

## *Chapter 5*

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## CHAPTER 5

### FINDINGS, SUGGESTIONS AND CONCLUSION

This chapter includes the findings of the study, the suggestions, conclusion and scope for further research.

#### 5.1 FINDINGS

##### 5.1.1 Finding about the Demographic Profile of the respondents

Equity F&O market is swarmed by traders between the age group 26 and 45. Majority (37%) of the traders are between the age group 36 and 45. 31% of the traders are between the age group 26 and 35.

- The Equity Derivatives market in Bengaluru is dominated by Men. 81.68% of the traders are men and only 18.32% of traders are women.
- Majority of the equity derivative traders have high formal education. 38% are postgraduates and 37% are graduates.
- 58% of the respondents are full-time day traders and among the rest majority of them (20%) are occupied in the field of science and engineering.
- Most (30%) of the equity F&O traders in the market have annual income between 10 and 30 lakhs.

##### 5.1.2 Findings about the Trading profile of the respondents

- Majority of the traders set aside 11 – 40 % of their annual income as trading capital. 34% of them set aside 11 -25% and 35% of them set aside 26 – 40%
- 38% of the equity F&O traders have more than 5 years of trading experience. 29% of them have trading experience between 3 and 5 years. Only 8.6% of the traders have an experience of less than one year in the market.
- Majority (74.9%) of the Equity F&O traders are speculators. 7.9% of them are arbitrageurs, 14.7% of them are hedgers and 2.6% involved in all three.
- Index option is the most preferred product (31.2 5%) among the F&O traders in the majority. 28% of the traders prefer to trade all or multiple combinations of

products (Stock Futures, Stock Options, Index Futures and Index Options). Stock options are popularly traded. Only 7.3% of the traders prefer to trade them.

- 30% of the traders in the market favour buying (long) Call/Put options. 28% of them prefer all combinations (Long Call/Put, Short Call/Put, and Long/Short Futures). Only a few respondents, 12% of them prefer selling (short) options.
- Majority (39%) of the traders prefer to track and trade more than 10 stock/Indices regularly.
- One in every two traders in the equity F&O market suffers an annual net loss by trading in equity F&O contracts. 31% of traders manage to make a net annual return between 0 and 20%. Less than 5% of them generate more than 60% net return.

### **5.1.3 Findings of cross tabulation, chi-square and correlation analysis**

- Age of a person has a significant impact on his/her success in equity F&O trades. Majority of young traders between the age group 18 and 25 disagree that they are successful in trading equity derivatives. Traders above the age of 36 tend to be more successful than the young traders.
- Trader's gender has no significant influence in his/her success in equity F&O trades.
- Educational Qualification of a trader has a significant effect in his/her trading success. Traders with high formal education tend to be more successful in trading Equity F&O.
- Trader's occupation has a significant effect on his/her trading success. Traders who are occupied in the field of science and engineering tend to be more successful.
- No. of years of experience of a trader in the market does not have an impact on his/her trading success. This is in line with the results of Barber et. al (2017) that the majority of day traders are unprofitable, and many continue regardless of their wide experience of losses in the market.
- One's trading style or type (Day-trader/ Swing-trader) does not have an effect on his/her success in trading equity derivatives.

- One's choice of products/instruments and his/her success in trading derivatives are not significantly related.
- Trader's choice of strategy and his/her success in trading derivatives is not related.
- There is a significant relationship between one's trading success and the No. of stocks and indices that he/she keeps track of. Good numbers of traders who keep track of more than 5 stocks/indices agree that they are successful in trading F&O.
- Traders who generate high net annual returns strongly agree that they are successful in trading equity F&O contracts and those who generate net annual losses in F&O trades strongly disagree that they are successful in trading equity derivatives.

#### **5.1.4 Findings of the Principal Component Analysis**

- 39 variables used to measure the trading success in equity derivatives were reduced and grouped into seven factors/components which includes – Knowledge, Trading Behaviour, Risk Management skills, Emotional Intelligence, Tech Savviness, Personal Habits and Social Interaction. The Seven-component solution explained 71.747% of the total variance.
- Component “Knowledge” explains the total variance of 39.59%. and the highest significant loading is on the variable - Trader's quantitative skills (0.801), followed by the trader's ability to ignore the apparent signals in the market and stay ahead the crowd (0.794), Systematic updation of trading plan to include new notions and eliminate the bad ones (0.792), Trader's aptitude to build his own trading strategy and not depending on the tips from brokers (0.784), Good Knowledge about technical and fundamental analysis (0.78), Well-researched stock picking strategy (0.771), Tracking the foreign markets (0.756) and the last is being motivated to learn more about the market each day (0.75).
- Component “Trading Behaviour” explains the total variance of 7.832%. The Highest significant loading is on the variable - trading objective (0.824) followed by treating F&O trades like any other serious business (0.815), Efficient planning (0.797), Maintenance of a trading journal (0.794), Discipline (0.791), Having a simple strategy (0.778) and the last is exit strategy in place for all the trades (0.762).

