value. This approach offers

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the potential for capital appreciation while encouraging investment decisions based on financial fundamentals rather than short-term market fluctuations. However, investors may face risks arising from inaccurate valuation, delayed price recovery and value traps, where a share appears undervalued but its price continues to decline because of persistent business weaknesses. Therefore, effective value investing requires thorough fundamental analysis, realistic valuation, careful assessment of business risks and patience.

1.2.7 IPO, FPO, and Rights Issue

Companies often require additional capital to finance expansion, acquisitions, technological upgrades and for other strategic initiatives. To raise funds, they may issue securities through various mechanisms such as Initial Public Offerings (IPOs), Follow-on Public Offers (FPOs) and Rights Issues.

1. Initial Public Offering (IPO)

An Initial Public Offering is the process through which a privately held company offers its shares to the public for the first time and gets listed on a stock exchange. This transition allows the company to raise significant capital from a wide pool of investors, which can be used for expansion, debt repayment, research and development, or other business activities.

For investors, IPOs present an opportunity to invest in a company at an early stage of its journey and potentially benefit from future growth. However, investing in IPOs involves careful analysis, as these companies may not have a long track record in public markets. Therefore, investors must evaluate multiple factors to make informed decisions and avoid unnecessary risks.

Key Factors to Evaluate Before Investing in an IPO:

- Financial Performance: Analyse revenue growth, profitability and financial stability
- Management Quality: Assess the experience and credibility of the company's leadership
- Industry Outlook: Understand the growth potential and risks in the industry
- Competitive Position: Evaluate how the company stands against its competitors
- Valuation: Check whether the IPO is fairly priced compared to peers
- Business Model: Ensure the company has a sustainable and scalable business model
- Growth Potential: Look at future expansion plans and opportunities
- Risk Factors: Carefully read the prospectus to identify potential risks

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Steps Involved in the IPO Process

i. **Decision to Go Public:** The company decides to raise capital from public investors to finance business expansion, repay debt, fund new projects or meet other corporate requirements. It evaluates the financial and strategic implications of becoming publicly listed, including the costs of the issue and continuing disclosure obligations.

ii. **Appointment of Intermediaries:** The company appoints merchant bankers, including a lead manager and other intermediaries such as legal advisers, auditors and a registrar to the issue. These intermediaries assist with preparation of offer documents, regulatory compliance, issue management and share allotment.

iii. **Preparation and Filing of Offer Documents:** The company, with the assistance of its lead manager, prepares a Draft Red Herring Prospectus (DRHP) containing information about its business operations, financial performance, promoters, management, risk factors and objectives of the issue. The draft is filed with SEBI and the relevant stock exchanges in accordance with applicable regulations. The required documents are subsequently updated and filed at the appropriate stages of the process.

iv. **Regulatory Review and Compliance:** SEBI reviews the draft offer document and may seek clarifications or require changes and additional disclosures. The company must address the applicable regulatory requirements and obtain listing approval from the relevant stock exchange or exchanges.

v. **Determination of Issue Price:** The company, in consultation with the lead manager, determines the pricing method for the IPO. Under the book-building method, a price band is announced and investors submit bids within the specified range. The final issue price is determined based on the demand reflected in the bids received during the subscription period. Under the fixed-price method, the issue price is determined in advance and disclosed in the offer document.

vi. **Opening of the IPO for Subscription:** After completing the required formalities, the IPO opens for public subscription for a specified period. Eligible investors, including retail individual investors, non-institutional investors and qualified institutional buyers, can submit applications under the applicable category rules. Applications can be made through permitted channels.

vii. **Allotment of Shares**: After the subscription period closes, the basis of allotment is finalised in accordance with the applicable regulations. Shares are allotted to successful applicants. In an oversubscribed issue, an investor may receive fewer shares than applied for or no shares at all. Funds corresponding to unallotted shares are unblocked or refunded, as applicable, while the amount due for allotted shares is transferred to the issuer.

viii. **Commencement of Trading:** Once all regulatory and listing requirements are fulfilled, the shares are listed on the recognised stock exchanges and trading commences. Investors can then buy and sell the shares in the secondary market at prevailing market prices. The market price may be higher or lower than the IPO issue price, depending on investor demand and prevailing market conditions.

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2. A Follow-on Public Offer (FPO)

A Follow-on Public Offer is the process by which a company that is already publicly listed on a stock exchange issues additional shares to investors to raise further capital. An FPO involves the sale of new or existing shares after the company is already trading in the market. Companies use FPOs to fund expansion plans, reduce debt, finance new projects, or strengthen their financial position. Since the company is already listed, investors have access to its past performance and market behavior, making FPOs generally less risky compared to IPOs.

Key Features of FPO:

- Offered by already listed companies
- Usually priced at a discount to the current market price to attract investors
- Involves less uncertainty compared to IPOs
- Requires regulatory approval and disclosure of financial details

3. Rights Issue

A Rights Issue is a corporate action through which a company offers additional shares to its existing shareholders in proportion to their current holdings, usually at a discounted price. This gives existing investors the right to purchase new shares before the company offers them to the general public. Companies typically use rights issues to raise capital for expansion, debt reduction, or other financial needs while maintaining ownership within the existing shareholder base. Since the shares are offered at a lower price, it provides an attractive opportunity for shareholders to increase their investment.

Key Features of Rights Issue:

- Offered only to existing shareholders
- Shares are issued in a specific ratio (e.g., 1:4 means 1 new share for every 4 held)
- Usually priced below the current market price
- Shareholders can choose to accept, reject, or sell their rights

1.2.8 Corporate Actions

Corporate actions are decisions taken by a company's management that directly affect its shareholders and the value of their investments. These actions usually involve distribution of profits, restructuring of share capital or returning excess cash to investors. Common corporate actions include dividend, stock split, bonus issue and buyback. Each of these actions influences the company's share price, number of shares held by investors and overall market perception. Understanding these actions helps investors make informed decisions and evaluate the true value of their holdings. Some Corporate Actions are as follows:

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1. Dividend

A dividend is the portion of a company's profits distributed to its shareholders as a reward for their investment. Dividends are most commonly paid in cash. The amount and frequency of dividend payments are not guaranteed and it is dependent on factors such as the company's profitability, cash position, future investment requirements and financial policy.

For example, if a company declares a dividend of ₹5 per equity share and an investor holds 1,000 shares, the investor would be entitled to a dividend of ₹5,000, subject to applicable conditions and taxes.

- Provides income to shareholders
- Indicates financial strength of the company
- Can be interim or final dividend
- Share price may fall slightly after dividend declaration (ex-dividend date)

2. Stock Split

A stock split is when a company divides its existing shares into multiple shares to make them more affordable. For example, in a 1:2 split, one share becomes two shares, and the price per share is reduced accordingly. Companies generally undertake a stock split to reduce the market price per share and make the shares more accessible to a broader range of investors. When the market price of a share becomes relatively high, a split can reduce the price per share without changing the overall value of the company.

- Increases the number of shares held by investors
- Reduces market price per share
- Improves liquidity in the market
- Does not change the total investment value

3. Bonus Issue

A bonus issue refers to the issue of additional shares to existing shareholders without any additional payment, in proportion to their existing shareholding. The shares are generally issued by capitalising eligible reserves or surplus of the company. For example, in a 1:1 bonus issue, a shareholder receives one additional share for every one share already held.

4. Buyback

A buyback occurs when a company repurchases its own shares from the market. This reduces the number of outstanding shares and often increases the value of remaining shares. When a company has excess cash and limited immediate investment requirements, it may use the funds to repurchase its own shares. It may serve as an alternative to distributing cash through dividends and can sometimes reflect management's view that the company's shares are attractively valued.

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1.2.9 Valuation of Bonds

A bond is a debt instrument under which the issuer agrees to make specified payments to the bondholder according to the terms of the issue. For an investor, understanding the value of a bond is important because the market price of a bond can differ from its face value and can change over time as market interest rates and other factors change.

Bond valuation refers to the process of determining the present value of the future cash flows expected from a bond. These cash flows generally consist of periodic coupon payments and the repayment of the face value at maturity. The present value is calculated using an appropriate required rate of return.

1.2.9.1 Key Concepts in Bond Valuation

The following concepts provide the foundation for understanding how bonds are valued and traded in the market.

Face Value

Face value, also known as par value or maturity value, is the amount specified in the bond agreement that the issuer is required to repay to the bondholder at maturity, subject to the issuer fulfilling its obligations. For example, if a bond has a face value of ₹1,000, the issuer normally repays ₹1,000 to the bondholder at maturity. Face value is also important because the interest payment on a fixed-rate bond is generally calculated as a percentage of the face value.

Coupon Rate

The coupon rate is the annual rate of interest specified in the bond agreement. It is applied to the face value to determine the periodic interest payment made to the bondholder. For example, if a bond has a face value of ₹1,000 and a coupon rate of 8%, the annual coupon payment will be ₹80.

Annual Coupon Payment = Face Value × Coupon Rate

The coupon payment is the actual periodic interest amount paid by the issuer to the bondholder. Thus, the bondholder receives ₹80 per year when the bond makes annual coupon payments and the issuer fulfils its payment obligations. For a fixed-rate bond, the coupon rate generally remains unchanged throughout the contractual life of the bond, even though its market price and yield may change.

Market Price

The market price is the price at which a bond is bought or sold in the secondary market. The market price changes according to prevailing market conditions. A bond with a face value of ₹1,000 may trade at ₹1,000, above ₹1,000 or below ₹1,000. When the market price equals the face value, the bond is said to be trading at par. When the market price is higher than the face value, it is trading at a premium, and when the market price is lower than the face value, it is trading at a discount.

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The market price of a bond is influenced by several factors, particularly prevailing market yields, changes in interest rates, credit risk, maturity and liquidity. For a conventional fixed-rate bond, an increase in the required market yield generally causes the bond's price to fall, while a decrease in the required market yield generally causes its price to rise.

Current Yield

Current yield measures the annual coupon income generated by a bond as a percentage of its current market price. It provides a simple measure of the income return from the bond relative to the price at which it is currently available in the market.

