

Essential of Trading

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E-Book Internals

TWENTY SEVEN EXAMPLES

MORE THAN 40 CONCEPTS

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Essential of Trading

Chapter 1

My Way of Analysis

This is my gift to all the investors and traders of the Indian market. In these past few days I have received a bunch of feed back from the readers of my books, seminarians, clients and many technocrats. Different people have different experience with me and with Smart Finance. In these years it is my attempt to teach the traders and the investors the noble art of investing and trading. However I feel it is practically difficult for an individual like me to train this big mass of traders and investors having different mode of understanding and different approach of understanding. The main aim of this E-book is to give you the 1st hand information about the essential knowledge of investing and trading.

I have plenty of information flagged in my website like [video tutorial](#), [lecture notes](#) on various topics, [calculators](#) with illustrated examples etc. I belief knowledge is an asset which need to be distributed among all same time it must be taken in a right spirit.

If you are reading this E-book then I personally assure you that this reading will dramatically change your trading skills and belief me this book will make you a winner. Why I say so? **The fact is that I always validate my methods mathematically and have a proper logic.** Hence I have all the rights to justify my arguments.

The key feature of this E-book is to give you authentic knowledge associated with the concept. I request you not to simply go by my words but just read the below mentioned argument. If you are convinced with my ways of thinking then read the remaining part of this E-book or else leave it.

➤ **I feel that the major traders and investors have only one area of concern that is they do not know what kind of action they need to take in which kind of market.**

Example : Say on 15th December 2008 nifty closes at a gain of +70 points and next day on 16th December it opens with a down side gap of 50 points then

Point 1: Whether this trend classified as bear day or a bull day.

Point 2: Which method one should follow to take a call on this day?

Point 3: What the trader will do if the trend suddenly changes its direction.

➤ **Traders/Investors lack the knowledge of money management**

Money management is the most difficult game. We must quantify our objective and principle. Say for example if I fix my tradable capital as 1 lakh and my objective is to earn 2% per month having risk appetite to take 2% loss risk then I must follow such type of trade strategies which will be suitable for my parameters of risk appetite and earning expectation rather than jumping into the big ticket trading.

➤ **Traders have less exposure to the authentic literature and expensive s/w tools.**

Many traders do not invest in computer, soft wares and books. They used to start investing on technology only after losing a significant capital on trade.

➤ **Trader/Investor accepts the losses as a mistake but never investigate on those mistakes rather indulge in the same mistake again and again.**

Many traders do not re-investigate their losing trades thinking that this act will increase their pain. Do not forget that at times to get a quick healing you need to bear with the pain. Practice this, I guarantee; this is the only method to make you a disciplined trader.

➤ **Money makes money but traders and investors always hunt for a magical person who will give them magical calls.**

Many times you would have taken many independent, wise trade decisions. Which must have rewarded you but you must have forgotten it. You have to analyse those decisions by yourself. It is my final advise that better you stop hunting for magical people and educate your self and take your own trade decision.

➤ **I accept that the successful stock traders/investors are the wisest persons in the world but their success will not repeat for all.**

I belief success come through hard work, discipline, right decision at right time, research, money management. Hence do all these as your home work and success will automatically come to you.

From now onwards we will only think trading and investing. Nothing other than that. Once again I assure you this book will change your trading habit forever.

Chapter 2:

Simple Way to Make Money in Intraday Trade

Through years of research in this subject I have come with 34 different intraday trading techniques. All these techniques I have featured in my book called “Gann Method” In all these techniques I have gone to the root of the money management and featured the essence of it.

Let me define an ‘Intraday Trade’. **“Trader take one position or express his view on a specific capital instrument (stock, commodity... etc) and take it granted that future price movement of this instrument will be according to his choice and it will occur in the same day.”**

1. In order to quantify the intraday trade I will say that the trade has the life till the end of that trading day. The trade may or may not give profit.
2. I have two ways to win this game
 - a. To apply any valid method to predict the future
 - b. To apply any method to protect from any future turn around situation.
3. I must know what the majority of the traders expect the market to behave.
4. I must know which technical weapon or method I must use in market.

If you analyze these facts and actively involve them in your decision process then I guarantee that you will win all the trades. In order to simplify your decision process I have devised these 34 intraday trading techniques.

All my techniques are grouped into 2 categories

1.2.1 Decoupling Technique

1.2.2 Gann & Fibonacci Technique to predict the future

1.2.1 Decoupling Technique: These techniques are being devised with the view that I will not try to forecast the future price and time. I will take a democratically neutral stand on my trade and on the market. The features of these techniques are as follows.

- i. Intraday** Trader is always neutral on market and least bothered about the directional movement.
- ii.** Trader follow the present and assume that the present situation will continue for the day
- iii.** Trader changes his view if the day starts changing and accepts the fact that the past day will repeat.

In this section of my development I have devised four most beautiful ‘Decupling Techniques’. Do not go by the look and feel of these techniques. Once you will start realizing the power of these techniques then you will never ever loose a single trade. I am going to discuss one of these techniques called **index decupling technique**. You can get the video presentation of this method with example from you tube channel <http://in.youtube.com/soumyaranjanin> .

This is an intraday method wherein I have the neutral stand on market and expect the current trading day will be a mirror of the previous day. This method you can also use if you expect the current day will be a deviant day or a changed day of the previous day but you need to change the proportion of long and short trade.

Be alert!!!! I am going to discuss the 100% secured Intraday Method Called Intraday Index decoupling Method. It is to inform you that this Method is being found by me and I am the inventor of this method. However I never guaranty the success of this method. It is you the readers need to test it and find its accuracy.

In many days you will observe that two different indices will behave none sequentially. For example some days you will observe nifty 50 indexes will be 3 % up however Nifty IT index will be 2% down on the same day and same time. This may be due to different internal or external factors.

Normally traders used to miss these fantastic trading opportunities due to their ignorance on this phenomenon. I have simulated hundreds of examples while developing this trade plan. This is useful in cash as well as in the future segment. You

can also construct good short term portfolio based on this concept.

Below mentioned are the procedure I will follow.

1. I will identify two different indices which decouple in a day.
2. I will identify four different most active stocks in these two indices.
3. I will identify whether the price actions in these four stocks are trending or trading.
4. I will use any one technical tool to identify the potential resistance and support points of these four stocks.
5. If the price actions are trending then probability of higher volatility is eminent and in this junction I will form 30 % to 50% hedge.
6. If the price actions are in a trading band then it indicates less volatility in this case I will form 50% hedge or less.

In this method hedge corresponds to reduce capital risk. For example in a 75% hedge If I will buy Rs 100/- worth of share in cash market then I must sell Rs75/- worth share in the same market segment or vice versa.

What is the logic behind this principle? In most of the trading days I have experienced that if the price action is trending then traders choice used to give success or else it gives failure. In the trading or the ranging market trader does the mistake.

Example: Refer the IT index and the Nifty index price on 14th August 2008 at time 11 a.m. You will find in many occasions during the day when the Nifty was drifting down and IT index was going up.

