# DEVELOPMENTS OF SKILLS TO MAKE FORTUNES IN SHARE MARKET BY RISKLESS HEDGING

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**Abstract :**The skill is defined as Proficiency, a developed talent, an ability or technique etc. The skill is a learned ability to carry out a task with pre-determined results often within the given time and inputs.

Managing your finance and creating the wealth, preservation of the wealth is again a skill. We have seen many people who earned enormous wealth during their peak years but died bankrupt because they did not possess the skill as to how to remain rich.

**Keywords:** Development, Skills ,share Market,riskless Hedging

## INTRODUCTION

**Today we will talk on Skill development in financial market.**

Wealth is measured by the assets one possesses.

**Wealth preservation:-**Although investment in gold and fixed deposits is or better was considered as wealth preservation strategies but in fact considering various factors affecting gold , it is no more a good investment vehicle, as regards fixed deposits the income is eaten away by inflation. Fixed deposits cannot protect you from inflation so it is again no more a good options.

**Wealth Creation: -** By investing in Real estate one can create the wealth and increase it many fold. Its drawbacks are large money is required at a time .and it is difficult to liquidate instantly when need occurs.

**Wealth Creation by investment in equity** is sure the best option available from small investors to big investors. The investment in equity is again classified in to two categories based on their risk taking ability.

**Passive investors** in equity participate in mutual fund schemes or take the help from Portfolio Management Services ( PMS)

**The active participants** in financial world invest actively on their own in equities. Or turn traders trading in futures and options.

Here we are talking about the active participation of traders in futures and options. And how to develop skill required for consistent and monthly profits where by one can create wealth by deploying the money which otherwise remain in post office fixed deposits or bank deposits.

The following table gives the returns on CAGR basis and the risk as measured by Standard Deviation over 1, 3 and 5 years holding periods of Sensex, 1 year SBI Fixed Deposit (FD) and Gold in INR terms for the last 30 years:

| **in last 30years** | **SENSEX** | **FD @ SBI** | **GOLD** |
|---|---|---|---|
| CAGR (%) | 16% | 9% | 10% |
| Rs. 10,000 has become | 9,12,496 | 1,22,434 | 1,84,990 |
| Standard Deviation 1 yr period | 58 | 2 | 14 |
| Standard Deviation 3 yr period | 22 | 2 | 8 |
| Standard Deviation 5 yr period | 15 | 2 | 7 |

Source: Bloomberg, 1 year FD rate has been taken for computation of FD returns

A careful reading of the above highlights that the Equity is the best investment vehicle. Now we will concentrate on share market and try to understand whether skill can be enhanced and deployed for making money and become super rich.

There is the common belief and feelings in the minds of general public right from the beginning that the share market is the gambling den. .Some people think that there are some companies branded as blue chips. These people just hold these shares for generations. Sometimes they get windfall gains and sometimes the value of the shares of these companies become zero and even companies get delisted from exchanges.

Development of any country is based on the industrial development of that country. And for industrial development what is required is large capital besides other things. The need of this capital is fulfilled to some extent from the investments infused in the capital market from general public. Therefore capital market is essential for the growth of the country.

As said above share market is considered risky market but no one can deny that if proper training is acquired and skill is developed then one can earn enormous money from these markets.

Now in the stock market various products are available. Some products such as derivatives which constitute futures and options are really good for faster wealth creations.

Now we will discuss more about futures & Options.

The ultimate proof that the futures and options are most popular product in market today is the fact that its daily turnover is around 2 cores.

**Exchange traded and most popular Derivatives products are Futures & Options**

The striking feature of the futures as against spot market is that one can buy just by keeping the margin of just 10 to 15% of value with the exchange and one can sell just by keeping the margin of just 10 to 15% of value with the exchange even if he does not have share. So just by 10 to 15% investment future trader keeps control on full value of contracts. Of course these are just contracts having expiry dates hence he does not enjoy the rights enjoyed by investors by buying the shares. The buying positions are known as long position and selling position is known as short position.

Options are fundamentally different from forward and future contracts. An option gives the holder of the option the right to do something. The holder does not have to exercise this right. In contrast, in a forward or futures contract, the two parties have committed themselves to do something. Whereas it costs nothing (except margin requirement) to enter into a futures contract, the purchase of an option requires an upfront payment.