Current Yield = (Annual Coupon Payment / Current Market Price) × 100

For example, suppose a bond has an annual coupon payment of ₹80 and is currently trading at ₹950. The current yield will be:

Current Yield = (₹80 / ₹950) × 100 = 8.42%

Therefore, the bond provides a current coupon yield of approximately 8.42% based on its current market price. However, current yield considers only the coupon income and does not take into account any capital gain or capital loss that may arise from the difference between the purchase price and the amount received at maturity.

Spot Interest Rate

A spot interest rate is the rate applicable to a single cash flow received at a specific future maturity. For example, a one-year spot rate applies to a cash flow received after one year, while a three-year spot rate applies to a cash flow received after three years. Spot rates are particularly relevant in detailed bond valuation because each future cash flow can be discounted using the spot rate corresponding to its maturity.

For example, if a bond provides cash flows at the end of the first, second and third years, a spot-rate valuation approach may discount the first cash flow using the one-year spot rate, the second using the two-year spot rate and the third using the three-year spot rate. This approach differs from using a single yield to discount all the bond's future cash flows and provides a more detailed method of valuation when the term structure of interest rates is available.

Yield to Maturity (YTM)

Yield to Maturity (YTM) is a comprehensive measure of the return on a bond when it is held until maturity. It is the rate of return that equates the current market price of the bond with the present value of all its future cash flows, assuming the bond is held until maturity and the underlying assumptions of the YTM measure are satisfied. These future cash flows include the periodic coupon payments and the repayment of face value at maturity.

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Yield to Call (YTC)

Yield to Call (YTC) is a measure of the potential return on a callable bond when it is assumed that the issuer redeems the bond on a specified call date rather than allowing it to remain outstanding until its maturity date. A callable bond gives the issuer the contractual right to redeem the bond before maturity, subject to the terms of the issue. YTC therefore considers the coupon payments received up to the call date and the amount paid by the issuer when the bond is called, known as the call price.

YTC is particularly relevant when a bond is trading in circumstances where the issuer may have an incentive to exercise the call date, such as when market interest rates have declined. In such a situation, the issuer may refinance its borrowing at a lower cost by redeeming the existing bond. For investors, YTC provides an alternative return measure to YTM because the investment may end before the stated maturity date.

Bond Prices

The value of bond is equal to the present value of the expected cashflows. For a conventional coupon-paying bond, these cash flows normally consist of periodic coupon payments and the repayment of face value at maturity. The fundamental principle of bond valuation is that the value of a bond equals the present value of its expected future cash flows.

Bond Value = Present Value of Coupon Payments + Present Value of Face Value

When a single required market yield is used as the discount rate, the value of a bond can be expressed as:

$$P = \frac{C}{(1+r)^1} + \frac{C}{(1+r)^2} + \ldots + \frac{C+F}{(1+r)^n}$$

Where:

P = Current value of the bond

C = Periodic coupon payment

F = Face value

r = Appropriate discount rate

n = Number of periods to maturity

A bond with a face value of ₹2,000 was issued 4 years ago at a coupon rate of 8 per cent. The bond had a maturity period of 8 years and, as of today, four more years are left for final repayment at par. If the current market interest rate is 11 per cent, the present value of the bond can be determined as follows.

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The present value of the bond is:

$$P_0 = \sum_{t=1}^{4} \frac{₹160}{(1.11)^t} + \frac{₹2{,}000}{(1.11)^4}$$

Using the present value factors:

PVAF (11%, 4 years) = 3.1024

PVF (11%, 4 years) = 0.6587

Therefore,

$$P_0 = (₹160 \times 3.1024) + (₹, 2000 \times 0.6587)$$

$$= ₹496.38 + ₹1{,}317.40$$

P_0 = 1,813.78

Thus, the present value of the bond is approximately ₹1,813.78. Since the present value is lower than the face value of ₹2,000, the bond is selling at a discount because the market interest rate (11%) is higher than the coupon rate (8%).

Relationship Between Bond Price and Yield

For a conventional fixed-rate bond, bond price and required market yield generally move in opposite directions. When the required yield increases, the present value of the bond's fixed future cash flows decreases, resulting in a lower bond price. Conversely, when the required yield decreases, the present value of those future cash flows increases, resulting in a higher bond price.

1.2.10 Managing Behavioural Biases in Investing

Investment decisions are often influenced by emotions, cognitive limitations and psychological biases. Behavioural finance examines how these factors influence investor judgement, decision-making and financial market outcomes. Under conditions of uncertainty, investors may interpret information through the lens of past experiences, personal beliefs and emotional responses, sometimes deviating from rational evaluation. These systematic patterns of judgement and decision-making are referred to as behavioural biases

Behavioural biases cannot always be completely eliminated because they are often associated with the way individuals naturally process information and respond to uncertainty. However, their influence can be reduced through disciplined and structured decision-making. Investors can establish clear investment objectives, assess the level of risk before making an investment, maintain adequate diversification and use predefined criteria for investment and exit decisions. They can also avoid making decisions solely in response to short-term market movements. Separating investment decisions from emotional reactions helps investors make more consistent and rational choices.

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1. Loss aversion

Loss aversion is a concept in behavioral finance that explains why investors often react more strongly to losses than to gains of the same size. Psychologically, the discomfort or pain caused by losing money is felt more intensely than the satisfaction of earning profits. Because of this bias, investors tend to make irrational decisions, they may continue holding losing stocks in the hope that prices will recover, avoiding the realization of a loss, while at the same time selling winning investments too early to "lock in" gains. This behavior disrupts logical decision-making and leads to poor portfolio management. Instead of focusing on long-term value and fundamentals, investors become emotionally driven, which can reduce overall returns and hinder wealth creation. Over time, consistently holding underperforming assets and exiting strong performers too soon can significantly damage portfolio performance.

Effects of Loss Aversion:

- Holding losing investments for too long
- Selling profitable investments too early
- Ignoring rational analysis and market signals
- Increased emotional decision-making
- Reduced overall portfolio returns
- Poor long-term wealth accumulation

How to Overcome Loss Aversion:

- Set clear investment goals and strategies
- Use stop-loss orders to limit losses
- Focus on long-term fundamentals rather than short-term emotions
- Diversify investments to reduce risk
- Regularly review and rebalance the portfolio

2. Herd mentality

Herd mentality in investing refers to the tendency of individuals to follow the actions of a larger group without conducting their own independent analysis. Instead of relying on fundamentals or rational judgment, investors influenced by herd behavior make decisions based on what others are doing, especially during periods of strong market movements. In bullish markets, this behavior can lead to excessive buying driven by fear of missing out (FOMO), which inflates asset prices and may create speculative bubbles. Conversely, during market downturns, herd mentality can trigger widespread panic selling, causing prices to fall sharply. This collective behavior often amplifies market volatility and leads investors to enter or exit investments at unfavorable times, ultimately affecting their returns and long-term wealth creation.

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Effects of Herd Mentality:

- Leads to buying at high prices during market booms
- Causes panic selling during market declines
- Contributes to formation of asset bubbles
- Reduces rational and independent decision-making
- Results in poor timing of investment decisions

How to Avoid Herd Mentality:

- Conduct independent research before investing
- Focus on fundamentals rather than market hype
- Set clear investment goals and strategies
- Avoid emotional decisions driven by fear or greed
- Diversify investments to manage risk
- Maintain a long-term investment perspective

3. Overconfidence bias

Overconfidence bias is a behavioral finance concept where investors overestimate their knowledge, skills, or ability to predict market movements. This bias leads individuals to believe they can consistently outperform the market or make better investment decisions than others. As a result, overconfident investors tend to take excessive risks, trade more frequently and rely heavily on their own judgments rather than objective data or expert advice. While confidence is important in investing, excessive confidence can lead to poor decision-making and lower overall returns. Over time, this behavior can negatively impact portfolio performance and hinder long-term wealth creation.

Effects of Overconfidence Bias:

- Excessive trading, leading to higher transaction costs
- Underestimation of risks involved in investments
- Ignoring expert advice or market signals
- Concentrated investments instead of proper diversification
- Increased chances of losses due to risky decisions
- Overreaction to past successes, leading to repeated mistakes

How to Overcome Overconfidence Bias:

- Rely on data, research and fundamental analysis
- Diversify investments to reduce risk
- Keep a record of past decisions to learn from mistakes

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- Seek advice from financial experts when needed
- Avoid frequent trading without strong justification

Case Study: Zomato's IPO

In July 2021, Zomato Limited entered the Indian equity market through an Initial Public Offering (IPO), offering its equity shares at a price band of ₹72–₹76 per share, with a face value of ₹1 per share. The IPO comprised a fresh issue of equity shares by Zomato and an offer for sale by its existing shareholder, Info Edge (India) Limited. The fresh issue enabled Zomato to raise capital for the purposes specified in its offer documents, while the offer for sale enabled the existing shareholder to realise part of its investment.

Zomato's equity shares were subsequently listed on the National Stock Exchange of India (NSE) and BSE Limited on 23 July 2021. Following listing, the shares became available for trading in the secondary market, where investors could buy and sell the already-issued shares through stock exchanges using registered intermediaries and online trading platforms.

Consider an investor who did not participate in Zomato's IPO but is considering purchasing the shares after their listing. The investor observes that the market price is different from the IPO price of ₹76 and that investor expectations about the company's future prospects are influencing trading activity. The investor must now determine whether the prevailing market price represents an appropriate entry point.

Before making the investment decision, the investor needs to examine several factors, including Zomato's business prospects, financial performance, valuation, competitive position, growth expectations, market conditions and associated risks.

A substantial increase or decrease in the market price relative to the IPO price, therefore, does not by itself establish whether the IPO was correctly or incorrectly priced. Such a price movement may reflect changes in investor expectations, new information about the company, market sentiment, trading activity, or a reassessment of the company's valuation. The investment decision consequently requires an assessment of the factors underlying the price movement rather than a comparison of prices alone.

Questions

1. An investor who did not participate in Zomato's IPO wants to purchase the shares after listing through an online trading platform. Analyse the process through which the investor would place and execute the transaction. What factors should be evaluated before making the investment decision?

