

Derivatives Thematic Report

Low volatility period to continue, helping Nifty positive bias...

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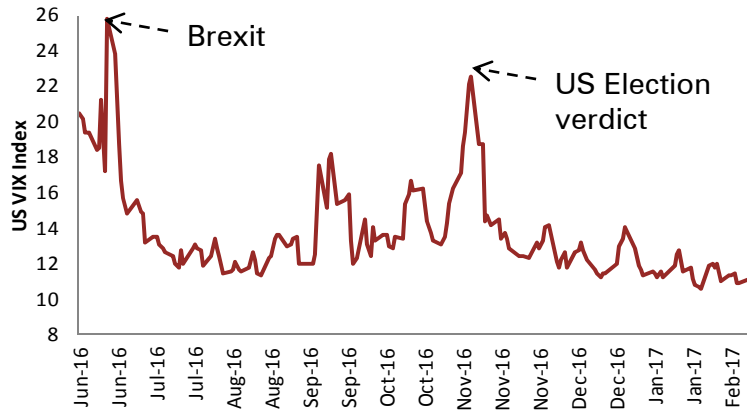
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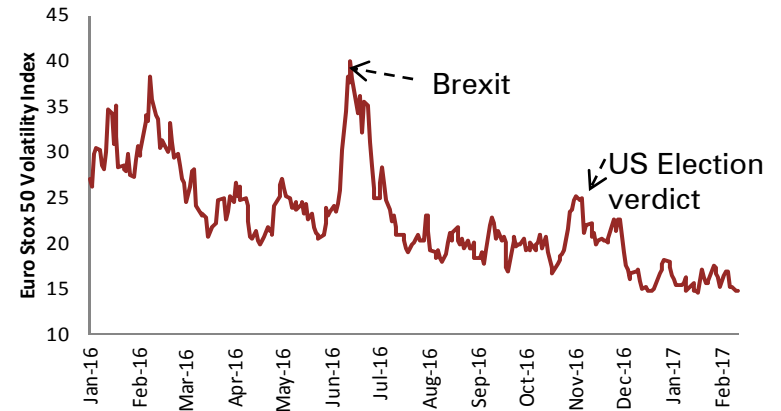
February 23, 2017

Volatility cool-off starts in US and widespread in developed markets...

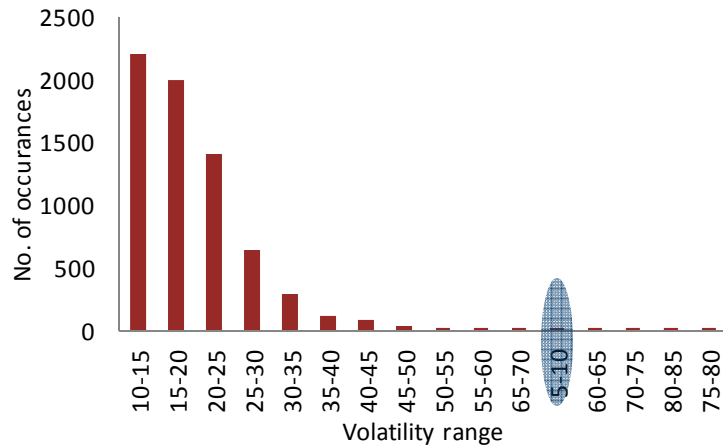
Declining trend of US VIX picks up pace post US Presidential elections...