I made a random choice of Satyam computer and Infosys in IT index and SBI & DLF in the Nifty segment. You can say these four stocks are the key movers and draggers of

both the indices. You can take any stock of your choice but keep in mind that the stocks of your choice must have some dominance on the index at that particular time. I will enter the trade in the dominance period and exit the trade once I observe that the decoupling is vanishing. I will use my [Intraday Gann Calculator](#) for estimating the support and resistances of these stocks.

Price Observation Table									
10 a.m. to 11 a.m.									
	High	Low	Res1	Res2	Res3	supp1	supp2	supp3	11:30 a.m. price
DLF	529	512	523	535	558	517	506	484	513.6
SBI	1524	1487	1506	1526	1565	1504	1485	1446	1487
INFOSYS	1667	1644	1664	1685	1726	1645	1626	1586	1666
SATYAM	414	407	417	427	448	404	394	374	414

In my 1st pair of SBI-DLF I found that SBI seems to be weaker as compared to the DLF because SBI is trading just above the support - 2 where as DLF just below the support 1. Hence I have decided to sell SBI one share and buy DLF one share at 11:30 a.m price. In price term also this long and short trade is 34% hedged (i.e. $513.6/1487 \times 100 = 34.50\%$). Now come to the second pair Infosys-Satyam computer where Infosys is just above its resistance 1 and Satyam computer is just below its resistance level 1. This seems Infosys looks stronger than the Satyam computer at this movement. I will decide to buy Infosys 1 share and sell Satyam computer 1 share at 11:30 a.m. price. Below mentioned are the trades I have initiated based on the ‘index decoupling method’.

		Trade table			
	Buy	quantity	sell	quantity	Net
DLF	513.6		1	X	514
SBI	X	X		1487	1 -1487
INFOSYS	1666		1	X	1666
SATYAM	X	X		414	1 -414
					279

Around 12:30 p.m period I found that both the index are moving in the same direction and the decoupling phenomenon is ending. At that time prices of DLF, SBI, INFOSYS and Satyam computer was trading at 511, 1487, 1673 and 413 and my net trade position was in Rs 5/- profit. Take an instance at 1:30 p.m when the prices of DLF, SBI, INFOSYS and Satyam computer was trading at 514,1479,1693 and 416 and my net trade position was sitting at a profit of Rs32.35.

The closing prices DLF, SBI, INFOSYS at and Satyam computer at 3:30 p.m. are 500,1455,1694,413 respectively . At his movement my net profit is Rs46.70.

Conclusion: One interesting thing in this index decoupling method is the maximum capital risk in this trade used to be very less because of the proper balance of the long and short position. The second assumption I made is during the day this decoupling will never end at least for few hours from initiating the trade. No need to initiate the trades in hurry. Do the proper calculation and then initiate the trade. This strategy will initiate loss if the decoupling phenomenon of both indices will re-couple.

Important :

- a. In this method if the trading day is a trending day or trailing day i.e. indices are making new highs and new lows then choose the most active stocks or dominating stocks in terms of value.
- b. If the trading day is a range bound days then choose the most active

stocks from the indices in terms of volume.

1.2.2 Gann & Fibonacci Technique to predict the future:

These techniques I have devised with the view that I will find the stop loss, target in such a way that it must occur in the real time chart in some future time. The second most important thing is that it must be simple to calculate and mathematically proven. I have given more than 25 different intraday trading techniques in this section.

As a trader or investor you must know who is Gann?

Why his study is superior to other technical tools?

W.D.Gann is the father of swing trading concept. He imagined the entire universe as geometry. The simplest fact is earth takes 365 days to revolve around the sun. It travels in a particular path without any deviation since millions of years. This is why we are in a position to predict the summer, winter, and spring seasons. Think in a different way. If this practical and authentic formula of the universe would have not been placed in consistence geometry then you must not be in a position to predict the future seasonal changes.

W.D.Gann has said that the price of the commodity or the financial instrument is a number and each number in this universe is associated with other numbers through some geometrical relation. He arranges the natural numbers 1, 2, 3...In different geometrical figures circle, triangle, and rectangle and found the common geometrical relations. Based on this relation we can predict the future price and time in an authentic way. This is the one way of forecasting the future price of a stock or commodity however I do not offer any guarantee of success.

Whether any technique is available for intraday?

How realistic the Gann's and Fibonacci method are?

This is a frequently asked question by all the traders. I personally trust on these techniques. Believe me these are the purely mathematical techniques which I have simplified for you. There are proofs of these techniques. It is always important to know, how to use these techniques for making a trade decision. In this article I am going to discuss two simple techniques used in Gann and Fibonacci study for price forecasting using the intraday price chart of few scripts.

Gann Technique of Prediction

In Gann's study we assume that each price movement of a stock is harmonic in nature. In simple terms harmonic means each future price movement is an outcome of its past price action. For example if I say Infosys after crossing its resistance level of Rs2000 will touch Rs2300 in near term, then it implies that my incremental harmonic movement will continue till a price target of Rs 2300/- provided the first hurdle point 2000 should cross significantly.

Now in Gann's study, we assume that the price moves in a rectangular spiral. Why it is so?

Gann has said that each number in universe is associated with the other number with some degree relation. Hence he has taken the help of different geometrical figures like triangle, rectangle, and hexagon for identifying the harmonic nature of the price. Now without going to the detailed feature of Gann's study just apply his first trick Price to Price squaring action to predict few trades.

What are the steps we need to follow for applying this technique?

Step 1: Identify the high and low in a particular time period.

Step 2: Compute the degree factors assuming the 180 degree as 1

Step 3: Now calculate the 15 degree price factor and add it to low. Using the

[square root formula](#) derive the resistances and same way subtracting the factors from high, identify potential support. We have used the same concept for deriving the [Gann calculator](#). This calculator is a FREE tool available in our website.

Step 4: Gann specifies that the third level of resistance break out or support break out is a confirmation of the trend, keeping the 1st level of resistance or support as its stop loss for the current trend. **I have done a little modification by taking the 2nd level of resistances and supports for the trend confirmation with stop loss below the low point for the long trade and above the high point for short trade.**

Example 1: Consider the Nifty future intraday chart on 16th June 2008. In the first hour of the trade Nifty future high- low is 4616-4594 respectively.

Analysis: Now it is my job to find the support and resistance and my long and short entry levels. For intraday I will take 15 degree jump as my trigger points. Now applying the square root principle in 4594 low with 15,30,45,60 degree factors I got 4605,4616,4628,4639 are the resistances for the current trend. Same way applying the square root principle in 4616 high with 15,30,45,60 degree factors I got the supports as 4604,4593,4582,4570.

If I am a long trader then I will make a long entry above 4616 with stop loss below 4594 for a target of 4639.

If I am short trader I will sell nifty at 4593 for target of 4570 with stop loss above 4616.

By 12.10 p.m Nifty future hits 4589 well below my entry point. Since the trend was down and it was near to my short entry level I have sold the Nifty and got the 1st target at 1.53 p.m.

Example 2: 16th June 2008 SBI high low cash price from 10 to 11 a.m. is 1362 and 1351 respectively.

By using the above discussed method my resistances are 1357,1363,1369,1375 and supports are 1356, 1349,1343,1337,1331 and 1325.