2. Zomato's IPO price was ₹76 per share. If the market price after listing moves substantially above or below ₹76, does this necessarily indicate that the IPO was wrongly priced? Analyse the factors that an investor should consider before reaching such a conclusion.

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Summarised Overview

Financial markets constitute an essential component of the financial system by providing an organised framework for the mobilisation, allocation and transfer of financial resources. They facilitate the issuance and trading of financial securities and support informed investment and financing decisions. An understanding of financial markets enables learners to relate fundamental financial concepts to the practical processes involved in investment and securities trading.

This unit examined the structure and functioning of securities markets, with particular emphasis on primary and secondary markets, equity shares, stock exchanges and electronic trading systems. It also explored the processes involved in trade execution, clearing and settlement, thereby providing an understanding of the mechanisms that ensure the efficient and orderly functioning of stock market.

The unit further discussed selected trading strategies and technical indicators used to analyse market movements and support investment decisions. Important investment concepts, including bond valuation and corporate actions, were also examined. In addition, the unit highlighted the significance of investor behaviour and behavioural biases, demonstrating how psychological factors can influence financial decisions and market outcomes.

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Self-Assessment Questions

1. Explain the various order types used in stock markets.
2. Discuss the importance of bid-ask spread in investment decisions.
3. Explain the IPO.
4. Explain the concept of technical indicators and discuss how they assist in analysing price movements and market momentum.
5. Discuss the concepts of bond valuation
6. Explain the settlement process.
7. Analyze the impact of corporate actions on shareholders.
8. Explain common behavioural biases and methods to overcome them.

Assignment Questions

1. Analyse the functioning of different order types (market, limit, and stop-loss orders) and evaluate their role in managing trading risk and improving investment decisions.
2. Compare and critically evaluate momentum trading and swing trading strategies with suitable examples, highlighting their advantages, risks and suitability for different types of investors.
3. Select a recent IPO and analyse the company's fundraising objectives, issue structure, subscription details, investor response and its post-listing performance.
4. Examine the valuation of a selected bond by analysing its coupon rate, yield, market value, and the factors affecting its price in the secondary market.

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Suggested Reading

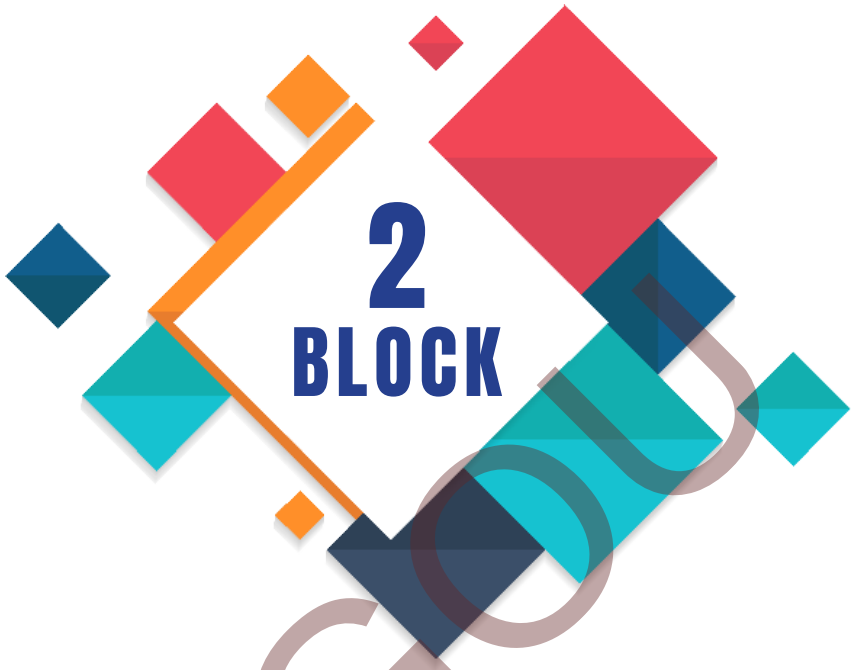
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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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Derivative Market

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Unit 1

Introduction to Derivatives

Learning Outcomes

After the successful completion of the unit, the learner will be able to:

- ◊ explain the concept of derivatives and their role in financial markets
- ◊ distinguish among the major types of derivative contracts
- ◊ analyse the functioning of derivative instruments

Background

An investor holding financial assets may experience gains or losses as market prices change. Since such changes cannot always be predicted with certainty, market participants need suitable mechanisms to manage the financial risks arising from changing market conditions.

Over time, financial markets have developed a variety of instruments to help participants manage such uncertainty. Derivatives are among the important instruments that have emerged for this purpose. They provide market participants with a means of managing their exposure to changes in the prices or rates associated with financial and other underlying assets. At the same time, derivatives can provide opportunities for traders and investors who anticipate particular movements in market prices.

The use of derivatives is not confined to a single purpose. Businesses and investors may use them to protect against unfavourable changes in market prices or rates, while traders may take positions with the expectation of benefiting from favourable market movements.

This unit provides an introduction to the world of derivatives and develops the concepts progressively. It begins with the basic nature and functioning of derivatives and introduces the major types of derivative instruments. The unit then examines their important features, uses and applications.

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Keywords

Derivative, Underlying Asset, Forward Contract, Futures Contract, Option Contract, Swap, Hedging, Speculation, Arbitrage, Over-the-Counter Market

Discussion

2.1.1 Meaning of Derivatives

A derivative is a financial contract whose value is derived from the value of another asset, known as the underlying asset.

The underlying asset may be, Equity shares, Bonds, Commodities, Foreign currencies, Interest rates, Stock market indices such as Nifty 50 and Sensex. A derivative does not usually represent direct ownership of the underlying asset. Instead, its value changes according to changes in the underlying asset.

According to the Securities Contracts (Regulation) Act, 1956, a derivative is a contract whose value is derived from the prices or values of underlying securities.

Suppose an investor enters into a contract to purchase 100 shares of a company after one month at a predetermined price. The value of this contract depends on the future market price of the shares. Therefore, the contract is a derivative because its value is derived from the value of the underlying shares.

2.1.2 Characteristics of Derivatives

The important characteristics of derivatives are as follows:

- **Value Derived from an Underlying:** The value of a derivative depends on the price or value of an underlying asset, rate, index, or other reference variable.
- **Contractual Nature:** A derivative is a contractual agreement that creates specific rights, obligations, or both, between the parties involved.
- **Future Settlement:** Derivative contracts generally involve performance or settlement at a future date, although some contracts may be settled before maturity.
- **Risk Transfer:** Derivatives enable one party to transfer or manage exposure to certain financial risks by taking an opposite position to another party.

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- **Price Discovery and Liquidity:** Derivative markets can contribute to price discovery by reflecting market expectations about future prices and can enhance liquidity in financial markets.
- **Variety of Underlying:** Derivatives can be based on different underlying assets or variables, including equities, commodities, currencies, interest rates and market indices.

2.1.3 Types of Derivative Contracts

Derivative contracts can be classified into four major categories:

1. Forward Contracts
2. Futures Contracts
3. Options Contracts
4. Swaps

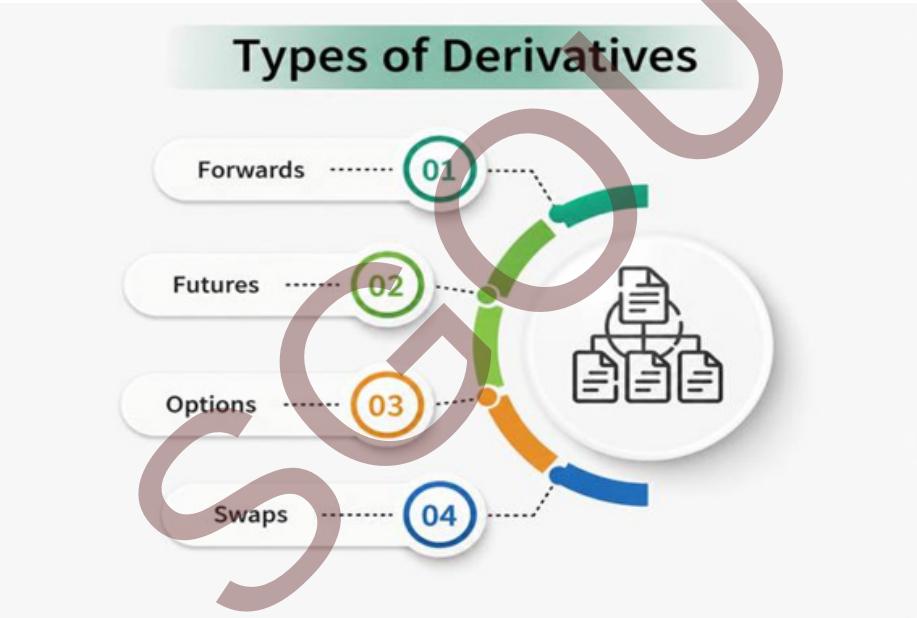


Fig. 2.1.1 Types of Derivatives

Each type differs in terms of trading mechanism, standardisation and risk characteristics. Let's look in detail into the different types of derivative contracts.

1. Forward Contracts

A forward contract is a customised agreement between two parties to buy or sell a specified asset at a predetermined price on a specified future date. It is one of the oldest and simplest forms of derivative contracts. The contract is privately negotiated between the parties and is generally traded in the Over-the-Counter (OTC) market rather than through organised exchanges. The primary purpose of a forward contract is to reduce uncertainty arising from future price fluctuations.

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For example, suppose an oil-refining company (buyer) expects to purchase 10,000 barrels of crude oil after three months and enters into a forward contract with a crude oil supplier (seller) at a predetermined price of ₹6,000 per barrel. The total contracted value is ₹6 crore. If the market price rises to ₹6,500 per barrel on the settlement date, the supplier must sell the crude oil to the refinery at the agreed price of ₹6,000 per barrel, helping the refinery control its future purchase cost. However, if the market price falls below ₹6,000 per barrel, the refinery is still obligated to purchase the crude oil at the contracted price. Thus, the forward contract provides greater certainty over future commodity prices while binding both parties to the agreed terms.