- Component “Risk Management” explains the total variance of 6.58%. The Highest significant loading is on the variable – Not trading on borrowed money (0.769) followed by capital protection (0.752), Risk reward ratio (0.751), Good risk management strategy (0.742), Diversification (0.729) and the last is risking only what is affordable to lose (0.729).
- Component “Personal Habits” explains the total variance of 6.58%. It has a very high significant loading on all the grouped variables that includes being a morning person (0.832) followed by having a balanced diet (0.83), Enough Sleep (0.827), Physical fitness (0.799) and the last is spending quality time with loved ones (0.762).
- Component “Emotional Intelligence” explains the total variance of 5%. The Highest significant loading is on the variable Emotional Control (0.751) followed by No revenge trading (0.717), Not losing confidence at times of loss (0.713) and moderate loading variables such as - Not becoming overconfident while booking profits (0.693), Never ignore Stop Loss (0.686) and the last is accepting responsibility (0.625).
- The component “Tech Savviness” explains the total variance of 4.17%. The Highest significant loading is on the variable – Back-testing of the trading strategy (0.751). followed by Trading use all types of gadgets and not getting tied down to a trading platform that is desktop only (0.733), Use of High-Speed Internet connection for trading F&O contracts (0.732) ad last using computer algorithms to automate the trading process (0.732).
- The component “Social Interaction” explains the total variance of 2.81% variance. The Highest significant loading is on the variable – Following the experiences of successful traders and fund managers (0.717) Moderate loading on the variable - Active interaction and discussion with like-minded people on the subject of F&O (0.675) and also participating in workshops/seminars/symposiums related to F&O trading (0.615).

### **5.1.5 Findings of Structural Equation Model**

- 59.8% of the variance in Trading Success is influenced by seven factors that include Knowledge (0.288), Trading Behaviour (0.241), Risk Management Skills (0.209), Emotional Intelligence (0.17.6), Tech- Savviness (0.043), Personal habits (0.032) and Social Interaction (0.012).
- The structural estimates reveal that out of the seven components: Knowledge, Trading Behaviour, Risk Management skills and Emotional Intelligence have a significant influence in determining a trader's success in trading equity derivatives. The three variables: Personal habits, Tech-savviness and social interaction do not have significant influence in determining a trader's success in trading equity derivatives.

## **5.2 SUGGESTIONS**

Based on the findings of the study, the following suggestions are made to various stakeholders in the market that include: The equity futures & options traders, SEBI the market regulator and the stock exchange and brokers

### **5.2.1 Suggestions to the Equity F&O traders**

- Findings of this study reveal that knowledge is the key to success in trading equity derivatives. Ignorance in the F&O market can be disastrous. Therefore, the F&O traders have to equip themselves with adequate knowledge to predict the future movement of the market using technical analysis (charts, indicators), fundamental analysis or mostly the combination of both, Option Greeks, various option strategies for changing market conditions, etc... The traders should never fail to invest in educating themselves to gain the required knowledge and skills to ace the market.
- Traders in the market have a general misconception that they only need to be equipped with the knowledge to pick up the best trades. What they fail is to be prepared for the worst. The findings of the study also expose that Risk management skills of trader significantly influence his/her trading success. One of the most important aspects of successful trading is protection of capital. As the popular

saying in the market goes *“If you don’t bet, you can’t win. If you lose all your chips, you can’t bet.”* Due importance should be given for stop loss and exit strategy for each and every trade and be prepared for the losses well in advance. Traders should develop the knack to cut their losses short and let their profits run.