The long entry will be made above 1363 with initial target 1375 and stop loss below 1351. The short entry will be made at 1349 with initial target of 1337 and stop loss above 1362.

See the amazing result this method has given. The day low for SBI is exactly 1337(this is the 60 degree price target from the high of 1362).

Example 3: Nifty spot one hour data from 10 to 11 a.m on 12th August 2008 -Its high was 4634 and low was 4598.

Using this data in the intraday calculator I found that my key supports are 4600-4566-4498 and resistances are 4631-4666-4735. You can use this data in the calculator and test its accuracy.

At 11:05 a.m. it has fallen and found support at 4565, 11:30 a.m it touched high 4599 and fallen. Hence it is confirmed in the next half an hour nifty was very much within the band of my calculated support 1 and support 2.

From trading point of view if I miss the chance to enter the short trade at 4611 then better in this junction I will wait or change my data points. Second observation is the bounce from the low 4565 failed to cross the 1st support 4600. So now the support turns into resistance as per basic technical analysis concept for next half an hour. In this junction also I can go short with my initial stoploss as 4611 and second stop loss as 4631 and target as 4565. See in the next half an hour Nifty created new low of 4557 at 11:52 a.m.

In this example I have used the past one hour high and low points for my observation and calculated all the resistance and support values for the next hour. It is not guaranteed that I will achieve my target or stop loss in the next one hour. It is just a mathematical assumption based on my observation. I will suggest all of you to treat this calculator as an alternative software tool as you treat all other indicators and tools.

Example 4: Reliance industry high and low in a time period from 10 a.m. to 12 p.m. on 13th august 2008. It was a trending day for reliance because it was

creating higher high and higher low. My Swing high and swing low for this two hour period is 2353 and 2315 respectively.

Using these two values on the gann calculator I got the following values:

Long entry price was: 2331 target 2339-2347-2363-2412
Short entry price was: 2337 target 2329-2320-2304-2256

Since it was a trending market for RIL and it was creating the higher high and higher low and the current price is much above my second target point and trending upward. I will use this swing action to enter a buy trade keeping my 1st stop loss as 2339 which is my key resistance, which turn into the support and my target will be 2363. I will come out of the trade at 2363 or slightly below that because this is the 3rd level of target and important resistance point.

Again I have observed that after touching the high of 2373.65 the price has started retracing back. Now I will change my swing low and high. The low as 2339 and high as 2373.65. The stock price 2339 is the low which the stock has made just before making this high of 2373.65. You can say this is the high following the low.

Notice it carefully that I have not taken the hourly high or low rather I have taken the latest low preceding the high.

Why this deviation in principle? If the current price action is against the previous trending nature of the price then you need to make this deviation. In the second case scenario if the price continues its trending behavior then also this deviation in principle will come into focus.

Using these two values 2373.65 and 2339 I got

Short entry price was: 2358

Long entry price was: 2355

This is congestion because the difference is only Rs 3 /- so now I will shift my focus to the 1st level of target for both the long and short. As per my calculation 1st long and short targets are 2363 and 2349. These two prices will act as my new long entry and short entry points. More precisely I will buy reliance above 2363 and sell below 2349. My stop loss for the sell entry will be 2358-2374-2398 and stop loss for buy trade will be 2355-2339-2314.

Observe the second part of the calculator which flags the important support and resistance points. My entry points also coincide with the 1st level of resistance and support.

As you can observe from the chart at 12:35 p.m after drifting to the level of 2362 the stock has a minor bounce back to 2366 and the greater downward action started once it has broken the level of 2349. My target level of short entry was 2342-2326-2277.

You can say it as a coincident or a mathematical wonder.

1. At 1:30 p.m. stock touched 2341 and bounced back to 2349 level.

2. At 2:20 p.m. stock touched the day's low of 2326 level.

Though Gann's other method is to calculate the time action but it is beyond the scope of this calculator. You can read all those methods in my book [Gann's method](#).

Conclusion: This [Gann's calculator](#) is a mathematical application. It is being developed using the price to price squaring action of Gann's method. It is my advice to all the traders/ investors to treat this application as an informative and educational tool.

Fibonacci Technique to predict the future

Introduction: Fibonacci numbers are the numbers of the nature. In Fibonacci number sequence each succeeding number is the sum of its two preceding numbers. The number sequence 1,1,2,3,5,8,13,21,34,55,89... is known as the Fibonacci number sequence.

What is the importance of these numbers?

In many natural occurrences this number is present. For example the electrons in an atom are arranged in the suborbital in Fibonacci sequences. The flower petals in most of the flowers are arranged in the Fibonacci sequence. You will find hundreds and thousands of examples of the fibonacci numbers in the universe which is beyond the scope of this E-book.

Fibonacci ratios are the rational numbers we derive by dividing one Fibonacci number with the other. For example alternate ratios are $3/5$, $5/8$, $8/13$ Inverse alternate ratios are $5/3$, $8/5$, $13/8$ Same way from different combinations you will find different ratios. One most interesting fact is that all these ratios in the Fibonacci sequence are equal. For example all the alternate ratios are 0.618 and all inverse alternate ratios are 1.618 and so on.

Presence of Fibonacci ratio in universe: Like the Fibonacci numbers the Fibonacci ratio is very much present in the universe and in our human body also. Like the longest part of the finger bone is 0.618 times the length of the finger. The length of the longest part of your hand is 0.618 time the length of the hand and many more.

Fibonacci Ratio for forecasting price of a stock or commodity: Due to its versatile natural presence and occurrences we find these rational ratios are very important to determine the price trend of a stock or commodity. In any directional price movement it is experimentally proved that the prices which map to the 0.236, 0.382, 0.5, 0.618, 0.786 retracement level act as the potential resistance and support point. I will define Retracement is a phenomenon where the ongoing trend take a halt and the new trend starts against its previous trend. According to me nothing wrong in interpreting the

retracement as a correction or a bounce back.

How to interpret retracement for making the trade decision?

Quite simple! I have segmented the retracement levels into three parts.

Segment 1: Bounce back level: If the price finds the support at 50% retracement level and resistance at 38.2% retracement level or vice versa then greater chance is there that it will go back to its previous trend.

Segment 2: Death zone level : If the price finds the support at 78.6% retracement level and resistance at 61.8% retracement level or vice versa then less chance is there that it will go back to its previous trend.

Segment 3: Range bound level: If the price finds the support at 38.2% retracement level and resistance at 23.6% retracement level or vice versa then greater chance is there that will remain ranged in that price until and unless it has not given any break out. Based on the above facts and argument the trader used to take trade decision.

How to initiate trade using Fibonacci Retracement?

Taking the swing high, low and applying the Fibonacci ratios on it we will project the buy/sell entry levels, stop loss and targets. Keep in mind that these targets are the resistances and the supports. Use the trailing stop loss mechanism for better result.

If the current market price of the script is in the “**Death zone**” calculated from the swing high i.e. “death zone” for the long traders then go short in the counter. In this case the 1st stop loss will be 50% retracement level and the 2nd stop loss point will be 38.2% of retracement level and I will keep my target as 1.618 of the retracement level drawn from the swing high.