Characteristics of Forward Contracts

- The parties can determine the quantity, price and delivery date according to their requirements.
- Forward contracts are traded directly between parties.
- Settlement occurs on a specified future date.
- Usually, no upfront payment is required at the time of entering into the contract.
- There is a possibility that one party may fail to fulfil contractual obligations.

2. Futures Contracts

A futures contract is a standardised agreement between two parties to buy or sell a specified quantity of an underlying asset at a predetermined price on a specified future date. Futures contracts are traded on organised exchanges and are subject to the rules and regulations of the exchange. Unlike forward contracts, futures contracts are standardised and traded through recognised exchanges. The exchange acts as an intermediary and guarantees the performance of the contract, thereby reducing the risk of default. The standardisation and exchange-based clearing help reduce counterparty risk compared with a forward agreement.

Characteristics of Futures Contracts

- Standardisation: Contract specifications are standardised by the exchange.
- Exchange-Traded: Futures contracts are traded through recognised exchanges.
- Margin Requirement: Participants must maintain a margin account.
- Daily Settlement: Profits and losses are settled daily through a process known as mark-to-market.
- Reduced Default Risk: The clearing corporation guarantees contract performance.

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3. Options Contracts

An option contract is a derivative contract that gives the buyer the right, but not the obligation to buy or sell an underlying asset at a predetermined price on or before a specified date. In return for this right, the buyer pays a certain amount known as the premium to the seller of the option.

Options are different from futures because the buyer of an option is not normally obligated to exercise the contract. There are two basic types of options: call options and put options.

A call option gives the buyer the right to buy the underlying asset, while a put option gives the buyer the right to sell the underlying asset. For example, if an investor expects a stock price to rise, he may purchase a call option. If the stock price rises sufficiently, the option may become valuable; if the expected movement does not occur, the buyer's loss is generally limited to the premium paid.

Unlike forward and futures contracts, where both parties are obligated to perform the contract, an option contract provides flexibility to the buyer. The buyer may choose whether or not to exercise the option depending on market conditions. The seller or writer of the option, however, is obligated to fulfil the contract if the buyer decides to exercise the option. For example, suppose an investor buys a call option to purchase a share at ₹100 by paying a ₹5 premium. If the share price rises to ₹120, the investor earns a profit of ₹15 per share after deducting the premium. If the share price falls below ₹100, the investor can choose not to exercise the option, and the loss is limited to the ₹5 premium paid

Characteristics of Options Contracts

- Right but Not Obligation: The buyer can exercise the option if it is beneficial or ignore the option if exercising it is not beneficial.
- Premium Payment: The buyer pays a premium to acquire the option. The premium represents the cost of obtaining the right granted by the contract.
- Limited Risk for Buyers: The maximum loss that an option buyer can incur is limited to the premium paid.
- Potentially Large Profit Opportunities: Options provide opportunities for substantial gains if market prices move favourably.
- Fixed Exercise Price: The contract specifies a predetermined price at which the underlying asset may be bought or sold. This price is known as the strike price or exercise price.
- Time-Bound Contract: Options remain valid only for a specified period. After expiry, the option ceases to exist.

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4. Swaps

A swap is a derivative contract in which two parties agree to exchange a series of cash flows over a specified period according to predetermined terms and conditions. The cash flows exchanged are generally linked to variables such as interest rates, exchange rates, commodity prices, or other financial indicators. Swaps are generally negotiated privately between parties and traded in the Over-the-Counter (OTC) market. Swaps are widely used by corporations, banks, financial institutions and governments to manage various types of financial risks. A swap can be viewed as an agreement to exchange one stream of future payments for another stream of future payments.

For example, A company with a fixed-rate loan may enter into a swap agreement with another company having a floating-rate loan. The two companies agree to exchange their interest payment obligations for a specified period. Suppose a company has a ₹10 crore loan at a floating interest rate and is worried that interest rates may rise. It enters into an interest rate swap with a bank, agreeing to pay the bank a fixed rate of 7% and receive the floating rate on a notional amount of ₹10 crore. If the floating rate rises to 9%, the bank pays the company the 2% difference under the swap, helping offset the higher interest cost on the loan. If the floating rate falls below 7% the company pays the difference to the bank. Thus, the swap helps company to reduce uncertainty in its borrowing.

2.1.3 Purpose of Derivatives

Derivatives serve several important purposes in financial markets. They are as follows:

1. Hedging

Hedging is one of the most important purposes of derivatives. It means using a derivative contract to manage the risk of an unfavourable movement in the price of an underlying asset. For example, an investor who owns a large portfolio of shares may be worried that the stock market will fall in the near future. So instead of selling the entire portfolio, the investor may use put options to protect against part of the potential loss. If the market falls, the derivative position may generate a gain that can offset some of the loss in the portfolio. Thus, derivatives help investors manage price risk and provide greater certainty about their financial position. However, hedging may not completely eliminate risk because the derivative and the underlying investment may not move exactly together.

For example, suppose a wheat producer expects to sell 1,000 kg of wheat after three months. The current market price is ₹30 per kg, but the producer is concerned that the price may fall. The producer enters into a futures contract to sell the wheat at ₹29 per kg. After three months, if the market price falls to ₹25 per kg, the producer can sell at the agreed price of ₹29 per kg, receiving ₹29,000 instead of ₹25,000. Thus, the futures contract helps the producer reduce the loss that could result from an unfavourable fall in the price of wheat.

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2. Speculation

Speculation is another major purpose of derivatives. Speculation involves taking a position in a derivative with the expectation of making a profit from future changes in the price of the underlying asset. A speculator may buy a contract when he expects the price of a stock or index to increase, or sell a contract when he expects the price to decline. Derivatives are attractive to speculators because they can provide significant market exposure with a relatively smaller initial capital requirement. However, this creates leverage, which can magnify both profits and losses. Therefore, speculation through derivatives involves considerable risk and requires a proper understanding of the underlying asset, market conditions and the terms of the derivative contract.

3. Arbitrage

Arbitrage refers to the practice of taking advantage of price differences for the same or closely related financial instruments across different markets. An arbitrageur takes offsetting positions in the relevant markets with the objective of benefiting from the price discrepancy. For example, if an asset is available at a lower price in one market and at a higher price in another, an arbitrageur may buy in the lower-priced market and sell in the higher-priced market. Such activities can help reduce temporary price differences and contribute to greater price consistency and market efficiency. However, the potential benefit from arbitrage may be reduced by transaction costs, taxes, execution delays, liquidity constraints and other market frictions.

For example: Suppose the shares of a company are trading at ₹200 per share on the NSE and ₹204 per share on the BSE. An investor simultaneously buys 500 shares on the NSE for ₹1,00,000 and sells 500 shares on the BSE for ₹1,02,000. Assuming transaction costs are negligible, the investor earns a profit of ₹2,000 from the price difference between the two exchanges. This example illustrates arbitrage, where an investor seeks to benefit from a temporary price difference for the same asset across different exchanges.

4. Risk Transfer

Derivatives facilitate the transfer of financial risk from one market participant to another. Different participants have different levels of willingness and ability to accept risk. For example, an investor may want to reduce the risk of a decline in the value of a stock portfolio, while another trader may be willing to accept that market risk because he expects to earn a profit. Through a derivative contract, the two parties can take opposite positions and effectively redistribute the financial consequences of future price movements. In this way, derivatives perform an important economic function by allowing participants who wish to reduce certain risks to transfer those risks to participants who are prepared to bear them.

The purposes of derivatives extend beyond simply making profits from stock-price movements. Derivatives are primarily instruments for managing and transferring financial risk, but they also support speculation, price discovery, portfolio management and liquidity. Their usefulness depends on how they are designed and used. A derivative can reduce risk when appropriately used for hedging, but the same derivative can increase risk when used with excessive leverage or for uncontrolled speculation.

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2.1.5 Difference between Hedging, Speculation and Arbitrage

Derivative instruments such as forwards, futures, options and swaps are used by market participants for different purposes. The three most important uses of derivatives are hedging, speculation and arbitrage.

Hedging refers to the use of derivative contracts to reduce or eliminate the risk arising from adverse movements in the prices of assets, commodities, currencies, or interest rates. The primary objective of hedging is risk management rather than profit generation. Hedgers use derivatives as a protective mechanism to safeguard themselves against uncertainty.

Speculation, on the other hand, involves taking positions in derivative contracts with the aim of earning profits from anticipated price movements. Speculators willingly assume risk because they expect favourable changes in market prices

Arbitrage refers to the practice of earning profit by exploiting price differences for the same asset or related assets in different markets. Arbitrageurs simultaneously buy and sell assets to take advantage of temporary pricing inefficiencies. The objective is to earn risk-free or nearly risk-free profits.

The major difference among the three are given in a table:

Basis of Difference	Hedging	Speculation	Arbitrage
Meaning	Reducing or eliminating risk through derivatives	Taking risk to earn profits from expected price movements	Exploiting price differences between markets to earn profit
Primary Objective	Risk management	Profit maximisation	Low-risk profit
Risk Level	Low	High	Very low
Market Exposure	Reduces exposure to risk	Increases exposure to risk	Neutral exposure through simultaneous transactions
Market View	Protection against adverse movements	Expectation of favourable movements	Focus on price discrepancies
Nature of Activity	Defensive strategy	Aggressive strategy	Market efficiency strategy
Typical Participants	Businesses, exporters, importers, investors	Traders, investors, fund managers	Arbitrageurs, financial institutions
Example	Exporter using a forward contract to lock exchange rates	Trader buying gold futures expecting prices to rise	Buying a stock option or currency option in one market and selling it in another market at a higher price

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Case Study: The Volatility of the Stock Market

The outbreak of COVID-19 in early 2020 created severe uncertainty for economies and financial markets across the world. In India, the nationwide lockdown announced in March 2020 brought substantial restrictions on economic activity, disrupted businesses and supply chains and raised concerns about corporate earnings and economic growth. These developments were quickly reflected in the stock market, where investors reassessed the prospects and risks associated with listed companies.

