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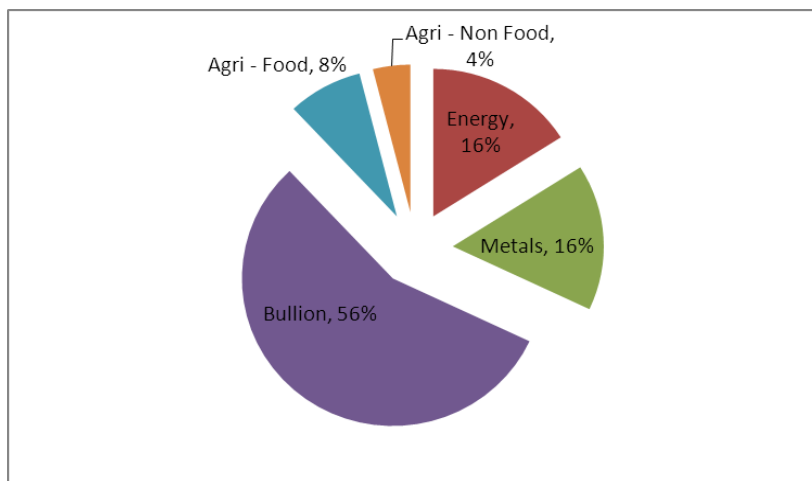
# Basics of Commodities Trading

Commodity trading is an age-old phenomenon, which involves the buying and selling of primary products packaged as standardized contracts. It is very similar to the trading of equity on a stock exchange; however, an investor buys and sells commodity products instead of the shares of a company. In this series of the Knowledge Center, we provide an insight into trading commodities in India.

## Where does commodity trading take place in India?

In 2003, the ban on commodity trading was lifted in India after forty years. At present, there are twenty four commodity exchanges in India, of which three operate at a national level – the Multi Commodity Exchange of India Ltd (MCX), the National Commodity and Derivative Exchange (NCDEX) and the National Multi Commodity Exchange of India Ltd (NMCE). 87% of commodity trading activity takes place on the MCX, which generates an average daily turnover of Rs 49,018 crore.

### India - Volumes by Category



Unlike equity markets which are regulated by SEBI (Securities and Exchange Board of India), the MCX is regulated by the Forward Markets Commission. Trading on the MCX takes place between 10am and 11:30pm from Monday to Friday, and 10am to 2pm on Saturday. The evening sessions were initiated to sync its trade timings with exchanges in London, New York and other major cities.

Using a commodities futures contract, a farmer can sell his harvest much before he has planted it, even though he may get a better price for it in the future. If a boom in demand raises prices by the time the crop is available, the buyer of the futures contract wins. However, if prices fall, the speculator will make serious losses.

## Why diversify into commodities?

Commodities form a unique asset class, which can be used in combination with equity and debt assets to diversify one's portfolio, lower long term risk and increase upside potential. By the very nature of primary products, commodity trading generates several investor benefits that trading in traditional assets cannot.

The current global economy is marked by uncertainty, and so, the biggest advantage of commodity trading is that it acts as a "hedge" (risk control) against inflation, even in a modest portfolio. In periods of high inflation, assets like bonds and stocks tend to suffer; however, the value of commodities tends to rise. For this reason, it is advisable to invest a small part of your portfolio in commodities – think of it as your own hedge fund.

Commodity markets are harder to manipulate than equity markets, because prices are driven by demand, supply, inventory and trading patterns.

### Yearly Returns of Commodities (India) & Nifty

Yearly Returns (%)	Gold	Silver	Copper	Crude Oil	Nifty
<b>2008</b>	28.51	-5.76	-42.64	-47.11	-51.84
<b>2009</b>	21.37	44.91	120.94	77.48	71.46
<b>2010</b>	24.22	72.84	15.87	9.86	17.25
<b>2011</b>	31.71	-10.21	-7.63	29.58	-24.9
<b>2012</b>	12.7	12.73	8.82	-5.82	27.35
<b>2013 (till 23rd May 2013)</b>	-14.65	-23.84	-6.19	-2.84	1.89
<b>Average Return</b>	17.31	15.11	14.86	10.19	6.87

The table above shows the yearly performance of four major commodities and the Nifty index. Gold is often pegged as a hedge for uncertain markets. Historically there is a low correlation between Gold and equity market performance.

## Delivery System

All exchanges have both cash and delivery settlement systems. If one wants the contract be delivered in cash, he must indicate this at the time of placing the order. If one opts for delivery of the commodity, he must have the necessary warehouse receipts. Sales tax may be applicable on delivery, however it is the seller's responsibility to collect and pay this tax.

### MCX : Main Contract Specifications

Commodity	Price Unit	Tick Size	Lot Size	Expiry Date	No. of Active Contracts
Gold	Rs per 0.1 gms	1	1 kg	5 <sup>th</sup> of every bi-month	3
Gold Guinea	Rs per 0.125 gms	1	8 gms	Last day of the month	2
Gold Mini	Rs 0.1 gms	1	100 gms	5 <sup>th</sup> of every month	3
Silver	Rs per kg	1	30 kg	5 <sup>th</sup> of every bi-month	4
Silver Mini	Rs per kg	1	5 kg	Last day of the month	4
Crude Oil	Rs per barrel	1	100 barrels	15 <sup>th</sup> of every month	3
Natural Gas	Rs per mmbtu	0.1	1250 mmbtu	Last day of the month	3
Copper	Rs per 100 kg	0.05	1 MT	Last day of the month	3
Zinc	Rs per kg	0.05	5 MT	Last day of the month	3
Lead	Rs per 100 kg	0.05	5 MT	Last day of the month	3
Nickel	Rs per 100 kg	0.1	250 kg	Last day of the month	3
Aluminum	Rs per 100 kg	0.05	5 MT	Last day of the month	3