If the current market price of the script is in the “**Death zone**” calculated from the swing low i.e. “death zone” for the short traders then go long in the counter. In this case the 1st stop loss will be 50% retracement level and the 2nd stop loss point will be 38.2% of retracement level and I will keep my target as 1.618 of the retracement level drawn from the swing low.

For your understanding we have provided the online Fibonacci retracement calculator in our web site www.smartfinanceeducation.com . We have also provided the Fibonacci

cluster calculator for your use.

Fibonacci Cluster: Fibonacci cluster are the two most important support and resistance points of a price. In other words if you will draw multiple retracement lines from different highs and lows then you will come across with one or more support and resistance points which will occur frequently in all the retracement lines. These two points are called Fibonacci cluster.

Fibonacci Calculator Explained.

How to use the calculator?

Introduction:

Fibonacci number sequence is one of the most important number sequences of mathematics. Its wide presence in many natural occurrences made many analysts to think and include this study in the financial forecasting. In this method of forecasting we will be using few ratios. These ratios are derived from the Fibonacci numbers by the way of dividing with each other. The most important phenomenon exhibited by the Fibonacci number sequence is that-these ratios are unique if we follow the unique style of division. For example if I will divide the previous number in the Fibonacci sequence with its next higher number (i.e. $2/3$, $3/5$, $5/8$, $8/13$) then the ratio will be 0.618. This is called alternate ratio. This phenomenon of ratio equality does not visible in any of the other number sequence. The detailed discussion of this number sequence is beyond the scope of this article. However you will find more on this subject in my book “**Fibonacci method**”.

Fibonacci calculator Interpretation and use:

Fibonacci calculator which I have devised for your use is using three most important Fibonacci methods called retracement, expansion and the fibonacci cluster. This calculator is a ready-to-use device which any one can use without knowing the Fibonacci methods in detail. In order to predict the support, resistance, stop loss, target, buy/sell entry prices.

I have used the concept of **bounce back price zone, death price zone and Fibonacci turning point price zone for identifying the precise buy and sell entry level**. All these price zones I have described in my book on Fibonacci Technique with example. If you have a copy of that then refer it for explanation. In order to use the retracement and the expansion part of the calculator you need to enter two values and the calculator will calculate the most probable support and resistance points with the long entry and short entry prices.

In order to use the Fibonacci cluster you need to provide three swing high and swing low price points as input to the calculator. Cluster will determine the most important support and resistance for current price movement. While choosing the inputs in the intraday

price chart take last one hour swing high and swing low for retracement part. Last one hour's three consecutive swing high and swing low you need to take for cluster.

Example: On 26th September 08 if I will take the Nifty future high as 4109 and low as 4053 at 11:30 a.m. Then the calculator will predict 12 resistance and 12 support points along with the buy entry and sell entry price with a set of 8 target levels 2 stop loss levels. In this calculator I am using the death zone calculated from the swing low as my buy entry price and same way the death zone calculated from the swing high as my sell entry price.

For this particular example we place the buy entry above 4088 with stop loss 4081 and 4074 and targets 4096-4109-4124...This buy entry price is the median price of death zone price calculated from the swing low and the bounce back price calculated from the swing high. Same principle we follow for calculating the sell entry price.

Five Rules To initiate trade using Fibonacci Calculator:

Rule 1: Four Support or four resistance breakouts is considered as the reversal of the trend. If it is against your initiated trade then reverse the trade.

Rule 2: Do not reverse your trade until and unless the support-2 or resistance-2 holds in the price chart.

Rule 3: Though Fibonacci technique is silent about the volume part but it is wise to use this technique if the support and resistance breakout happens with rise in volume.

Rule 4: Cluster is the most important swing turning point. Hence watch the cluster points carefully for trade decision.

Rule 5: Use the trailing stop loss mechanism in all your trades.

Chapter 3

Simplest Way of Stock Investment

1.3.1 Introduction: In financial market in-order to understand and evaluate any stock the 1st basic step we adopt is to see the financial ratio. Financial ratios are derived from one or more financial parameters by the way of dividing one parameter with the other. With the help of these ratios one can make the primary investigation on the stocks and its fundamental outlook. These ratios will also provide the comparative analysis of the good stocks to invest from a group of stocks available in same sector. Before going deep into the ratios let me explain few basic terms associated with the financial ratios.

1.3.2 Investment basics:

Balance Sheet: Balance sheet of a company is the consolidated information about the assets and liability of the company. This part of the information also contains various figures like the sale volume, net profit, reserve and surplus etc. If you are a non commerce graduate then definitely you will find it difficult to understand the balance sheet. However as a trader or investor in the capital market you don't require knowing the construction and detailed feature of the balance sheet. Only little information on balance sheet is enough for our understanding.

Net profit: The profit made by the company during a financial period deducting the taxes and other liabilities is called net profit.

Reserve and surplus: The amount of profit which is not disbursed to the investors by the way of dividend is called reserve and surplus. It is kept in the reserve and surplus book. However company can use this capital for the well being of the company and investors with the approval of the share holders of the company. Many times this capital is being used by the company to issue the bonus shares to the investors.

Book value of the share: Book value of a share is defined as the net asset of the company per each ordinary out standing share. In other words you can say each share holder's value in the company in terms of assets is called book value.

Ratio analysis: The financial ratios which I am going to explain in the following section are **a.** EPS (Earning per Share) **b.** P/E (Price to Earning Ratio) **c.** Debt -equity ratio. **d.** Price to book value ratio. You may find many more ratios in the financial mathematics but all are not important for our study.

After understanding the basic definitions of these ratios if you will take a group of industries from a particular sector and compare their ratio then you will get to know which is the best company to invest; based on the current market price. My aim is not to teach you the theory of these ratios. My aim is to make you aware of the best method to choose a stock of stocks. In this article I will explain the various ratios and the next article “**Stock valuation and stock picking using financials**” I will discuss how to choose a stock by using these ratios.

a. EPS (Earning per Share): EPS is derived by dividing the net earning of the company by the number of outstanding shares of the company. These out standing shares are the general shares. This does not include the equity convertable preference shares, bonds or the commercial paper. Out standing shares are the tradable shares.

b. P/E (Price Earning Ratio): Price earning ratio is derived by dividing the market price of the share by the EPS.

c. Debt –Equity Ratio: Debt equity ratio is the total debt of the company divided by the number of ordinary equity shares. This Ratio exhibits the debt per share holder.

d. Price to book value ratio: This is derived by dividing the book value of the share with the current market value of the share.

These four ratios are the key ratios for fundamental analysis. The main job of the fundamental analyst is to provide you the information on the growth stock and value stock.

How to identify which stock is growth stock and which stock is value stock?

When the stock will be trading at a high premium as compared to its peer companies available in the same sector then we will say it is a growth stock. However this does not guarantee that the stock will be in premium forever with respect to its peer companies. Value stocks are the stocks which trade at discount with respect to its peer companies as per the financial ratio multiple.