The BSE Sensex and NSE Nifty witnessed sharp declines during March 2020, with trading characterised by unusually high volatility. Investors faced uncertainty not only about the immediate impact of the pandemic but also about how long the disruption would continue and how different industries would be affected. Companies in sectors such as aviation, tourism, hospitality and retail faced particularly severe challenges, while some businesses experienced increased demand as economic activity shifted towards digital and remote services.

The market environment changed as governments and central banks introduced measures to support economic activity and financial stability, while developments concerning vaccines and economic reopening gradually influenced investor sentiment. Stock markets subsequently recovered substantially from their initial lows, although market movements continued to respond to changing expectations about the pace and strength of economic recovery.

The COVID-19 episode provides an important context for understanding stock-market risk, volatility, investor expectations and trading behaviour. It also raises questions about how different market participants respond when uncertainty is exceptionally high and how financial markets accommodate differing views about future prices and risks.

Questions

1. What factors contributed to the sharp volatility in the Indian stock market during the COVID-19 pandemic?
2. How might investors with different risk preferences respond differently to such a highly uncertain market environment?

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Summarised Overview

Derivatives are financial instruments whose value is derived from an underlying asset such as shares, commodities, currencies, interest rates, bonds, or stock market indices. They are widely used in modern financial markets for managing risk, facilitating price discovery, enhancing market liquidity and supporting portfolio management. The major types of derivative contracts include forward contracts,

futures contracts, options contracts and swaps. Forward contracts are customised agreements traded in the over-the-counter (OTC) market, while futures contracts are standardised and traded on organised exchanges. Options provide the buyer with the right, but not the obligation, to buy or sell an asset at a predetermined price, whereas swaps involve the exchange of cash flows between two parties over a specified period to manage financial risks such as interest rate and currency risks.

Derivative markets are primarily used for hedging, speculation and arbitrage. Hedging aims to reduce or eliminate the risk arising from unfavourable price movements. Speculation involves taking calculated risks to earn profits from expected changes in market prices, while arbitrage involves exploiting price differences in different markets to earn risk-free or low-risk profits. Although their objectives differ, hedgers, speculators and arbitrageurs collectively contribute to the efficiency, liquidity and stability of financial markets. As a result, derivatives have become indispensable tools for risk management and financial decision-making in today's business environment.



Self-Assessment Questions

1. What are derivatives? Explain their importance in modern financial markets.
2. Discuss the major purposes of derivative instruments.
3. Explain the concept of a forward contract. What are its advantages and limitations?
4. What is a future contract?
5. Define arbitrage.
6. What is a futures contract? How does it differ from a forward contract?
7. What is an option contract?
8. Distinguish between call options and put options.
9. Explain the concept of swaps.
10. Compare and contrast hedging, speculation and arbitrage.

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Assignment Questions

1. A wheat farmer expects to harvest 5,000 quintals of wheat after three months. The current market price is ₹2,500 per quintal, but the farmer fears that prices may decline before harvest. Explain how the farmer can use derivative instruments to manage this risk.

2. A financial institution has borrowed funds at a floating interest rate, while another institution has borrowed at a fixed interest rate. Both institutions wish to alter their interest payment obligations. Explain how an interest rate swap can help achieve this objective. Illustrate your answer with a suitable example and evaluate the benefits and risks involved.

3. Derivative markets are often criticised for encouraging excessive speculation, while supporters argue that they improve market efficiency and facilitate risk management. Critically examine the roles of hedgers, speculators and arbitrageurs in derivative markets and assess their contribution to the stability and efficiency of the financial system.

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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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Unit 2

Strategies for Derivative Trading

Learning Outcomes

After the successful completion of the unit, the learner will be able to:

- ◊ apply futures trading strategies such as Long Futures and Short Futures
- ◊ analyze various options trading strategies
- ◊ explain margin requirements and settlement mechanisms associated with derivative trading strategies

Background

Financial markets operate in an environment of continuous change, where prices, interest rates, exchange rates and other market variables may fluctuate over time. These changes create both opportunities and risks for businesses, investors and financial institutions. Derivative markets provide a framework through which market participants can respond to such changes and structure their financial positions according to their objectives.

It also involves understanding how their values are determined, how different positions respond to market movements and how risk and return vary across different strategies. The outcome of a derivative position depends on factors such as changes in the underlying asset, time, contract terms and prevailing market conditions.

A good understanding of these aspects enables market participants to evaluate derivative positions more effectively and use them in a disciplined manner. It also helps in recognising the relationship between potential return, market expectations, financial risk and contractual obligations.

This unit focuses on the practical application of derivatives and develops an understanding of how derivative positions are priced and managed in financial markets.

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Keywords

Cost-of-Carry Model, Long Call, Long Put, Covered Call, Bull Spread, Bear Spread, Calendar Spread, Bull Calendar Spread, Bear Calendar Spread, Strike Price, Premium, Margin Requirement, Initial Margin, Maintenance Margin.

Discussion

2.2.1 Pricing of Forward Contracts

A forward contract derives its value from the underlying asset. The forward price is the price agreed upon today for the purchase or sale of the underlying asset at a specified date in the future.

Cost of carry refers to the total cost incurred in holding or carrying an asset from the present date until the maturity date of the forward contract.

The benefits associated with holding the asset, such as dividends or income generated by the asset, are deducted from carrying costs.

Cost-of-Carry Model

The cost-of-carry model is used to determine the theoretical forward or futures price of an underlying asset. The basic idea is that holding an asset until a future date involves certain costs and benefits, such as financing costs, storage costs, insurance and income received from the asset. The forward or futures price is therefore related to the current spot price after adjusting for these costs and benefits.

For an asset that provides no income and has no additional carrying costs, the basic relationship is: $F_0 = S_0(1 + r)^T$

Where:

- F_0 = Theoretical forward/futures price
- S_0 = Current spot price of the asset
- r = Annual financing or risk-free interest rate
- T = Time to maturity in years

For example, suppose a stock is currently trading at ₹1,000, the annual financing rate is 8%, and the forward contract expires after 6 months. Using annual compounding:

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$$F_0 = ₹\ 1,000(1 + 0.08)^{0.5}$$

$$F_0 = ₹1,000(1.08)^{0.5}$$

$$F_0 = ₹1,039.23$$

This means that, assuming no dividends or other carrying costs, the cost-of-carry model suggests a futures price of about ₹1,039.23 for a six-month contract.

When the underlying asset provides income, such as a dividend, the income reduces the cost of carrying the asset. Similarly, storage and other holding costs increase the cost of carry. Therefore, the general formula can be expressed as:

Futures/Forward Price = Spot Price + Cost of Carry − Benefits from Holding the Asset

2.2.2 Futures Trading Strategies

Futures contracts are widely used by investors, traders and businesses for hedging risks as well as for speculative purposes. A futures trading strategy refers to the position taken by a market participant in anticipation of future price movements of the underlying asset. The two basic futures trading strategies are the long futures strategy and the short futures strategy. These strategies form the foundation for more complex derivative trading techniques.

2.2.2.1 Long Futures Strategy

A long futures strategy involves purchasing a futures contract with the expectation that the price of the underlying asset will increase in the future. By taking a long position, the investor agrees to buy the underlying asset at a predetermined price on a specified future date.

The strategy is based on a bullish outlook, meaning that the investor expects market prices to rise. If the market price increases above the futures price, the investor earns a profit. Conversely, if the market price falls below the futures price, the investor incurs a loss.

Long futures positions are commonly used by both speculators seeking profit and hedgers seeking protection against rising prices.

Suppose NIFTY 50 futures are trading at 24,000, and a trader expects the index to rise over the next few days. The trader therefore takes a long position by buying one NIFTY 50 futures contract at 24,000. Assume, for illustration, that the contract lot size is 75 units.

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If the NIFTY 50 futures price subsequently rises to 24,500, the trader closes the position by selling the futures contract at 24,500.

Profit = (Selling Price − Buying Price) × Lot Size

= (24,500 − 24,000) × 75

= 500 × 75

= ₹37,500

Thus, the trader earns a profit of ₹37,500, before transaction costs and other applicable charges.

2.2.2.2 Short Futures Strategy

A short futures strategy involves selling a futures contract with the expectation that the price of the underlying asset will decline in the future. By taking a short position, the trader agrees to sell the underlying asset at a predetermined price on a specified future date.

This strategy is based on a bearish outlook, meaning that the trader expects market prices to fall. If prices decline as expected, the trader earns a profit by buying the underlying asset at the lower market price and selling it at the higher agreed price. If prices rise, losses occur.

2.2.3 Options Trading: Stock Options

Options are among the most versatile derivative instruments available in financial markets. An option gives the buyer a right, but not an obligation to buy or sell an underlying asset at a predetermined price within a specified period. In return for this right, the buyer pays a premium to the option seller or writer.

2.2.3.1 Parties Involved in an Option Contract

Every option contract involves two parties: the option buyer (holder) and the option seller (writer). The buyer pays the option premium and obtains the right to exercise the option, but is not required to do so. If exercising the option is not beneficial, the buyer can simply allow the option to expire, with the loss generally limited to the premium paid. In contrast, the option seller receives the premium but assumes an obligation to fulfil the terms of the contract if the buyer exercises the option. Thus, the buyer has a right without an obligation, whereas the seller has an obligation in exchange for the premium received.

2.2.3.2 Specifications of Stock Options

A stock option contract contains certain standard specifications that define the rights and obligations of both parties. These include the underlying stock, type of option, strike price, expiry date, option premium, contract size, exercise style, and settlement

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method. The underlying stock identifies the asset covered by the contract, while the strike price specifies the price at which the stock can be bought or sold. The expiry date specifies when the option ceases to be valid. The premium is the price paid by the buyer to the seller. The contract size specifies the number of shares covered by the contract. The exercise style determines when the option buyer can exercise the option. The two main exercise styles are American-style, which generally allows exercise at any time up to and including the expiry date, and European-style, which allows exercise only on the expiry date.