**The options are of two types:- a call option and put option.**

Calls give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date. Puts give the buyer the right but not the obligation to sell a given quantity of the underlying asset at a given price on or before a given date. There are mainly 3 kinds of participants.

**1) Speculators** bet or speculate on future movement in the price of assets by forming bullish or bearish opinion.
**Bullish view** in the security market (spot market) the person may buy a security future where profit and loss both are unlimited 0r buy call where his loss is limited and profit is unlimited.
Bearish view in the security market (spot market) the person may sale a security future where profit and loss both are unlimited 0r buy put where his loss is limited and profit is unlimited.

**2)Arbitrageurs:** Take advantages of discrepancy between prices in two Different markets.

**3)Hedging:** We will talk more about hedging.

**Hedgers:-**To face the risks associated with the price of assets widely used risk management tool is hedging. If He hold equity then he can sell the future of that security or buy put option of that security Futures which can be used as an effective risk-management tool.

Take the case of an investor who holds the shares of a company and gets uncomfortable with market movements in the short run. All he need do is enter into an offsetting stock futures shorting position. Now if the price of security falls he will suffer losses on the security he holds. However, the losses he suffers on the security will be offset by the profits he makes on his short futures position which will offset the National loss on security. If the price instead of falling went up as against anticipated, the loss on selling of stock future or buying of put options will be offset by rise of valuation of stock held by him.

Hedging in financial terms is defined as entering transactions that will protect against loss through a compensatory price movement. Designed to reduce or eliminate financial risk,

Hedging is the calculated installation of protection. Derivatives like stock options are created just to use hedging. Hedging a portfolio of stocks is easy and convenient using stock options.

**Here are some popular methods**

**1)Protective Puts: -** Hedging against a drop in the underlying stock by buying put options. If the stock drops, the gain in the put options offsets the loss in the stock.

**2)Covered Calls:-** Hedging against a small drop in the underlying stock by selling call options. The premium received from the sale of call options serves to buffer against a corresponding drop in the underlying stock.

**3)Covered Call Collar:-** Hedging against a big drop in the underlying stock using put options while simultaneously increasing profitability to upside through the sale of call options.

Option traders' needs to consider 4 forms of risk, known as the **Option Greeks.** These risks are factors that influence the value of a stock option. Lets Understand main risk.

**Delta:-**Directional risk. If a drop in the value of the underlying stock is of greatest concern, then delta neutral hedging should be used. An option position which is relatively insensitive to small price movements of the underlying stock due to having near zero or zero delta value.
Hedging directional risk takes on one of two techniques; Delta Neutral Hedging

**Delta neutral hedging** not only removes small directional risks but it is also capable of making a profit on an explosive upside or downside breakout if a position's gamma value is kept positive. As such, delta neutral hedging is also great for uncertain stocks that are expected to make huge breakouts in either direction.

A share has a delta value of 1 as its value rises by Rs1 for every Rs1 rise in the stock. If you own 100 shares of a stock, you can attain a delta neutral position by buying 2 contracts of it's at the money put

options with delta value of -50 per contract.

100 (delta value of 100 shares) - 100 (2 x 50) = 0 Delta

Any small drop in the price of the shares will be instantly offset by a rise in the value of the put options. Any small rise in the price of the shares will also be offset by a drop in the value of the put options. This is an extremely popular option trading technique used by option traders who owns shares to protect the value of that position when the stock reaches a strong resistance level.

**Time decay. ( Theta) :-** When a position is delta neutral, having 0 delta value, it is not affected by small movements made by the underlying stock, but it is still affected by time decay as the premium value of the options involved continue to decay. An option trading position can be set up to take advantage of this time decay and one such example is the Short Straddle which profits if the underlying stock remains stagnant or moves up and down insignificantly.

**By Volatility.( Gamma) : -** By executing a delta neutral position, one can profit from a change in volatility with no directional risk when the underlying stock moves insignificantly. This option trading strategy is extremely useful when implied volatility is expected to change drastically soon. One example of such an option trading strategy is the Long Straddle. This is because a typical delta neutral position is still Gamma positive, which increases position delta in the direction of the move, allowing the position to profit in either direction.

**Warning :-** Hedging does not always make money. The best that can be achieved using hedging is the removal of unwanted exposure, i.e. unnecessary risk,. The hedged position will make less profit than the un hedged position, half the time. One should not enter into a hedging strategy hoping to make excess profits for sure; all that can come out of hedging is reduced risk.