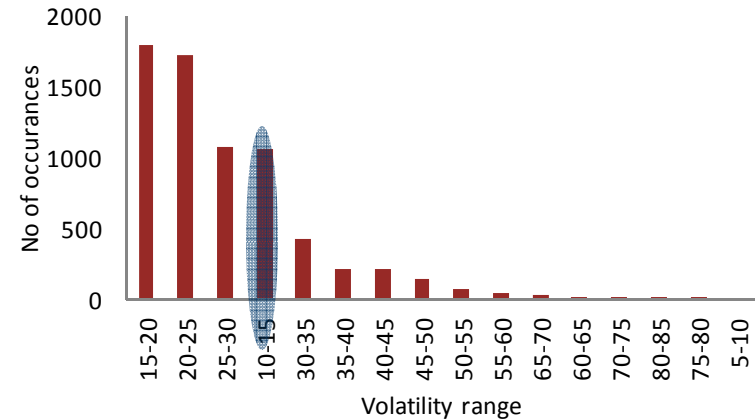
European volatility also moving lower despite its own headwinds



US VIX reading at multi-year lows



European Volatility Index drifting lower but still has scope for further drop in volatility

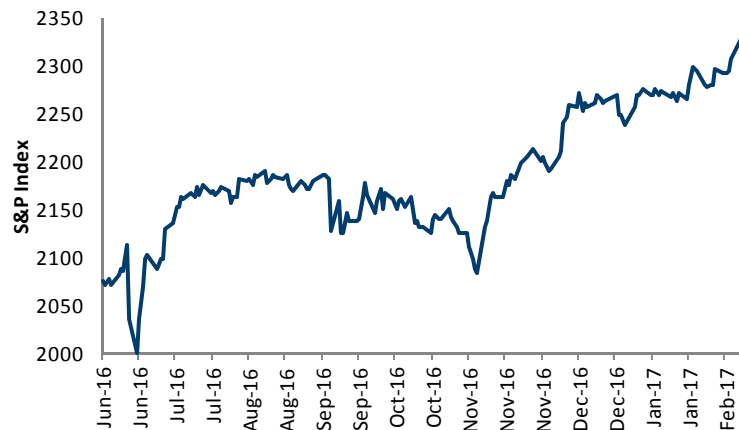


From historical standpoint, the current Volatility readings are near lows, suggesting Calm equity markets...

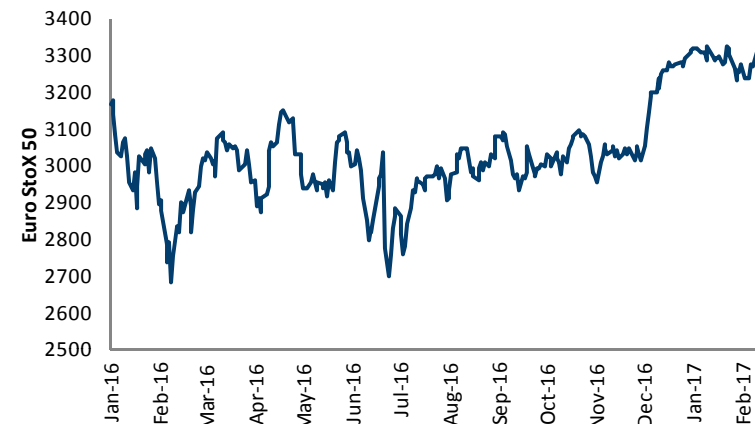
Source: Bloomberg, ICICIdirect.com Research

Lower volatility in current phase helps developed markets climb higher...

S&P 500 at record highs ...



Euro Stoxx 50 near multi year high...

