

Derivative insights - Beat the volatility

PORTFOLIO HEDGING

The peak of 11,856 appears to be a distant memory as Nifty in the month of May has so far lost ~5%. Index has underperformed its global peers despite a hurray in March & April 2019. Along with issues of heightened trade tensions between US & China, India is facing plethora of local risks (i.e. Bank NPA issue, liquidity crunch, auto industry & consumption slowdown to name a few). Plus, we are moving into the seasonally high volatile phase of the year, it is prudent to protect your portfolio ahead of the election verdict.

Historical evidence suggests, that irrespective of trend, Nifty tends to face challenging environment during every election year. We probed into Nifty's historical data (i.e. performance in election years of 1999, 2004, 2009 and 2014) and observed that it tends to drop by more than 5% at least four times during election year.

✓ Nifty Bear put spread (Expiry: 30th May)

Buy Nifty strike 11,200 Put @ 320 and Sell 10,500 Put @ 108

Current spread: 210-213 points outflow

Target spread: 450/650

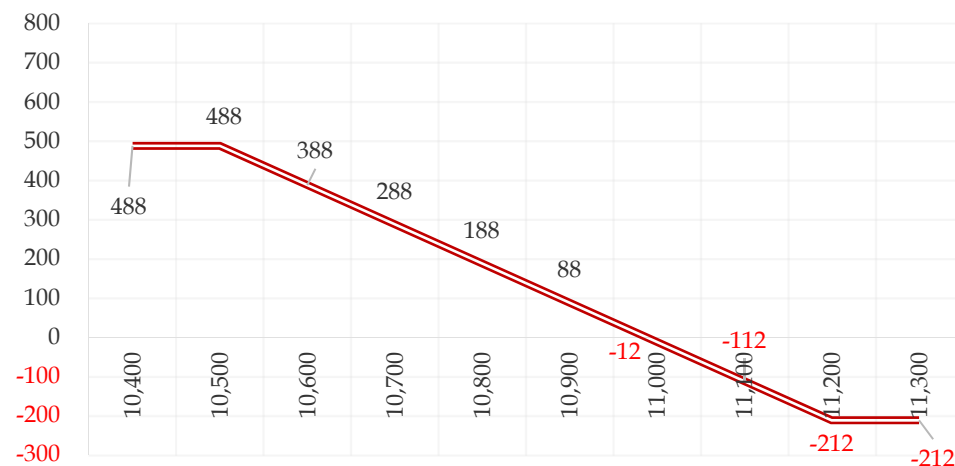
Maximum profit on May expiry @ 10,500 ~488 points.

Maximum loss on May expiry @ 11,200 and above ~212 points.

Rationale:

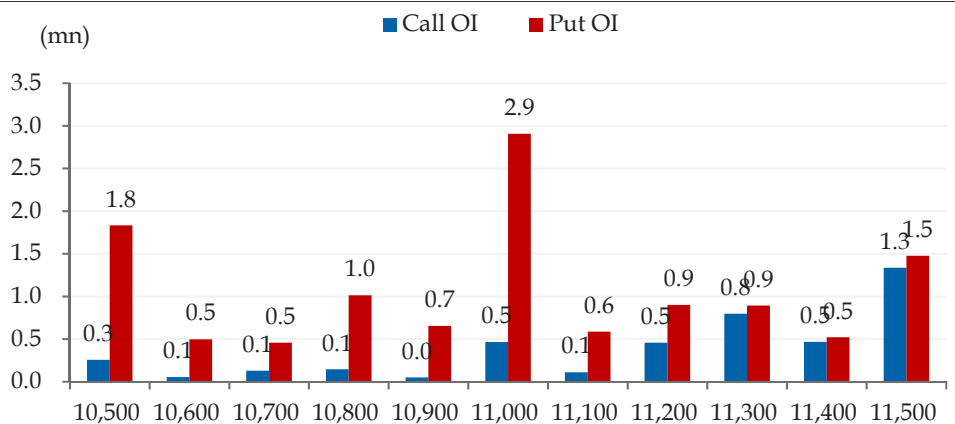
- 1) OTM options on Nifty expensive to sell compared to ITM put.
- 2) Vega rise would be compensated from theta decay.

