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Nifty futures

Nifty is a portfolio of 50 stocks which make up an index value which in its full form is called S&P CNX Nifty. The present level of the Nifty is fluctuating around the **5000** mark. The Nifty is traded on **the National Stock Exchange (NSE)** of India. It is jointly owned by **CRISIL and NSE through IISL** (India Index Services and Products Ltd.)

Nifty futures are index futures where the **underlying is the S&P CNX Nifty index**. In India, index futures trading commenced in **2000** on the National Stock Exchange (NSE). The Nifty index reflects **23 sectors of the economy**. The Nifty tracks the movements of **50 shares of prominent Indian companies**. The complete picture of 'what is Nifty futures' can only be understood if we make a study of futures trading. A futures trade is a sort of bet. The duration of the bet can be one day or three months.

For Nifty futures contracts, the permitted lot size is **50**, and in multiples of **50**. Like other futures contracts, Nifty futures contracts also have a **three-month trading cycle -- the near-month, the next month and the far-month.**

The first month is called the near month, the second is called next month and the final third is called the far month. New contracts are introduced on the trading day following the expiry of the near month contracts. The new contracts are introduced for a three month duration. This way, at any point in time, there will be 3 contracts available for trading in the market (for each security) i.e., one near month, one next month and one far month duration respectively.

A big aspect of understanding 'what is Nifty futures' is that the **National Stock Exchange is the intermediary** in this contract. This is enforced through **margin money** kept with the NSE **on behalf of both the buyer and the seller** . This margin is a percentage of the contract value. It is usually about **10-12%.** Daily fluctuations make a profit for one party and a loss for the other party. The difference is credited to the account of the party making the profit. In this way the accounts are maintained in a regular way till the delivery date.

It is truly difficult to learn 'what is Nifty futures' without having some hands on practical experience. **Buying, selling, margin money, delivery, long and short are part of the terminology used in these futures trades.**

Trading the Nifty

Hedging. In simple terms, hedging is a strategy that helps limit losses. Exposure to a stock is equivalent to exposure to an index. This is because most stocks move in tandem to the market. Exposure to index futures helps hedge this risk.

Speculative gains: If you are certain about future market movements, you can make profits through index futures. If you are bullish on the market, buy index futures. If bearish, you should sell index futures.

How do they work? You enter into a Nifty futures contract at a specified index value. On the expiry of the contract, the investor's profits would be the difference between the level of the index on expiry and the level specified in the futures contract at the time of purchase.

Strategies

Short stock, long index futures: There are times when you sell the stock, but there is an upside in the market, thus resulting in lost potential profits. Index futures help you mitigate this risk. By buying index futures when you are short on the stock, you can minimise the amount of potential profits lost.

Long stock, short index futures: There are times when you own a portfolio and are uncomfortable about market conditions. You can hedge this risk by selling index futures. The concept vests on the fact that every portfolio has index exposure and risks are accounted for by fluctuations in the index.

Examples

Long Stock, Short Index Futures

Suppose you are long **500** shares of ABB at the price of **Rs 1,000** per share; spot Nifty is at **5,000**; and Nifty futures is **at 5,020**.

To protect your Rs 5 lakh **(500 X Rs 1000)** position from a market downturn, you need to **sell 100** (i.e., **Rs. 5,00,000/5000) Nifty futures**. Suppose on the expiry date, the spot/futures Nifty is at **4,750 (5 per cent fall).**

Your position in ABB would have dropped by **Rs 25,000** and the short Nifty would have gained **Rs 27,000 [i.e., 100 x (5,020-4,750)]**

Short Stock, Long Index Futures

Suppose you are short **400** shares of Wipro at the price of **Rs 2,500** per share; spot Nifty is **at 5,000**; and Nifty futures is at **5,050.**

To protect your **Rs 10 lakh (400 X Rs 2500)** position from a market upside, you need to **buy 200** (i.e., **Rs. 10,00,000/5000) Nifty futures**. If, on expiry, the spot/futures Nifty is at **5,250 (5 per cent rise),** on closing both positions, you lose nothing.

Your position in Wipro would result in a loss Rs 50,000 and the short Nifty would have gained **Rs 50,000 [i.e., 200 X (5,250-5000)]**

Hedging Portfolio Risk

Suppose the spot Nifty is at **5,000** and the **three-month Nifty futures at 5,015**. To protect a portfolio of **Rs 5 lakh (Rs 500,000)** from a drop in the market, you need to sell **100 December Nifty futures.**

Suppose on the expiry date, the spot/futures Nifty is at **4,500 (10 per cent fall).** Your hedging strategy would earn you a profit of **Rs 51,500[i.e., 100 X (5,015-4500)],** which compensates you for the **Rs 50,000 (10 per cent)** fall in your portfolio.