

FORWARD, FUTURE AND OPTIONS ON STOCK EXCHANGE MARKET

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Abstract: The main motive of the formation and use of forward contracts and futures, and options, was certainly profit. Making financial markets more efficient, in terms of expanding the range of available financial instruments and reduction in transaction costs, these financial innovations are beneficial for both investors and managers company. Primary purpose of derivatives such as forwards, futures and options is to enable control risks by investitures and primarily from inadequate price trends for all types of assets that could be subject to transactions in financial markets.

Keywords: *forward contracts, futures contracts, options, stock market, financial market*

INTRODUCTION

Derivative securities or financial derivatives are a large group of financial instruments. They are called so because their value is derived from the value of other underlying assets located in their basis. They do not reflect the property (shares) not indebted (bonds), but carry with them a kind of conditional - contingent rights to other forms of financial assets. The value and price of derivatives depends not only on the supply and demand for them, but also on the value of a number of factors to which they relate. Financial derivatives are very important to the business and risk management in financial markets. Allow the risk to be awarded much more rational control. They are used by the hedger and speculators, but

about them later. In theory and practice, a distinction is made following securities:

- Forwards Contracts,
- A liquid futures contracts - futures
- Option

1. FORWARD CONTRACTS

Forward is the simplest type of financial derivatives. A classic futures contract. This is a contract under which the buyer and seller agree and express their will, the delivery of a certain quantity and quality of the assets on a specific date in the future.

The price at which it will be executed purchase and sale contracts in advance. The existence of forward contracts is associated with distinguishing two types of markets:

- prompt, cash markets, where delivery and payment is made immediately, not later than 5 days
- futures, where the billing, payment and delivery carried out on a certain day in the future.

Forward contract or the futures contract is an agreement between the two entities, the buyer and the seller, on the sale of certain assets - goods, which achieves to take delivery of these assets - goods and its final payment to be made in the future.

It is believed that the first stock exchange and commodity futures contract (forward) was created on 12 March 1851. In the CBOT in Chicago. Related to the delivery of 3,000 bushels of corn in June.

Characteristics of forward contracts:

- Classic futures contract
- Not standardized
- Adjusted to the specific needs of contracting parties
- The transaction is performed on the OTC market
- Do not forward the clearing house.

Disadvantages of a forward contract are:

- Inability to easily find other contractual party will accept the terms of the contract
- Insolvency Contracting Parties
- Susceptibility to risk of default - default risk
- Inability to trade on the secondary market.

Forward position can be twofold, namely:

- 1) Long - when there is a defined obligation to buy assets that is specified in the contract, and
- 2) Up - when there is an obligation to carry out a sale of assets which in turn is regulated, that is pre-defined as a forward contract.

As an illustration, we give an example of pure interest forward. In her first need to defined debit instrument, or assets that will be delivered under the contract (in a way, on time and according to the defined financial and quantitative elements). For example, when a bank decides to sell forward it eliminates the risk of changes interest rates for each subsequent sale of financial instruments in their portfolio, and this means that the bank determines the precise price at which to sell securities. On the other hand, the other party, or the customer forwards is also protected from changes in prices of securities in a transaction with the aforementioned financial institution.

2. FUTURES CONTRACTS

Futures are similar to forwards essentially. Some even considered by the authors since the variation of forward and futures originated from forward. But the fact is that the futures actually resulting from forward contracts to represent a newer version or a modern type of futures contract. Similar, if not identical to that of forward contracts and futures are in fact contracts concluded between the two sides, according to which one party - the seller undertakes to deliver precisely defined assets (money or goods or services) in exactly the specified time limit and pre-agreed price, while the buyer is obliged to take over the assets and make the payment at a specified day (usually it is the day of delivery).

"Futures is a contract for the delivery of goods, currency or financial instrument at a pre-agreed futures price and the contractual term in the future."¹

Futures is also the expression of the will of the two sides of the assets, price and future delivery and payment. Futures buyer and seller sign a purchase contract, at a predetermined price, or payment is not done until the moment when the goods are not delivered to the purchaser in the future. The contract also defines the conditions of delivery and only when these conditions are met, the payment is happening. "Futures are derivatives or derivative financial instruments as they are derived from products that are in their basis."²

"According to the Law on Securities of Serbia futures contract is defined as a portable contract to sell standardized amounts of market material that could conclude legal persons through brokers and with the help clearing house."³

¹ Unković, M., Milosavljević, M., Savremeno berzansko I elektronsko poslovanje, Singidunum, Beograd, pp.85

² Ibidem, pp.86

³ Ibidem, pp. 87

What is the difference between futures and forwards? Futures are highly standardized financial instruments and are also called liquid futures contracts just because they are liquid and there is a different mechanism of payment of forwards. Further, among them the delivery is not linked to a specific date, like forwards, but for the month in which it must be done.