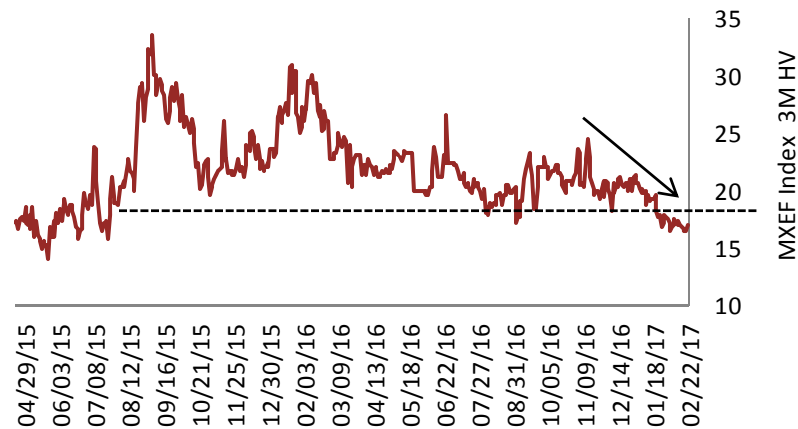


- The fear indicator - volatility index for the US has entered new lower territory since July 2016. Before the US Presidential elections, a surge in this index was seen but that was also restricted till 23%. It could not reach the previous year's higher levels of 45%
- Historically, we have seen that whenever the US volatility index has declined below the lower base of previous high volatility period, it has remained lower for quite a long period of time
- Eurozone was considered the most vulnerable in 2016 due to impending events like Brexit. Both economic and geo-political events remained in the limelight throughout 2016 in the eurozone
- From 2014-16, eurozone remained at high volatility of 20-40%. Post July 2016, it declined from 40% and even breached the lower base of 20%. This indicates towards a new lower volatility period for eurozone

Source: Bloomberg, ICICIdirect.com Research

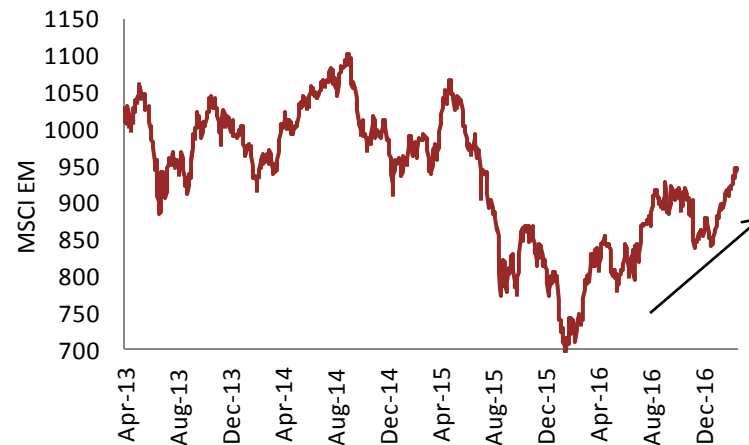
Emerging market volatility also on declining trend...

Declining volatility in Emerging markets



Despite recent headwinds, volatility has even breached the last one-year lows in EMs