- Traders should stop the herd behaviour of following the crowd, tips of brokers and news channels. Such traders are often referred to as sheep that follow the herd happily, unmindful that the majority of them end up being lambs to the slaughter. Therefore, the traders should introspect themselves to find their suitable trading style which is mostly based on factors such as one’s patience level, capital availability, risk tolerance and other priorities.
- Another important finding of the research is that the trading behaviour of a person has a significant influence in determining his/her trading success in the market. It is important that the participants in the market should consider trading like a serious business and not take it lightly. They should be clear with their trading objective and have a proper trading plan that specifies the entry, exit and money management criteria for every trade. With the advent of technology, it is easy to test a trading idea before risking real money. Known as back-testing, this practice allows the trader to apply his trading idea using historical data and test if it is practicable. Once a plan has been developed and back-testing shows good results, the plan can be used in real trading. The key here is to stick to the plan. Taking trades outside of the trading plan, even if they turn out to be profitable, is considered poor strategy.
- The results of the study also indicate that emotional intelligence of a trader plays a significant role in determining one’s trading success. Trading equity F&O is certainly stressful. There are more chances for a stressed trader to easily deviate from his established trading system and incur losses. Therefore, it is crucial for a trader to be disciplined enough to stick to his trading plan. Unfortunately, discipline can’t be taught in seminars or workshops. Traders tend to spend a lot of money trying to compensate for their lack of self-control without realising that a long look in the mirror will enable him to achieve similar results at a much lower price.

The important lesson is that, once a trader has confidence in his/her trading plan, he must have the discipline to stick to it, even when there are foreseeable losing streaks. The gullible traders in the market are driven by emotions such as fear and greed and without the right education these emotions are time and again exaggerated, thus leading to costly mistakes.

### **5.2.2 Suggestions to SEBI, the market regulator**

- The results of the study show that despite having good amount of experience in the market the majority of traders are not successful. This indicate that they are persistent and trying their best to get things right. It would be great if the market regulator can join hands with the exchange and organise workshops and webinars for the traders on specific topics like position sizing and risk management, the role of emotional control in trading success, How to identify and benefit from arbitrage opportunities in the market, etc.
- The study also finds that the majority of the individual traders in the equity F&O market fall under the high-income brackets and therefore SEBI need not worry about them risking their capital.
- The research expose that more than 75% of individual participants in the equity F&O market are speculators and options are the most preferred derivative product by them. This could be because of the low securities transaction tax charged on the options (only the premium) by SEBI. Whereas in the cash segment the tax is levied on the total trade value of the transaction. The regulator can consider reducing the tax in the cash segment in order to bring down the huge difference in the turnover between the cash and F&O segment which in turn would reduce the speculative activity in the risky F&O market.

### **5.2.3 Suggestions to the stock exchange and brokers**

- There are lot of free platforms that provide simulation trading in the cash segment but there are hardly any in the Equity F&O segment. The exchange and their members can work on this so that the traders can initially learn from hands on experience in simulated real-world environment without risking their money.



### 5.3 SCOPE FOR FUTURE RESEARCH

- The relationship between the factors driving trading success can be explored. For example: The influence of knowledge on trading behaviour and how trading behaviour affects trading success.
- Similarly, the influence of emotional intelligence on trading behaviour and in turn how trading behaviour affects a trading success can be studied.
- Similar study can be carried out among equity F&O traders in cities like Mumbai and Ahmedabad as these cities contribute a huge trading volume in Equity F&O trades.

### 5.4 CONCLUSION

The study was aimed at understanding the demographic and trading profile of the equity derivative traders in Bengaluru city. The findings of the study exposed that the majority of the traders in the equity F&O market are men with high formal education between the age group 36 and 45. Most of them are High Networth Individuals (HNI) and full-time day traders (speculators) with around 5 years of trading experience who set aside 11 – 40% of their annual income as trading capital. Vast majority of them prefer to trade in Index options as it is the most liquid and highly traded (volume) contract in the market. Many (30%) traders in the market prefer buying (long) Call/Put options probably because of its protected downside risk and the financial leverage. One of the important findings of the study is that the market is dominated by speculators and more than 50% of traders suffer an annual net loss by trading in equity F&O contracts. Handful of them makes extraordinary returns.

Nithin Kamath, CEO of Zerodha, The No.1 discount broking firm in India, says that less than 1% of active traders earn more money than a bank fixed deposit over a 3-year period. While this percentage seems terribly small, the crux of this study is focused in comprehending the factors that enable a trader to be successful so that the rest of the failing crowd can gain valuable insights and implement them in their future trades.

Principal component analysis and structural equation modelling was used to analyse and develop a model that explains the factors influencing trading success. The results of the analysis revealed that the success in the equity F&O market is

significantly driven by factors such as the trader's knowledge about the market, his trading behaviour, risk management skills and emotional control. Components such as tech savviness, social interaction and personal habits do not significantly affect the trader's success in the equity derivatives market.

A trader should never be in the market to gamble or for the thrill that it offers. Equity F&O trading should be treated like any other serious business and a lot of time should be devoted to learning and refining the required skills. Traders should never rely on their gut feelings, news, tips, views or rumours; instead, they should develop and follow their own trading system while keeping risk management in mind. Working on one's emotional control and following the trading plan with rigorous discipline is the only way to make consistent returns in the market.