2.2.3.3 Trading in Call Options

Options trading involves taking positions based on expectations about the future movement of the underlying stock. Stock options are mainly classified into Call Options and Put Options.

A Call Option gives the buyer the right, but not the obligation to purchase the underlying stock at the agreed strike price. The buyer normally expects the market price of the stock to increase. If the market price rises sufficiently above the strike price, exercising the call option may provide a profit. The seller of the call option receives the premium but assumes the obligation to sell the stock at the strike price if the buyer exercises the option.

A Put Option gives the buyer the right, but not the obligation to sell the underlying stock at the agreed strike price. The buyer normally expects the market price of the stock to decline. If the market price falls sufficiently below the strike price, exercising the put option may provide a profit. The seller receives the premium and assumes the obligation to buy the stock at the strike price if the buyer exercises the option.

An investor expecting a rise in the stock price may purchase a call option, while an investor expecting a decline may purchase a put option. Investors can also sell or write options to earn premium income, although the writer assumes greater obligations and potential risks. By combining buying and selling positions in calls and puts, traders can construct different option strategies according to their market expectations, risk tolerance and investment objectives.

Certain standard notations are used to explain the trading of call options. The exercise price or strike price is denoted by K, the expiry date of the option is denoted by T, and the market price of the underlying asset is denoted by S. The price paid for a call option, known as the option premium, is denoted by C. When prices need to be identified at different points in time, time subscripts may be used. The subscript 0 represents the current time, t represents a point of time between the present and expiry, and T represents the expiration date of the option.

An option contract is created when a buyer and a seller, known as the writer, agree to the terms of the contract, including the option premium. The buyer pays the premium to the writer and obtains the right, but not the obligation, to purchase the underlying asset at the specified exercise price. The buyer may exercise this right any time permitted under the terms of the option contract, up to the expiry date.

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Illustration: Consider an investor who purchases a call option on a share with a strike price (K) of ₹470 by paying an option premium (C) of ₹20 per share. The break-even price for the call option is: Break-even Price = K + C

= ₹470 + ₹20 = ₹490

If the market price of the share rises to ₹740, the call option is profitable to exercise because the investor has the right to purchase the share at ₹470 when it is available in the market at ₹740. The gross profit from exercising the option is:

Gross Profit = S − K

= ₹740 − ₹470 = ₹270

After deducting the option premium of ₹20, the net profit is:

Net Profit = S − K − C

= ₹740 − ₹470 − ₹20 = ₹250 per share

Thus, at expiry, the call option buyer earns a net profit when the market price of the underlying share exceeds the sum of the exercise price and the option premium, that is: S > K + C

In this example, the break-even price is ₹490. Therefore, if the share price is above ₹490 at expiry, the investor earns a net profit. If the market price of the underlying share does not rise above the exercise price, exercising the call option would not be economically beneficial. For example, if the market price is ₹450 while the exercise price is ₹470, the call option is out-of-the-money. The option may therefore expire without being exercised, and the investor loses the premium paid.

The maximum loss for the buyer of a call option is limited to the option premium paid. In this example, the maximum loss is ₹20 per share. In contrast, the profit potential of the call option buyer is theoretically unlimited, because the market price of the underlying share can continue to increase. Therefore, buying a call option provides an opportunity to participate in the potential upward movement of the underlying asset while limiting the buyer's maximum loss to the premium paid.

2.2.3.4 Profit and Loss of a Call Option Writer

A call option writer is an investor who sells a call option and receives a premium from the option buyer. In return, the writer has the obligation to sell the underlying asset at the agreed strike price if the buyer exercises the option. The profit or loss of the call writer depends on the market price of the underlying stock at expiry. If the stock price remains at or below the strike price, the option generally expires without exercise and the writer keeps the entire premium as profit. However, if the stock price rises above the strike price, the buyer is likely to exercise the option, and the writer must sell the stock at the strike price even though its market price is higher. The writer's profit or loss can be expressed as:

$$\text{Profit/Loss} = \text{Premium Received} - \max(0, S_T - K)$$

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where S_T is the stock price at expiry and K is the strike price. For example, if a call option has a strike price of ₹1,000 and the writer receives a premium of ₹50, the writer earns the full ₹50 if the stock remains at or below ₹1,000. If the stock rises to ₹1,100, the writer's loss on the option is ₹100, but the ₹50 premium reduces the loss, resulting in a net loss of ₹50. The break-even price for the writer is ₹1,050, calculated as the strike price plus the premium received. Thus, the maximum profit of a call option writer is limited to the premium received, while an uncovered call writer can face potentially unlimited losses if the stock price rises substantially.

2.2.3.5 Option Premium

The option premium is the price paid by the option buyer to the option seller for obtaining the right provided by the option. The buyer pays the premium whether or not the option is eventually exercised, while the seller receives the premium for taking on the obligation. The premium is not fixed; it changes according to various factors affecting the value of the option.

The option premium is influenced by several factors, including the current price of the underlying stock, strike price, time remaining until expiry, volatility, risk-free interest rate and expected dividends. Changes in the stock price affect call and put options differently. The strike price, also called the exercise price, is the predetermined price at which the option buyer can buy or sell the underlying stock when exercising the option. The strike price determines how favourable the option is compared with the current market price. More time remaining generally increases the possibility of favourable price movements and therefore increases the premium. Higher volatility generally increases the premium because there is a greater possibility of significant price movements. Intrinsic value is the amount that an option would be worth if it were exercised immediately. A call option has intrinsic value when the market price is above the strike price, while a put option has intrinsic value when the market price is below the strike price.

Time value is the portion of an option premium that reflects the remaining time until expiry and the possibility that the option may become more valuable before the expiry date. Generally, the longer the time remaining until expiry, the greater the time value, all else being equal. As the option approaches expiry, its time value generally declines, a process known as time decay. At expiry, the time value becomes zero and the option premium consists only of its intrinsic value, if any.

In-the-Money, At-the-Money and Out-of-the-Money

To understand the value of an option, it is necessary to compare the current market price of the underlying stock with the strike price.

A call option is In-the-Money (ITM) when the market price is above the strike price, while a put option is ITM when the market price is below the strike price.

An option is At-the-Money (ATM) when the market price is approximately equal to the strike price. A call option is Out-of-the-Money (OTM) when the market price of the

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underlying asset is lower than the strike price, while a put option is Out-of-the-Money when the market price is higher than the strike price.

For example, if the stock price is ₹1,100 and the strike price is ₹1,000, a call option is ITM, while a put option with the same strike price is OTM. If both the stock price and strike price are ₹1,000, the option is ATM.

Let us consider an investor who has purchased the shares of Reliance Industries, currently trading at ₹2,500. Suppose an investor expects the stock price to increase and buys a call option with a strike price of ₹2,550 by paying a premium of ₹50 per share. If the stock price rises to ₹2,700 at expiry, the call option is In-the-Money (ITM) because the market price is higher than the strike price. Its intrinsic value is ₹150 (₹2,700 − ₹2,550), and after deducting the ₹50 premium, the investor earns a net profit of ₹100 per share. If the stock price is ₹2,550 at expiry, the option is At-the-Money (ATM) because the market price equals the strike price. The option has zero intrinsic value, and the investor loses the ₹50 premium paid. If the stock price falls to ₹2,400, the call option is Out-of-the-Money (OTM) because the market price is below the strike price. The investor would not exercise the option because buying the stock at ₹2,550 would be more expensive than buying it in the market at ₹2,400, so the option expires worthless and the investor loses the ₹50 premium. The investor's break-even price is ₹2,600, calculated as the strike price of ₹2,550 plus the premium of ₹50.

2.2.4 Options Trading Strategies

Options trading strategies are combinations of buying or selling call and put options designed to achieve a particular investment objective. Traders may use these strategies based on their expectations about the direction of the market, the extent of price movement, volatility and time to expiry.

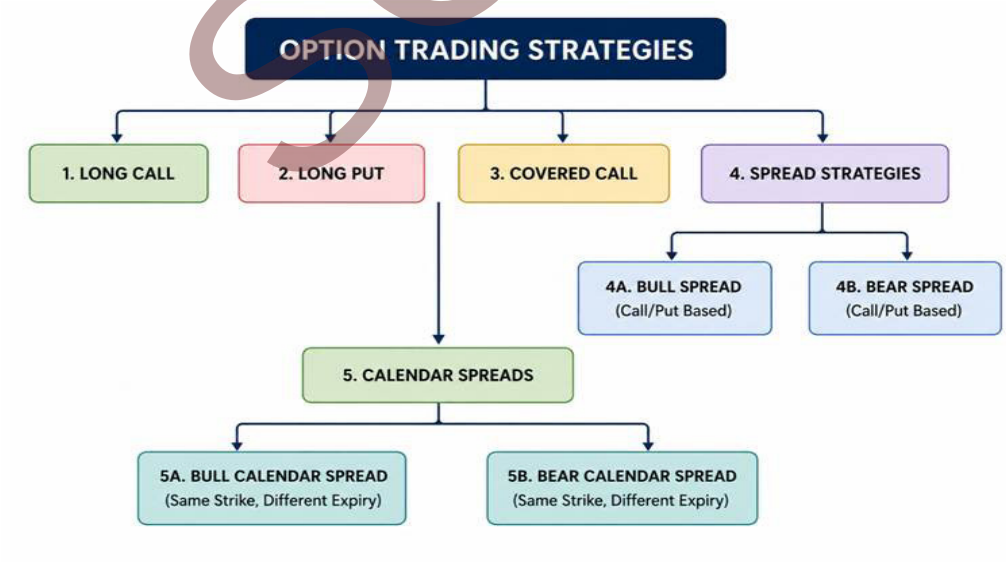


Fig. 2.2.2 Option Strategies

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The commonly used strategies include Long Call, Long Put, Covered Call, Bull Spread, Bear Spread, and Calendar Spread.

2.2.4.1 Long Call

A Long Call strategy involves buying a call option. A call option gives the buyer the right, but not the obligation, to buy the underlying asset at a specified strike price on or before the expiry date.