Pullback seen in MSCI EM index

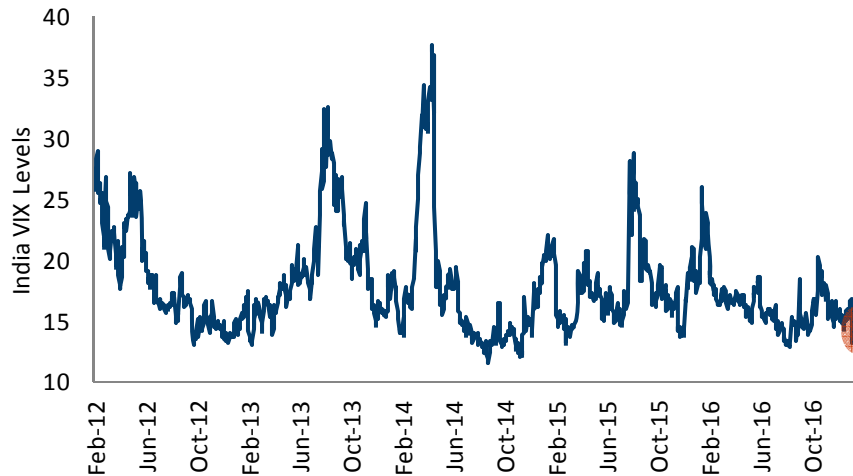


MSCI EM index has also started moving up on low volatility

Source: Bloomberg, ICICIdirect.com Research

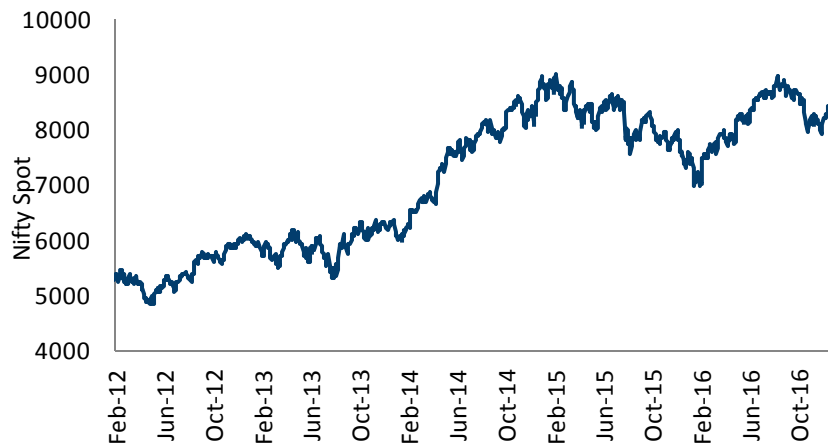
India VIX following suit: Entered low volatility regime post Union Budget: Nifty on course to make new highs

India VIX decline to sub 14 level post Budget key



Volatility has come below pre-demonetisation levels. Post Union Budget, India VIX declined from 17% to 14% in a single day

Positive bias in Nifty likely to remain



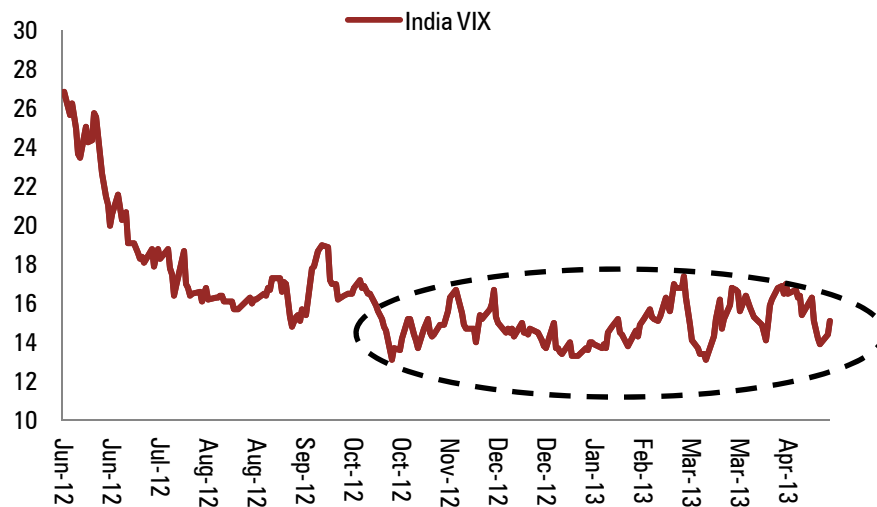
Nifty on course to make new highs on account of falling volatility scenario

Source: Bloomberg, ICICIdirect.com Research

Historically low volatility periods in India have extended, limiting declines in Nifty

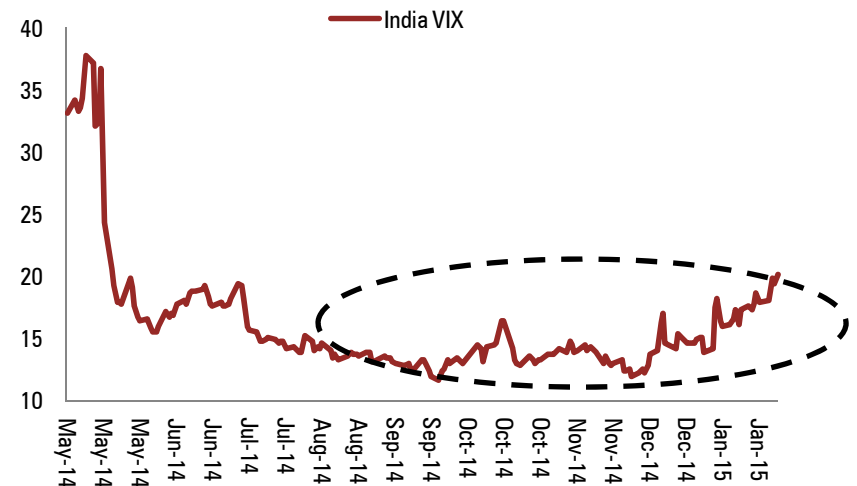
Indian markets: July 2012 – April 2013 (10 months of low volatility period)