Exhibit 1: Nifty bear put spread expiry pay-off



Source: YES Sec - Research, Bloomberg

Exhibit 2: Nifty open interest distribution (Expiry: 30th May)



Source: YES Sec - Research, Bloomberg

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PAIN POINT FOR BANKNIFTY STANDS AT 29K

✓ BankNifty Short Iron butterfly (Expiry: 30th May)

BankNifty Sell strike 29,000 Call & Put

BankNifty Buy strike 27,500 Put and Buy strike 30,500 Call

Total Spread of inflow ~1100

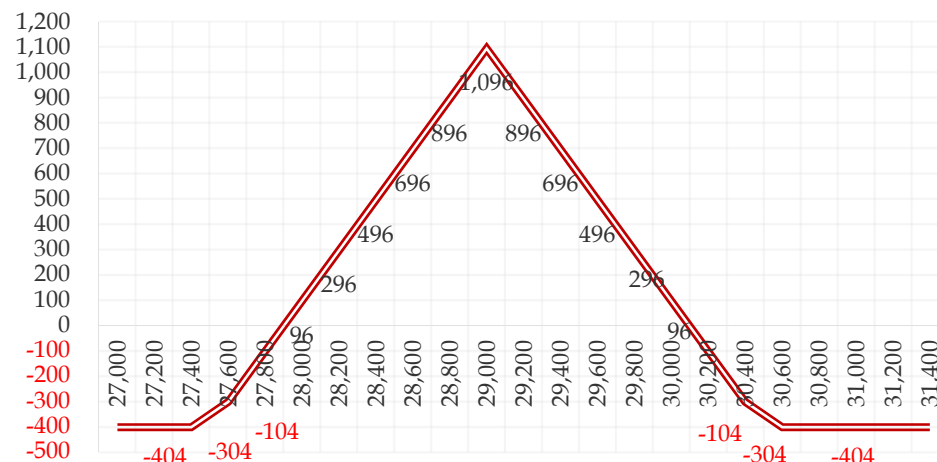
Max Loss of ~400 points

Break Even Points:

Downside at 27,900 and Upside at 30,100

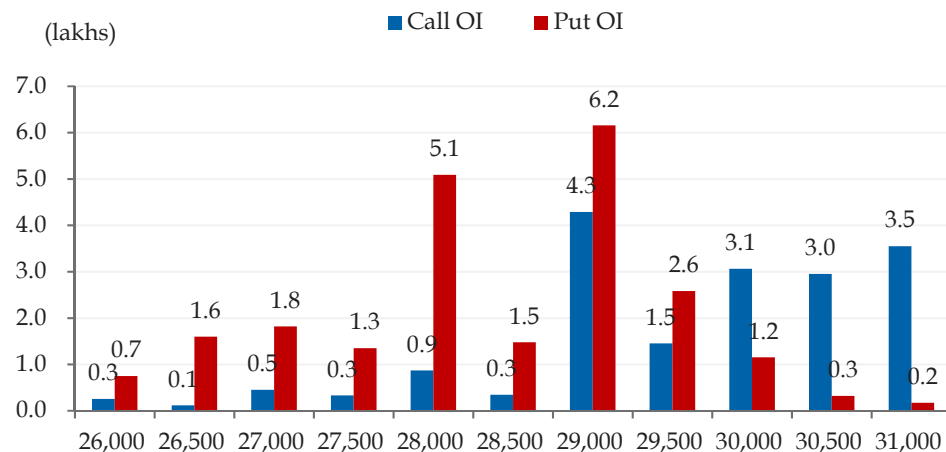
- ✓ BankNifty has corrected by ~4% this month after marking a peak of 30,670 in April 2019. With outcome of election on the horizon, BankNifty could continue to behave in volatile manner. However, eventually it could stabilize around 29,000 mark.
- ✓ We believe, recent volatility is likely to subside around 29k mark (As maximum combined Open Interest is seen at 29,000 strike & monthly WAP stands at 29,200).

Exhibit 3: BankNifty expiry pay-off



Source: YES Sec - Research, Bloomberg

Exhibit 4: BankNifty open interest distribution (Expiry: 30th May)



Source: YES Sec - Research, Bloomberg

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BUY > 15%

ADD 5% to 15%

HOLD -15% to +5%

SELL > - 15%

NOT RATED

UNDER REVIEW

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