The second attribute of growth and value stock is that the growth stocks will have higher financial ratios and higher pricing and the value stock will have lower financial ratio and lower market price

Example: For example let us take SAIL and TISCO both the companies are in the same sector having EPS as (14.70, 38.29) and P/E as (9.18, 17.62) taking the current market price as 135 and 675 respectively.

Now in these two stocks the SAIL is called value stock having low P/E ratio and low EPS. However the Tata steel is called a growth stock having high EPS and high P/E ratio.

Investor having high risk appetite can choose the growth stock and the investors having low risk appetite can choose value stock. In both the case the period of investment must be medium to long term.

1.3.2 Five best stock picking formula

Introduction: Stock picking is a complex and serious act. While designing an investment portfolio in equity, one needs to examine various aspects in order to choose the stocks. Before going deep in to the technical and mathematical approach of choosing the stock let me explain few basic terms associated with the stock picking. I will also discuss **FIVE** best known formulas for stock picking. The portfolio irrespective of number of stocks and capital employed is being developed by using following procedure.

Take it as an assurance from me that as an investor if you follow these five steps then your portfolio will yield you more.

a. The nature of the Portfolio: Whether it is a growth portfolio or value portfolio or a hybrid portfolio (i.e. growth and value stocks together in a common portfolio)

b. Phases and maximum life: The portfolio can go through different phases like accumulation, distribution and harvesting. Same way based on the investor's investment objective the life of portfolio must be taken into account for construction of portfolio.

c. Assessment: This is the place where the investor assess his portfolio to examine whether the base objective or goal of constructing the portfolio is satisfied or not. This is a place the investor needs to see the performance of various portfolio components over a time period.

All the above things do not have any direct link with the stock selection. However it is better to keep in mind the above mentioned facts.

Formula 1: Buy the stocks having low P/E ratio.

This is a common and most talked about formula in investors' community. Low P/E stocks used to yield more as compared to the high P/E stocks. You need to see some other facts before grabbing a low P/E stock. If the future earning of the company is suspicious and that result the fall in the current market price of the stock then low P/E will not increase the chance of a de-

rating in the stock.

Example: Take the case of Tata Steel and SAIL. Though the current P/E which is 9,17 based on the current prices of the stock as 135 and 675 suggests SAIL is a better investment stock as compared to Tata Steel but I will suggest to buy Tata Steel. Why? SAIL is a government controlled company having less freedom and lacks global presence. However Tata steel has global presence and better market presence. Note that in this analysis I kept my thoughts silent on the Growth and Value part of the investment.

Formula 2: Buy the value stock or growth stock having low debt / equity ratio and high reserve and surplus.

Investor having long term outlook in any counter can stick to this concept. The reserve and surplus will come to the investors in the form of bonus shares or in the form of dividend. Hence the reserve and surplus is always good for the investor's future. Debt/equity ratio is a parameter which signifies how the company's profitability is being exposed to the interest rate risk. If the company has a fat debt book then any time the interest rate rises the company has to meet the interest rate needs and it will have direct impact on the profit of the company. Second case if the company management is conservative in its approach then they will raise minimum debt from the market and this will also arrest the growth of the company. I conclude my discussion by saying that lower the debt equity ratio lower is the growth of the company and the future is protected from interest rate risk. But the future is not protected from the competition risk or growth risk.

Formula 3: Buy the stock having good track record of giving bonus shares to his investors.

Investors always have greater expectation from their company. The management's greatness to distribute the accumulated wealth in the form of bonus share always brings more number of shares to the market and invites more new investors into its investor's camp. This also one way brings more democracy to the company in the form of new independent directors. In other words greater the democracy means greater transparency in the business and policy making. In this case the long term investors are the winners in all

aspects.

Formula 4: Buy stock having low PEG ratio (i.e. price to earning ratio divided by annual EPS growth).

PEG ratio is the best parameter for choosing the value stocks. This ratio measures in terms of the value how far the current market price is justified. Lower PEG ratio signifies that the current price movement is not justified with respect to the earning growth. Hence it is a good buying opportunity for the investors.

Formula 5: Buy Value stock with high beta or growth stock with low beta.

Beta is a factor which measures the price movement of individual security with respect to the price movement in the index. High beta stocks used to rise or fall more as compared to the index and vice versa. Contrast to my above formula the value stocks always have low beta and the growth stocks have high beta. In any case if you find the divergence occurred in this rule then you can say some kind of great change is going to take place in the value stock and use this opportunity to buy the stock. Second case: If any growth stock after a prolonged period of correction shows the signal of low beta then you may say the valuation is fair and the stock is in strong hand. Use this opportunity to buy the stock.

Chapter 4

Welcome to Technical World

Introduction: You must have some knowledge or deep knowledge in technical analysis. In this chapter I am not going to discuss the age old concept of patterns, moving average or oscillator. I strongly believe as a trader you must know the facts and findings and the secrets of the technical analysis. In simple words it is the study of past occurrence to predict the future event.

I have made many changes in technical studies and featured them in my book on technical analysis volume 1, 2, 3. However I have not changed the very definition or the fundamental attribute of these studies. Few of these studies I am going to present you in this e-book.

Pivot point: This is the simplest method in the technical stuff. We calculate the pivot support and resistance points by providing *the high, low and close* price in the calculator. The formula used to calculate the pivot resistances and supports are as follows.

$$\text{Resistance 3} = \text{High} + 2 * (\text{Pivot} - \text{Low})$$

$$\text{Resistance 2} = \text{Pivot} + (\text{R1} - \text{S1})$$

$$\text{Resistance 1} = 2 * \text{Pivot} - \text{Low}$$

$$\text{Pivot Point} = (\text{High} + \text{Close} + \text{Low}) / 3$$

$$\text{Support 1} = 2 * \text{Pivot} - \text{High}$$

$$\text{Support 2} = \text{Pivot} - (\text{R1} - \text{S1})$$

$$\text{Support 3} = \text{Low} - 2 * (\text{High} - \text{Pivot})$$

Many traders used to argue that these pivot points never work in real life. However a little change in this used to produce the amazing result. I made the following changes to find out best result out of this.

a. For intraday trade I have taken the hourly high, low and current Market price.

b. In the 5 minute price chart I have taken the longest candles high low and

close and found the result.

After making these two changes in the input I found this method has produced amazing result for me for taking the trade decision.

Example: on 18th December 2008 around 12.30 p.m. I found the Nifty longest candle happen at 12:10 p.m. in the 5 min price chart. The high was 2990 low 2984, 2986 was the price at 12.30 p.m

Now using these values on the pivot calculator I got

Pivot point =2986.60

Resistance 1=2989.30

Resistance 2=2992.60

Resistance 3=2995.30

Support 1: 2983.30

Support 2: 2980.60

Support 3: 2977.30

Refer the data after 12:30 p.m. after finding the support at 2986 the index penetrate the resistance 3 i.e. 2995 and touched the high of 3004. If you observe the volume then you will find that at 2993-2996 level maximum volume get traded. This signals that the resistance and support calculated from the longest candle produced the potential swing points.

I will advise you to follow the pivot calculator with this modified approach. You will find many more applications of the technical tools with the modified approach on my books on technical analysis.