- The volatility index remained at sub 17 levels for almost 10 months in 2012-13 while broader markets consolidated with a positive bias
- Volatility stayed in the range of 13-17% in this period while intermediate profit booking in the market failed to spike up volatility beyond 17%



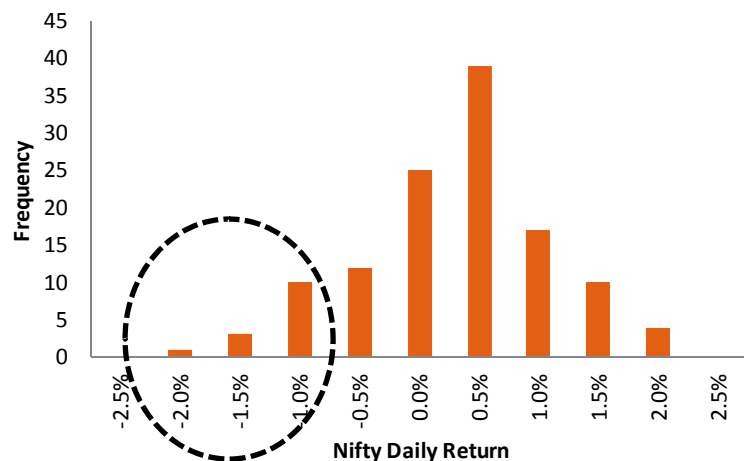
Indian Markets: July–December 2014 (Six months of low volatility period)

- Volatility remained near low levels of 15% for almost six months after the Modi government was formed in May 2014
- The decline in volatility started post Union Budget in July 2014 and remained in the range of 12-17% from July-December 2014. These six months witnessed a continued positive bias in the broader market

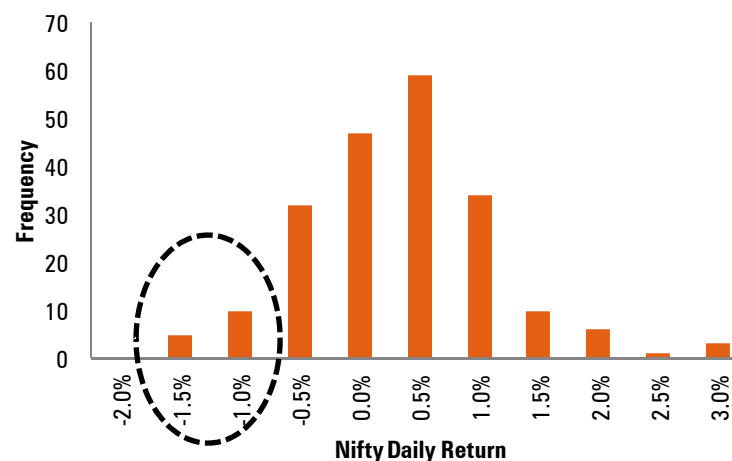


Nifty daily price distribution in low volatility period: Indicating sustainability at higher levels

Low volatility period of 2012-13 (207 sessions)



Low volatility period of 2014 (121 sessions)



In both instances, we can see that days with negative returns were quite low. In 2012-13, not even a single session witnessed negative returns of 2% or more. Moreover, just 14 days out of 207 trading sessions saw negative returns of more than 1%

Similarly, from July-December 2014, just one session saw negative returns of more than 2%. Total days with more than 1% negative returns were just 15 out of 121

Source: Bloomberg, ICICIdirect.com Research

FII's cash leverage, which was trigger in earlier market declines, not there in current market pullback, suggesting market likely to find support...