An investor generally uses a long call when they have a bullish expectation about the underlying asset. The investor expects the price of the stock or index to rise significantly before the option expires. Since the investor pays a premium to acquire the call option, the potential loss is limited to the premium paid, while the potential profit can increase substantially as the price of the underlying asset rises.

Illustration: Suppose the current market price of a stock is ₹1,000. An investor purchases a call option with a strike price of ₹1,050 by paying a premium of ₹30 per share.

If the stock price rises to ₹1,200 at expiry:

- Intrinsic value = ₹1,200 − ₹1,050 = ₹150
- Premium paid = ₹30
- Net profit = ₹150 − ₹30 = ₹120 per share

If the stock price remains at or below ₹1,050 at expiry, the call option has no intrinsic value and the investor would generally allow it to expire without exercise. In this case, the investor's maximum loss is limited to the premium of ₹30 per share, ignoring transaction costs.

Risk–Return Profile

Characteristic	Description
Market outlook	Strongly bullish
Position	Buy a call option
Initial investment	Premium paid
Maximum loss	Limited to the premium paid
Maximum profit	Theoretically unlimited
Break-even price at expiry	Strike price + Premium paid
Risk–return profile	Limited downside with potentially unlimited upside
Best suited for	Investors expecting a substantial rise in the underlying stock price

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2.2.4.2 Long Put

A Long Put is an options strategy in which an investor buys a put option. A put option gives the buyer the right, but not the obligation to sell the underlying stock at a predetermined strike price, subject to the terms of the option contract. The buyer pays a premium for this right.

An investor generally uses a Long Put when they have a strongly bearish expectation about the underlying stock and anticipate a significant decline in its price before expiry. A Long Put can also be used to protect an existing stock position against a decline in market value.

For example, suppose a stock is trading at ₹1,000. An investor purchases a put option with a strike price of ₹950 by paying a premium of ₹25. If the stock price falls significantly below ₹950, the put can increase in value. If the stock price remains above ₹950 at expiry, the option may expire without exercise value, and the buyer's loss is generally limited to the premium paid.

Risk–Return Profile

Characteristic	Description
Market outlook	Strongly bearish
Position	Buy a put option
Initial investment	Premium paid
Maximum loss	Limited to the premium paid
Maximum profit	Substantial; approaches the strike price less premium if the stock price approaches zero
Break-even price at expiry	Strike price − Premium paid
Risk–return profile	Limited downside with substantial profit potential
Best suited for	Investors expecting a substantial decline in the underlying stock price

2.2.4.3 Covered Call

A Covered Call is an options strategy in which an investor owns the underlying stock and simultaneously sells a call option on the same stock. By selling the call option, the investor receives an option premium, which provides additional income from the existing stock holding. The strategy is generally suitable when the investor has a neutral to moderately bullish view and expects the stock price to remain stable or increase only moderately.

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For example, suppose an investor owns a stock currently trading at ₹1,000 and sells a call option with an exercise price of ₹1,100 for a premium of ₹30. The investor immediately receives ₹30 as premium. If the stock price remains at or below ₹1,100 at expiry, the call option will generally expire worthless, and the investor will be able to keep the ₹30 premium while continuing to own the stock.

If the stock price rises above ₹1,100, the call option may be exercised. In that case, the investor may have to sell the stock that he holds at the agreed exercise price of ₹1,100, so the potential gain from a further rise in the stock price is limited.

Risk–Return Profile

Characteristic	Description
Market View	Neutral to moderately bullish
Action	Own the stock and sell a call option
Income	Premium received from selling the call
Maximum Profit	Limited
Downside Risk	Substantial, because the investor continues to own the stock
Main Objective	Generate additional income from an existing stock holding and enhance potential returns

2.2.4.4 Bull Spread

A Bull Spread is an options strategy designed to benefit from a moderate increase in the price of the underlying asset. It involves taking two option positions with the same type of option with the same expiry but different strike prices.

One common form is the Bull Call Spread, which involves:

- Buying a call at a lower strike price, and
- Selling a call at a higher strike price.

The maximum profit is limited because the short call limits the upside beyond the higher strike. However, the maximum loss is also limited to the net premium paid.

Risk–Return Profile

Characteristic	Description
Market View	Moderately bullish
Strategy	Buy a lower-strike call + sell a higher-strike call
Maximum Loss	Limited to the net premium paid

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Maximum Profit	Limited
Risk	Limited
Reward	Limited

Suppose a share is currently trading at ₹100. An investor expects its price to rise moderately. The investor therefore buys a call option with an exercise price of ₹100 by paying a premium of ₹8 and sells another call option with an exercise price of ₹120 for a premium of ₹3. Since ₹8 is paid and ₹3 is received, the net premium paid is ₹5 per share.

If the share price remains at or below ₹100 at expiry, both options expire without value, and the investor loses ₹5, which is the maximum loss. If the share price rises to ₹110, the investor gains ₹10 from the ₹100 call and, after deducting the ₹5 premium, earns a ₹5 profit. If the share price reaches ₹120 or more, the investor earns the maximum profit of ₹15 per share. Any further increase above ₹120 does not increase the profit because the sold call limits the gain.

Thus, a Bull Call Spread allows an investor to benefit from a moderate rise in the share price while limiting both the maximum loss and maximum profit. In this example, the maximum loss is ₹5 per share, the maximum profit is ₹15 per share, and the break-even price is ₹105.

2.2.4.5 Bear Spread

A Bear Spread is an options strategy used when an investor expects the price of the underlying asset to decline moderately. It involves buying and selling two options of the same type, with the same expiry date but different exercise prices.

One common form is the Bear Put Spread. In a Bear Put Spread, the investor buys a put option with a higher exercise price and sells another put option with a lower exercise price. The investor pays a premium for the put option purchased and receives a premium from the put option sold. The difference between these two amounts is the net premium paid.

If the asset price does not decline and remains at or above the strike price, both options expire without value, and the investor's loss is limited to the net premium paid. If the asset price declines, the purchased put gains value and the investor can earn a profit. However, the profit is limited because the sold put, limits the benefit from a further decline in the asset price.

Thus, a Bear Put Spread allows an investor to benefit from a moderate decline in the asset price while limiting both the potential loss and the potential profit.

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Risk–Return Profile

Characteristic	Description
Market View	Moderately bearish
Strategy	Buy a higher-strike put + sell a lower-strike put
Maximum Loss	Limited to the net premium paid
Maximum Profit	Limited
Risk	Limited
Reward	Limited

2.2.4.6 Calendar Spreads

A calendar spread, also known as a time spread, is an options strategy that involves the simultaneous purchase and sale of same underlying asset with the same strike price but different expiration dates. The strategy aims to profit from differences in the rate at which option premiums decline over time (time decay).

Typically, an investor buys a longer-term option and sells a shorter-term option with the same strike price. Since the options expire at different times, their premiums behave differently, creating opportunities for profit. Calendar spreads are commonly used when investors expect the underlying asset price to remain near a particular level during the life of the shorter-term option while anticipating future price movements. A bull calendar spread is employed when an investor has a moderately bullish outlook and expects the price of the underlying asset to rise gradually over time.

A bear calendar spread is used when an investor has a moderately bearish outlook and expects the price of the underlying asset to decline gradually over time.

The short-term put loses value more rapidly because of time decay, while the long-term put retains value and may gain from a gradual fall in the asset price. Calendar spreads are generally considered limited-risk strategies because the investor owns a longer-term option that provides protection against extreme price movements.

Maximum risk is usually limited to the net premium paid and occurs when both options lose significant value. The profit potential is generally limited but can be attractive if the underlying asset remains near the strike price around the expiry of the short-term option.

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Risk–Return Profile

Characteristic	Description
Primary Consideration	Time to expiry and volatility
Strategy	Sell a shorter-term option + buy a longer-term option
Exercise Price	Same for both options
Expiry Dates	Different
Risk	Generally limited to the net premium paid
Main Objective	Benefit from differences in time decay and changes in volatility
Typical Outlook	Expect the asset price to remain near the exercise price in the short term

Comparison of the Strategies

Strategy	Basic Position	Market View	Maximum Profit	Maximum Loss
Long Call	Buy Call	Bullish	Theoretically unlimited	Premium paid
Long Put	Buy Put	Bearish	Substantial as price falls	Premium paid
Covered Call	Own Stock + Sell Call	Neutral/ Moderately Bullish	Limited	Substantial downside on stock, offset by premium
Bull Spread	Buy lower-strike call + Sell higher-strike call	Moderately Bullish	Limited	Limited
Bear Spread	Buy higher-strike put + Sell lower-strike put	Moderately Bearish	Limited	Limited
Calendar Spread	Buy longer-dated + Sell shorter-dated option	Time/volatility-oriented	Depends on structure	Generally limited for a standard debit calendar

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2.2.5 Basic Understanding of Margin Requirements and Settlement

Margin requirements and settlement are important concepts in derivatives trading, particularly in futures and options. They help ensure that traders are able to meet their financial obligations arising from their positions.

2.2.5.1 Margin Requirement

Margin is the amount of money or eligible collateral that a trader must deposit with the broker or clearing system when entering a derivatives position. It acts as a financial security or performance guarantee rather than the full value of the underlying asset. For example, if a futures contract has a value of ₹1,00,000 and the required margin is ₹20,000, the trader needs to provide ₹20,000 as margin to take the position. The actual margin percentage varies according to the contract and applicable market requirements.

Settlement refers to the process through which the financial obligations arising from a derivatives contract are completed. Depending on the contract, settlement may take place through cash settlement or physical settlement. In cash settlement, the difference between the agreed contract value and the settlement value is paid or received in cash. In physical settlement, the underlying asset is actually delivered or received according to the terms of the contract. In India, the applicable settlement method depends on the type of derivative contract and the rules of the relevant exchange and clearing corporation.

2.2.5.2 Types of Margin Requirements

1. Value at Risk Margin

Value at Risk (VaR) margin is the margin collected to cover the potential loss that may arise from adverse price movements in a derivatives position under normal market conditions. It is calculated using historical price movements and other risk measures to estimate the amount that could be lost over a specified period at a specified confidence level. Thus, VaR margin acts as a financial cushion against normal market risk.