Once again I will quote that none of the studies in this universe is wrong. Only we the people should have the inability to interpret and use it. As a trader or investor try to use the tools. However always have an attitude to experiment on these tools.

Chapter 5

Profitable Future & Option Trade Technique

1.5.1 Future and option basics:

Introduction: Future and options are the two trading instruments available in the capital market for risk management. When we speak about the risk in the capital market, they are of two types:

- A. capital value risk
- B. time value risk.

In stock market the way the price of certain stock used to appreciate same way the chance of decay also not ruled out. To manage the above said risk, we take the help of futures and options. To be a wise trader in the future and options market you need to follow the **strategic trading mechanism**.

The key benefit of the strategic trading is you know the maximum loss what the position can incur if it goes against you. Same way you also knew the maximum profit what you can get if the position favors you

With the help of our [Online Future and Option Calculator](#) you will get the information about 24 different Future and option strategies for one stock or index of your choice. The calculator will also inform you the maximum loss and profit you can get from each strategy at different levels. If you want to learn more about the future and option strategies then follow my book named "[Master's key to Future and Options](#)". In this E-book I will discuss all the basic issues related with the future and options trading. Also the trading techniques. I will advise all the users to read this book once or twice before using the calculator.

This is the finest quote I use to give it to all my seminarians “*Only the attitude of learning the good literature and openness in the mind to accept the new concepts will make you a successful trader or investor. No one’s advise or recommendations will act cent per cent accurate and no one can make you the winner in this market*”

Future: Future as per the stock market definition is a contract between the buyer and seller to settle or execute a trade in some future date at a pre agreed price.

For example if you bought 100 shares of Tatasteel at 575 with the condition that the trade will be settled 3 months from now then it is called a future contract. Once the contract is formed then both the parties need to obligate the contract till the end of the contract period in daily basis by the process of **Mark to Market Margin** procedure. Refer the previous example of Tatasteel. If Tatasteel falls by Rs10/- today then for 100 shares you need to pay $100 \times 10 = \text{Rs}1000$ to the seller. This amount Rs1000/- is called the mark to market margin. One most important thing is this trade is going to happen in some future date so both you and the seller need to pay some initial margin on the trade value to the person who regulated this trading activity. In our case the stock exchange and the broker is regulating the trade hence you need to pay the margin to your stock broker.

Option: Option is nothing but the non obligated future contract for the buyer. However it is an obligated contract for the seller. The basic difference is both the parties can execute the contract in different price strikes by paying and receiving a token amount called premium. If the underlying stock or index associated with the option goes in the favour of the buyer then the buyer has the right to exercise the contract or ask the seller to buy or sell the shares at a particular price mutually agreed by both in some past date. However if the trade moves against the buyer of the contract then the buyer do not have to obligate the contract and the maximum loss he can suffer is the amount of premium which he have paid to the seller.

Options are classified into two categories based on their exercise nature like **European and American**. Further more based on the strike price with respect to the underlying stock or index price it is being classified as **in the money, at the money and Out of money**.

The buying right options are called **call options** and the selling right options are called

the **put options**. Totally 6 types of options are available.

1. In the money call option: If the strike price of the call option is lower than the underlying stock or index then it is called in the money call options.

Example: If Reliance industry share is trading at 2100 then the call option strike of 2050, 2000 are called in the money call option.

2. At the money call option: If the strike price of the call option is equal to the underlying stock or index then it is called at the money call options.

Example: If Reliance industry share is trading at 2100 then the call option strike of 2100 is called at the money call option.

3. Out of money call option: If the strike price of the call option is higher than the underlying stock/index then it is called out of money call option.

Example: If Reliance industry share is trading at 2100 then the call option strike of 2130 is called out of money call option.

4. In the money put option: If the strike price of the put option is higher than the underlying stock or index then it is called in the money put option.

Example: If Reliance industry share is trading at 2100 then the put option strike of 2200 is called in the money put option.

5. At the money put option: If the strike price of the put option is equal to the underlying stock or index then it is called at the money put option.

Example: If Reliance industry share is trading at 2100 then the put option strike of 2100 is called at the money put option.

6. Out of money put option: If the strike price of the put option is lower than the underlying stock or index then it is called in the money call

options.

Example: If Reliance industry share is trading at 2100 then the put option strike of 2050 is called out of money put option.

The option premium always has two components.

A. Intrinsic value

B. Time value.

Intrinsic value only exists for the *in the money call options and in the money put options*. Intrinsic value is the direct money value factored in the option premium.

For example if Nifty is trading at 4500 and Nifty 4400 call option is trading at 150 then you can say it has Rs100 (i.e. $4500-4400=100$) as intrinsic value and Rs50/- as the time value.

1.5. 2: Option Greeks

Option Greeks are the mathematical factors derived from the option premium and the underlying asset price or time or from other factors. The commonly used Greeks are delta, gamma, theta and Vega. The definition these parameters I will define below however the detailed discussion on Greeks you will find on my book “Master’s key to futures & options”

Delta: It is defined as the rate of change of option premium with respect to the unit change in the underlying price.

Example: If nifty is trading at 4000 and the 4000 ce is trading at Rs150 then delta is defined as the rate of change in option premium with unit change in nifty. More precisely if nifty change by 50 points then what is the % change you will see in the option premium. However the mathematical interpretation is quite different. The delta of a call option is less than or equal to +1 and the delta of the put option is less than equal to -1. Same way the delta of a future is always 1.

Gamma: It is defined as the rate of change of delta with respect to unit change in the underlying price. More precisely I can say gamma defines how the delta of an option changes as per the movement of the underlying.

Example: If I say gamma is 0.1 then you can interpret it for unit change in the underlying price the delta of the option changes by 10%.

Vega: It defines the unit change in the option premium with 1% change in the volatility.

Example: If the Vega is defined as 5% then you can say for each 1% change in the volatility will bring 5% changes in the option premium.

Theta: it is defined as the % change in the time value of the option for unit change in the time.

Example : If theta is 0.02 or 2% for a particular option then this can be interpreted as for each one day we near towards the expiry we will loss 2% of the time value associated in the option .

All the Greeks which I have discussed above and their interpretation are correct but the mathematical procedures to calculate and interpret these Greeks are bit different.

1.5.3 Volatility and Implied Volatility:

Volatility is the most ambiguous term in capital market. I always say that the mystery of volatility is still unfolded in the context of capital market. We define the volatility as the “annualized standard deviation of the price change”. I have given a brief introduction on the volatility and the logarithmic mathematical procedure to calculate the historic volatility in my book [“Master’s Key to Future and Option”](#). In this article I am going to describe few important issues associated with the volatility.

- 1.The increase in the volatility will result higher premium for the options.
2. Increase in volatility will result rise in the margin requirement
- 3.Increase in volatility brings more uncertainty in the market and results more loss for traders.
- 4.The decrease in volatility lacks participation, results less premium in

options and signals the change in the market direction on the near future.

Refer the trading strategy section of this article to know more about the strategy one must follow in different volatility conditions discussed above.

