Chapter – 25: Derivatives and Hedging Risk

Title of the Mini Case: **PLAYING WITH RELIANCE FOR RELIANCE**

Case hint:

A separate excel file attached contains the Reliance trading data is also provided (to help do the computations).

The expiry dates for the May and June month contracts are last Thursdays of the month … in our case it would be 29th May 2008 and 26th June 2008. These dates are important to consider issues of time value of money.

Given that cost of capital has to be taken as 10%, the respective rates to be used for May and June month instruments discounting would be:

Time related discounting factors			
contract month	**Same day**	**May**	**June**
days left	0	33	60
discounting factor	na	0.9041%	1.6438%

While trading in futures contract, Reliance Industries stock usually attracts a margin requirement of 15% of the contract value. Hence, the time value of money for this margin requirement is to be taken into account while computing the benefit from the arbitrage deal.

The brokerage rates charged by popular volume-based brokers promoting speculation and day trading such as ICICIDirect.com, Sharekhan.com, Indiabulls, 5paisa.com and Kotak Securities could be considered for computing the net gain from the deal.