DII flows support markets; their buying at lower levels has increased, limiting downsides...

- FIIs have sold ₹ 34,000 crore since October 2016. Since January 2016, they have bought only ₹ 6500 crore (excluding recent HDFC Bank inflows) in contrast to 2015 when they had bought ₹ 80,000 crore a year before reaching 9000 levels
- FIIs lack of buying is compensated by DIIs who are utilising declines to buy heavily in the market. In the November sell-off, the highest monthly inflows of ₹ 18,000 crore were seen on part of DIIs. This is another reason why volatility is not surging beyond the major risk levels



FII outflows have been compensated by DII inflows. In November when Nifty declined, DIIs poured in highest ever monthly inflows. Thus, volatility was unable to hold elevated levels and is inclined to remain low

Conclusion : Downside seems limited in low volatility regime

- ❖ **Sustainability at life high levels :** The sharp decline in volatility could keep the positive bias intact in the Nifty. The equity index could make newer highs. Intermediate profit bookings are expected to attract buying, which would limit downsides
- ❖ **Low volatility level can continue for up to 10 months:** Markets tend to continue their outperformance in low volatility scenario. Historically, the Nifty has witnessed up to 10 months of low volatility period. Considering the latest low volatility regime, which started in February 2017, is expected to continue in 2017
- ❖ **India's performance in line with global equity markets :** As of now, the Nifty has performed in line with other global markets with almost 13% upsides from November lows. However, the current performance came despite the local demonetisation drive, which makes India a standout performer
- ❖ **FII inflow resurgence likely:** FIIs have still remained largely spectators in the Indian context while other emerging markets have observed inflows. Clarity on CBDT circular in Budget, better-than-expected results from Indian corporates and also lower probability of three rate hikes in the US in 2017 could lead to a resurgence of FII buying in Indian equities
- ❖ **Indian currency remains strong performer:** Rupee turned out to be one of the best performing currency and still remains below 2013 levels of 69. This could push for fresh inflows from FIIs

Portfolio allocation in Derivatives Products...

- It is recommended to spread out the trading corpus in a proportionate manner between the various derivatives research products
- Please avoid allocating the entire trading corpus to a single stock or a single product segment
- Within each product segment, it is advisable to allocate equal amount to each recommendation.
- For example: The 'Daily Derivatives' product carries two intraday recommendations. It is advisable to allocate equal amount to each recommendation
- Quant Picks recommendations should be considered in cash segment and stoploss on closing basis. Time frame for these recommendations is 3 month.

Products	Allocation		Number of Calls	Return Objective		Duration
	Product wise allocation	Max allocation per stock		Frontline Stocks	Mid-cap stocks	
Daily Derivatives	5%	2-3%	2 Stocks	1%	2-3%	Intraday
Weekly Derivatives	10%	3-5%	2 Stocks	3-5%	5-7%	1 Week
Monthly Derivatives	15%	3-5%	4-7 Stocks	7-10%	10-15%	1 Month
Global Derivatives	5%	2-3%	4-5 stocks	-	-	1 Month
Quant Picks	15%	2-3%	6-8 stocks	7-10%	10-15%	3 Months
Alpha Trader	10%	2-3%	2-3 strategy	5%	-	1-2 Month
Volatility Insights	10%	2-3%	3-4 Strategy	8-10%	10-15%	1-2 Month
Arbitrage Opportunity	5%	2-3%	2-3 Stocks	> 2.5%	>2.5%	Event Based
Short term Futures	5%	2-3%	8-12 Stocks	1-3%	2-5%	1-2 days
Positional Index Strategy	5%	3-4%	2-4 Index calls	-	-	1-14 days
Stock option strategy	5%	3-4%	2-8 Stocks	-	3-5%	1-2 days
Daily Currency Future	5%	3-4%	3-5 Calls	-	-	1-2 days
Monthly Currency Futures	5%	3-4%	2-3 Calls	-	-	1 Month



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