Implied volatility is the actual volatility associated with the option premium at particular time. Though many successful method is available to calculate the implied volatility. I always recommend Brenner and Subramaniam formula for calculation of implied volatility. Though many other method like Newton rapsons interpolation method and bisection method also highly recommended for calculating the Implied volatility

1.5.4: Put / Call Ratio & Open Interest:

Put /Call ratio is defined as the number of put options divided by the number of call options available at a particulate time. Put call ratio is the most sensitive parameter for identifying the **markets future direction**.

Now take the 1st case when the **put call ratio is rising**. This signifies that number of put option contracts is in rise. It has following interpretations.

- a. The future traders are hedging their long positions against the put options.
- b. The traders are buying the put option anticipating the market to fall
- c. The traders are forming the covered put strategy against their future short positions.

In all these above cases the directional anticipation is negative. Means maximum people expect the market to come down significantly from the current level.

The 2nd case when the **put call ratio is falling**. This signifies that the number of call option contracts is in rise. It has the following interpretations.

- a. The future traders are hedging their short positions against the call options.
- b. The traders are buying the call options anticipating the market to rise.
- c. The traders are forming the covered call strategy against their future long positions.

In all these above cases the directional anticipation is positive. Means maximum people expect the market to go up significantly from the current level.

Only from this date it is difficult to predict the directional movement of the market. We need to analyse the open interest, volatility and some of the technical factors like moving averages to make a formulated decision.

Open interest is defined the number of open contract at a particular point of time. While deriving the OI (open interest) one buy and sell contract is consider as open interest one.

If the open interest is on rise with rise in the put call ratio and the volatility is higher than the past 10 days weighted average volatility along with the sensitive moving average prices are acting as the major resistances then this confirms the market undertone is negative and vice versa.

If the put call ratio is unchanged with rise in open interest then the confidence is in the direction of the market and major positions are un-hedged. In this case put call ratio can be avoided for analysis and the trader needs to follow the technical indicators along with the volume to derive the decision on the trade. However in such a scenario the directional trend is suspicious and may not hold for a long time. More about this subject you will find in my book [“Master’s Key to future and option”](#).

1.5.5 Future and Option Trading Models

Many different methods are followed while forming the future and option trading models. However it is being classified into three categories.

- a. Capital Risk Model (CRM)
- b. Volatility Risk Model (VRM)
- c. Time Risk Model (TRM)

These models are my own innovated models .These trade models I have formed by doing extensive research on this subject. Since these works are the essence of my trade secrete I want to keep it away from the public domain. However you will find all these models in my book. The brief introductions of these models are as follows.

In capital risk model we need to give importance to the maximum risk appetite of the trader and derive a combination of trade strategy which will not result loss greater than the risk set by the trader.

Same way in the VRM and TRM the volatility and time are given importance. From the base strategies we classify. Future long/short with put/call option long, 2/1 and 5/2 call and put spread strategy, iron condor strategy and many more are the VRM strategies. Covered call, butterfly strategies and many more are the TRM strategies. No specific strategies fall under the CRM. In CRM many combinations are being formed keeping the capital risk as the prime objective. To learn more about the individual strategy internals refer my book on futures and options "[Master's Key to future and option](#)".

I am going to give you the idea to get **700% return on your risk capital** if the index moves down by 7% from the current level.

On 23rd September 08 when Nifty was trading at 4250 plus I have observed that the 4100 put option for October expiry was trading at Rs145/- and 4000 put option of October expiry was trading at Rs 110/- . Same time 4200 call option of October expiry was trading at Rs195/- and 4300 call option of October expiry was trading at Rs145/-. Based on the above said inputs I have formed the following strategies.

The Nifty bear spread in the strike of 4100 and 4000 has loss risk of Rs35/- and profit of Rs 65/-. The nifty bull spread 4200 Ce and 4300 Ce has loss risk Rs 50/- and profit Rs 50/-. The market internal suggests above 4265 Nifty may touch 4400 level and below 4150 it may touch 3850 level based on the Fibonacci retracement.

If you take a capital risk of Rs17500/- on the bear spread by the way of forming 10 bear spreads and capital risk of Rs 12500/- on the bull spread by the way of taking 5 bull spread then 7% downward movement of Nifty will award you Rs 22000+ and 5% up move in Nifty will result you Rs3500/- as loss keeping the volatility as 35% and time till 2nd week of October.

Now on 26th September 08 when the Nifty falls below 4000 I got the following out comes. 4000, 4100 put was trading at Rs240/- and Rs185/-. 4200, 4300 ce was trading at Rs92/- and Rs60/-.

Hence the net P/L is derived as follows:

Profit in 4100 put option long = $(240-145)*50*10=Rs47500/-$

Loss in 4000 put option short = $(185-110)*50*10=Rs37500/-$

Loss in 4200 call option long = $(195-92)*50*5=Rs25750/-$

Profit in 4300 call option short= $(145-60)*50*5 =Rs 25500/-$

Net profit is = Rs9800/-

When I will decide whether to hold the strategy or exit, quite simple in the above example I have encountered nifty is just below 4000. So 4000 put option short is resulting more loss because of higher time value. If I will wait for a level below 3900 then my bear spread may result higher profitability keeping my bull spread losses bit higher than my current loss. All in all my profit will be higher than the current net profit.

Hence I conclude that any rational approach in deriving the F&O strategy will always give you good return. You need to have patience and persistence to follow these wonderful combinations.

1.5.6 Future and Option Evaluator:

How to use the Future and Option calculator?

You need to input three call/put option strike price and premium. Same time you need to input underlying future price and lot size. The calculator will simulate and give you the out put in the form of **24 different strategies with the maximum loss projection and profitability in each level.** You need to choose the strategy having good risk reward ratio. Means for each one rupee of loss risk what is your reward.

In this calculator we have used following strategies.

1.Future long with put options: In this you need to buy one future and buy one put

option of the desired strike.

Example: Buying Nifty future at 4500 with at the money put option cover of 4500 Rs100/-. The benefit of this strategy is that the trader gets involved in the bull market with limited exposure. That is if Nifty falls from the level of 4500 after the trader has initiated the position then the maximum loss the trader can suffer is the extent of time value in the put option.

2. Future short with call options: In this you need to sell one future and buy one call option of the desired strike.

Example: Selling Nifty future at 4500 with in the money call option cover of 4400 Rs160/-. The benefit of this strategy is the trader get involve in the bear market with limited exposure. That is if Nifty raise from the level of 4500 after the trader has initiated the position then the maximum loss the trader can suffer is the extent of time value in the call option. In our case the time value in the call option is Rs60/- per one unit. Multiply it with the lot size to derive the exact amount of loss in the strategy.

3. Net debit bull spread: In this you need to buy a lower strike call option and sell higher strike call option.

Example: Buying the IDBI 90 call option at Rs 4/- and selling the 95 call option at Rs 2.60. In this strategy the trader has maximum loss of $Rs\ 4 - Rs\ 2.60 = Rs\ 1.40$ per unit and the profit of $Rs\ 95 - Rs\ 90 - Rs\ 1.4 = Rs\ 3.6$ per unit. Multiply it with the lot size to derive the net profit and the loss.