2. Extreme Loss Margin

Extreme Loss Margin is an additional margin collected to cover the possibility of large and unexpected losses arising from extreme adverse movements in the market. It provides an additional safety buffer beyond the VaR margin and helps protect the clearing system against losses that may occur during unusual market conditions.

3. Mark-to-Market Margin

Mark-to-Market (MTM) margin relates to the daily settlement of profits and losses arising from changes in the market price of a futures position. At the end of each trading day, the position is valued at the current market price. If the position results in a loss, the trader is required to pay the corresponding amount; if it results in a profit, the amount is credited to the trader's account. This process ensures that losses are settled regularly rather than accumulating until the contract expires.

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4. Initial Margin

Initial margin is the amount of money or eligible collateral that a trader is required to provide before entering a derivatives position. It acts as an initial financial safeguard against possible losses resulting from adverse price movements. The required initial margin depends on the type of derivative and the applicable margining rules.

5. Exposure Margin

Exposure margin is an additional margin requirement collected to provide an extra financial buffer against potential losses arising from market movements. It is maintained in addition to the applicable basic risk margin and helps protect the clearing system from the risk associated with open positions.

Importance of Margin Requirements

- Protects brokers and exchanges from default risk.
- Ensures traders have sufficient funds to cover potential losses.
- Promotes discipline and responsible trading.
- Maintains market stability during periods of high volatility.

Case Study: Hindalco Industries – Commodity Prices and Share Price

Hindalco Industries Limited, a leading metals company, operates across the aluminium and copper value chains. Its financial performance is closely linked to global commodity-market dynamics, where prices are influenced by international demand, supply constraints, energy costs, inventory levels, exchange-rate movements and geopolitical developments. These factors create uncertainty in the company's operating environment and influence investors' assessments of its profitability, growth prospects and market valuation.

Commodity-price fluctuations affect a metals company through multiple channels. Changes in selling prices can influence revenue and operating margins, while movements in raw-material, energy and other production costs determine the extent to which these changes translate into profitability. The overall impact also depends on operational efficiency, product mix, demand conditions and the relative contribution of different business segments. Consequently, a decline in aluminium prices does not necessarily imply a proportionate decline in the company's earnings or share price.

Consider a situation in which international aluminium prices decline substantially over several months due to weakening global industrial demand and an increase in market supply. Investors holding shares in Hindalco must evaluate whether the price decline is temporary or indicative of a prolonged downturn in the commodity cycle. A short-term decline may have limited implications if demand recovers quickly, whereas a sustained decline could place pressure on revenue, margins and future earnings expectations.

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Some investors may interpret falling aluminium prices as a signal of deteriorating business prospects and sell their shares, while others may view the decline as a temporary cyclical movement and consider accumulating shares at a lower price. Their decisions may differ because of variations in risk tolerance, investment horizons, expectations of future economic conditions and interpretations of available information.

For an informed investment assessment, investors need to distinguish between changes in the company's underlying financial performance and changes in market sentiment. Relevant considerations include commodity-price trends, production costs, operating margins, cash flows, debt levels, capital expenditure requirements and management's assessment of market conditions. Investors must also consider whether the prevailing share price adequately reflects the risks and future earnings potential of the business. The central managerial and investment challenge is to determine whether the available information indicates a temporary fluctuation or a fundamental change in Hindalco's future earnings prospects.

Questions

1. How can fluctuations in global aluminium prices influence Hindalco's revenue and profitability?
2. What financial and economic factors should investors examine before deciding to buy, hold or sell Hindalco shares?
3. As an investment analyst, how would you distinguish a temporary commodity-price decline from a sustained deterioration in Hindalco's business prospects?



Summarised Overview

Derivative trading strategies enable market participants to manage risk, respond to changing market conditions, and pursue profit opportunities based on their expectations regarding future price movements. Forward contract pricing is explained through the Cost-of-Carry Model, which establishes the relationship between spot prices, carrying costs, and forward prices. Basic futures trading strategies such as Long Futures and Short Futures illustrate how investors can benefit from anticipated increases or decreases in the prices of underlying assets.

Various options trading strategies are also examined, including Long Call, Long Put, Covered Call, Bull Spread, Bear Spread, Bull Calendar Spread, and Bear Calendar Spread. These strategies demonstrate how options can be structured to suit bullish, bearish, and moderately changing market conditions while controlling risk exposure. The discussion of risk and reward profiles highlights the potential gains and losses associated with each strategy, thereby facilitating informed decision-making. The concepts of margin requirements and settlement procedures further provide insight into the mechanisms that support derivative trading and ensure the orderly functioning of derivative markets.

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Self-Assessment Questions

1. Explain the Cost-of-Carry Model used in the pricing of forward contracts
2. Discuss the Long Futures Strategy and Short Futures Strategy. Under what market conditions would each strategy be appropriate?
3. What is a Covered Call Strategy?
4. Discuss the Bear Spread Strategy and analyse its suitability for investors expecting moderate declines in asset prices.
5. What are Calendar Spreads?
6. Explain the concept of risk-reward profiles in derivative trading.

Assignment Questions

1. An investor expects the share price of a company, currently trading at ₹1,000, to rise moderately over the next three months. Evaluate the suitability of a Long Call Strategy and a Bull Spread Strategy for this situation. Compare the risk, reward, and cost implications of both strategies and recommend the most appropriate strategy with justification.
2. The current market price of a company is 250. The investor anticipates a short-term bullish market. In order to avail the profit potential, an investor buy call options on company, with exercise price of 255, at a premium of 5 Rs. Evaluate the profit/loss to the investor when the market price of the share rises to ₹280.
3. A trader expects a gradual increase in the price of an underlying asset over the next six months but believes that significant price movement is unlikely in the immediate future. Analyse the applicability of a Bull Calendar Spread in this situation.

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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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MODEL QUESTION PAPER SETS

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QP CODE: …… Reg. No: …….....

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FIRST SEMESTER

MASTER OF BUSINESS ADMINISTRATION (MBA)EXAMINATION

ABILITY ENHANCEMENT COURSE

M25BS02AC – Stock Market Operation

2025-26 Admission

MODEL QUESTION PAPER SET-1

Time: 3 Hours **Max Marks: 70**

SECTION A

*Answer any **five** questions.* Each question carries ***two*** marks. **(5 × 2 = 10 Marks)**

1. Define an Initial Public Offering.
2. What is overconfidence bias in investment decision-making?
3. What is meant by the bid-ask spread?
4. What is a stock split?
5. Define a derivative contract
6. What is hedging in financial markets?
7. What is Dividend?
8. What is Momentum Trading?

SECTION B

*Answer any **six** questions.* Each question carries ***five*** marks. **(6 × 5= 30 Marks)**

9. Describe the major functions of the secondary market.
10. Explain the procedure for IPO.
11. Explain the Candlestick Charts
12. What is meant by Speculation?
13. Explain the Rights Issue and its features.
14. What is meant by option premium?

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15. Explain the clearing and settlement process in the Indian stock market.
16. Explain the concept of bonus issue as a corporate action.
17. Explain the concept of bond valuation and discuss the factors that determine the present value of a bond.
18. Examine the potential advantages and risks of swing trading.

SECTION C

*Answer any **two** questions.* Each question carries ***fifteen*** marks. **(2 × 15 = 30 Marks)**

19. Discuss the different types of stock market orders and their significance in executing trades.
20. Compare long futures and short futures strategies. Illustrate the circumstances in which each strategy may be appropriate and assess their potential gains and risks.
21. Explain the major types of Margin Requirements and their importance in derivatives trading.
22. Explain options trading, including the types of options and their applications.

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FIRST SEMESTER

MASTER OF BUSINESS ADMINISTRATION (MBA)EXAMINATION

ABILITY ENHANCEMENT COURSE

M25BS02AC – Stock Market Operation

2025-26 Admission

MODEL QUESTION PAPER SET-II

Time: 3 Hours **Max Marks: 70**

SECTION A

*Answer any **five** questions.* Each question carries ***two*** marks. **(5 × 2 = 10 Marks)**

1. What is the Relative Strength Index (RSI)?
2. What is arbitrage in financial markets?
3. Define Value Investing
4. What is a futures contract?
5. What is Arbitrage?
6. What is a covered call strategy?
7. What is meant by market liquidity
8. Define loss aversion in investment decision-making

SECTION B

*Answer any **six** questions.* Each question carries ***five*** marks. **(6 × 5= 30 Marks)**

9. Explain the role of stock exchanges in facilitating securities transactions.
10. Explain the major functions of Primary Market?
11. Explain the concept of Support and Resistance
12. Describe the concept of bond valuation and the factors influencing the value of a bond.
13. Examine the use of technical indicators such as RSI and MACD in trading decisions.
14. Explain the uses of Candlesticks charts.

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15. Explain the purposes of derivatives.
16. Define Cost of Carry Model.
17. An investor wants to purchase a share only if it is available at ₹450 or below. Which order should the investor use? Explain the working of the order with an example.
18. An investor continues holding a falling stock because most of their friends believe that the price will recover. Identify the behavioural biases involved and explain how the investor could overcome them

SECTION C

*Answer any **two** questions.* Each question carries ***fifteen*** marks. **(2 × 15 = 30 Marks)**

19. Explain the trading mechanism in the stock market in detail. Discuss the clearing and settlement process.
20. Explain the different methods of raising capital through the stock market.
21. Elaborate the different types of derivative contracts.
22. Explain the major options trading strategies. Discuss the risk, reward and breakeven considerations of each strategy.

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സർവ്വകലാശാലാഗീതം

വിദ്യയാൽ സ്വതന്ത്രരാകണം
വിശ്വപൗരരായി മാറണം
ഗ്രഹപ്രസാദമായ് വിളങ്ങണം
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കൂരിരുട്ടിൽ നിന്നു ഞങ്ങളെ
സൂര്യവീഥിയിൽ തെളിക്കണം
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ISBN 978-81-181797-3-3