4. Net debit bear spread: In this you need to buy higher strike put option and lower strike put option.

Example: Buying Nifty 4500 put option at Rs160/- and selling 4400 put option at Rs110/-. In this strategy the trader will have maximum loss of Rs 50/- per unit and profit of $4500 - 4400 - 50 = Rs\ 50$ /- per unit. Multiply it with the lot size to derive the net profit and loss.

5.2/1 and 5/2 call spread : In this you need to buy higher strike call options either 2 lots or 5 lots and sell lower strike call option 2 lots or 5 lots.

Example: Buy 2 lots of Nifty 4500 call option at Rs 115/- and sell one lot of 4400 call option above Rs165/-. this strategy is called 2/1 call spread. If you will do the same with 5:2 lot size then it is called 5/2 call spread. For net profit and loss calculation refer Ranjan's book on futures and options named "Master's key to future and options."

6.2/1 and 5/2 put spread : In this strategy one need to buy lower strike put options 2 lots or 5 lots and sell higher strike put option 2lots or 5lots.

Example: Buying 2lots of Nifty 4400 put option at Rs88/- and selling one lot of Nifty 4500 put option above Rs120/-. This strategy is called 2/1 put spread. If you will do the same with 5:2 lot size then it is called 5/2 call spread. For net profit and loss calculation refer my book on futures and options name "Master's key to future and options."

In the future and option calculator after giving 8 inputs you will get the access to all 24 strategies formed with different option pairs and future. After simulating this process observe **the maximum loss column and the profit column** to identify which strategy is awarding more profit as compared to the loss and act accordingly.

[Learn more than hundreds of strategies from our book named “Master’s Key to Future and Options”.](#)

Example 1: If I am taking Reliance industry future in to account and I have the following information in hand on 17th September 2008.

- a. The lot size of the contract is 75.
- b. Future is trading at 1875.
- c. The nearest ‘in the money call option’ of strike 1860 is trading at a premium of Rs 65/-.
- d. The nearest ‘in the money put option’ of strike 1890 is trading at a premium of Rs 62/-.
- e. The ‘out of money call option’ which follows the in the money call option of my choice are of strike 1890 and 1920 are trading at a premium of Rs 40.35 and Rs32/-.
- f. The out of money put option which follows the ‘in the money put option’ of my choice are of strike 1860 and 1830 and are trading at Rs 50 /- and Rs40/- respectively.

Now using this set of data in the F&O strategy evaluator we got 24 different strategies formed in different combinations. Since the stock is in down trend. Assuming the stock to fall further down I found all the bear spread combinations has good risk reward ratio.

Out of which 1860 and 1830 put option strike has 1:2 risk reward ratio i.e. it has maximum loss risk of Rs750 /-and profit potentiality of Rs 1500/-. Same way the 1890 and 1920 call option bull spread also has max loss of Rs 626/- and profit of Rs1626/-.

Same way if you expect the script to move up by 10% from the current level then 5/2 call option in the 1860 and 1890 pair also has good risk reward ratio of max loss Rs9882/- and profit Rs32644/-.

Same time none of the put option strategy has good risk reward ratio. But good risk reward opportunity exists in future long/short with call or put option.

How to take a neutral stand on this point of time to form a trade plan?

Out of all these possibilities I will choose 5/2 call strategy of the 1860 and 1890 pair having maximum loss of Rs9882/- and profit Rs32644/- and take a future short with 1860 call option long. My view is if the stock moves 10% down from the current level then I will not be making any loss or profit. In contrast if the price moves 10% up from the current level then I will be making profit of Rs32644/- in the 5/2 call spread and my loss in the future short and 1860 call option will be Rs 3750/-.

Similarly you can form many combinations with neutral stand on the market.

#Results 1 on 18th September 2008

The synopsis of the strategy is I will take 5/2 call spread in 1860 and 1890 call option pair. And I will sell reliance industry above 1880 and buy 1860 call option 65. For the smoothness to form a good neutral strategy I always advise to keep two different trading accounts for flexibility. If you have only one trading account then it will be difficult for you to initiate this strategy.

Now when Reliance Industry has moved up by 4% from its previous day close to a level of 1940. Then this neutral strategy resulted the following out come.

Profit in 1890 call option $(78-40)*75*5 = \text{Rs}14250$ /-

Loss in 1860 call option $(97-65)*75*2 = \text{Rs}4800$ /-

Profit in 1860 call long $(97-65)*75*1 = \text{Rs}2400$ /-

Loss in future short $(1940-1880)*75*1 = \text{Rs}4500$ /-

Net Profit= Rs 14250 +Rs2400-Rs4800-Rs4500=Rs7350 /-

#Results 2: on 19th September 2008

Now when reliance industry has moved up by 4% from its previous days close to a level of 1940. Then this market neutral strategy resulted the following out come.

Profit in 1890 call option $(151-40)*75*5 =Rs41625/-$

Loss in 1860 call option $(185-65)*75*2=Rs18000/-$

Profit in 1860 call long $(185-65)*75*1 =Rs9000/-$

Loss in future short $(2040-1880)*75*1=Rs12000/-$

Net Profit= Rs 41625 +Rs9000-Rs12000-Rs 18000=Rs20625 /-

Chapter -6

Portfolio Management Magic

Introduction: The art of portfolio management is quite difficult and complex also. Over these years after learning from failures and success I have devised few simple tricks for portfolio management. To my knowledge the portfolio management is being divided in to two types.

Portfolio classification and management:

- A. The Investment Portfolio
- B. The Trading Portfolio

Investment portfolio is a place where in the Investor Park his money in shares, bonds, mutual funds etc to get the medium term to short term benefits. In the context of this book I will talk about the construction procedure of investment portfolio in Shares. It is too simple I have earlier describe Five best stock picking formula just give 20 % weightage to each formula and construct the portfolio. I will assure you that this method will award you very good gain.

The trading portfolio has the life span of one month to three month. In this you need to take formulated actions and follow disciplinary steps. If you have portfolio value more than five lakhs then follow these steps.

- a. Your portfolio must have one 5/2 spread either bull spread or bear spread or butterfly or long/short iron condor.
- b. Your trade portfolio must have one covered call/put with wide leg bear spread.

c. You must form few bull spread or bear spread with 10% gap between the strikes after a 10% fall or rise in the market.

Do remember always - Form the option spread, covered call or put strategy in trading portfolio. The proportion and weightage of these strategies will vary based on the market condition and situation.

Your trading portfolio must be designed in such a way that in each 10 to 15% directional move must award you the profit. Do not expect too much from the trading portfolio. Once the portfolio gives profit, encase it. I used to discuss many interesting models in my seminars. If you find the opportunity to join me in any program then do not forget to take a note of those sample models. Certainly I will not provide those things in this free book because of my commercial compulsion.

Conclusion: I feel this E-book will solve the purpose of understanding the basic concept of trading and investing. I have taken a mission to educate all the traders and investors the art of investing and trading. To be a part of this mission you no needs to invest anything just distribute this E-book to all your friends especially to the peoples who are new to this market. In future based on the users demand I will upgrade this book with new concepts.