Also, there are some certain freedom on delivery, but the seller is obliged to inform the clearing house via the customer when it will make the delivery.

Then, with the forwards no payment prior to maturity, the maturity date is carried out delivery and payment, while the futures market there is little difference - the buyer and seller take particular for security deposit, which ranges from 5 to 15% of the contract value. Deposit guarantees delivery and payment.

Futures can be traded on the Stock Exchange and all participants can be divided into two groups:

- hedger
- speculators

Hedger the entities carrying out futures transactions with futures want to protect themselves from risks and loss due to changes in prices, but also to bring more certainty and security in their business. As a hedger occur banks, construction companies, etc. For example, a German company engaged in exporting and she will be made to pay exactly 45 days in euro.

Speculators are participants in the futures where the main motive is not to protect themselves from the risk of changes in asset prices, but to realize trading profit. They accept the risk of buying or selling futures contracts in order to earn. So, they are not interested in commodities, but the difference in price you can achieve. There are the following types of speculators:

1 Scalpel - they react to changes in the minimum price of the day.

2. Day traders - like a scalpel but with a different philosophy.

3. Positional traders - with the aim of holding positions for more than a day.

Especially important emphasized that approaching maturity so gradually equalize respectively, settled futures prices and the prices of assets from futures contracts. This still means that at maturity futures price exactly coincide with the price of the assets of the original contract on futures.

There are several types of futures, and futures all can be divided into:

- Edge - includes a number of different commodities: metals, agricultural products, gas, oil, etc. and

- Financial - some authors distinguish currency, foreign exchange, interest rate futures on securities, futures on market indexes, etc.

Commodity futures contracts are liquid in which the underlying assets - the goods. "9 The goods which are usually traded agricultural products - cereals (wheat, corn, soybeans, rice); livestock; agro-industrial products (coffee, cocoa, cotton, sugar); metals; oil; and natural gas. How could it be traded commodity futures trading is necessary to standardize quantities.

"Financial futures involves a number of different futures contracts, where as fixed assets appear other materials market."⁴

Futures is essentially a real contract that bears the rights and obligations of both the buyer and the seller. The buyer of the futures contract has the right on assets which was contracted futures and the obligation to pay these assets. On the other hand, the seller of the futures contract is entitled to receive the funds, and the obligation to deliver assets.

⁴ Ibidem, pp.88

Around the fulfillment of obligations created by the clearing house, which always has a zero position, I can not affect the price changes of individual futures contracts, because the sum of the profit or loss equal to each other.

Futures have the following characteristics:

- Standard - in terms of size, the trade cycle in the month in which the trade takes place, the day of delivery, quotes, minimal price changes, etc.
- The ability to trade securities and neutralize the original contract or the same trade in the opposite direction. Only a few futures before the end of validity (maturity)
- The public market in which prices are available contracts - trading is done shouting at the trading floor and the prices published on boards Stock Exchange, the financial press or through agencies.

Participants in futures trade are:

- Hedger, trying to protect themselves from the risk of changes in exchange rates or interest rate by taking positions in futures, which is the opposite of the risk they face.
- The speculators, they trade futures in the hope that it will make a profit from price changes in the future.

Arbitrageurs, while trade in the futures and securities that are the subject of futures in

order to generate profit from the price difference.

2.1 TYPES OF FUTURES CONTRACT

There are several types of futures contracts:

- Commodity futures-futures represent standardized contract between the seller and buyer, where the buyer to accept delivery of certain goods at the agreed price in a specified period in the future.
- Currency futures-trading of currency futures appear regularly participate, such as traders and speculators hedger. The specificity of currency futures trading is that there are arbitrageurs, who are trying to make profit on the basis of spatial and temporal variations in the amount of the course.
- Interest futures-futures are futures contracts binding the seller to deliver and the buyer to accept delivery of a specified amount of a financial instrument in the allotted time in the future. The main reason for the interest-bearing Trade futures charging interest determined in securities.
- On-index futures price index futures decisively influence the current value of the index and the expected value of the index in the future.

Table 1. Example futures contract

CME Butter Futures	
Trade Unit	40,000 pounds of Grade AA butter
Settle Method	Physically Delivered
Point Descriptions	1 point = \$.0001 per pound = \$4.00
Contract	Six months of March, May, July, September, October, and December.
Listing	Current Listings
Product Code	Clearing=DB Ticker=DB
Trading Venue	Floor
Hours	9:30 a.m. to 1:10 p.m. LTD (12:10 p.m. If the LTD is on a day that the market closes early, then the time is 11:10 a.m.)
Listed	All listed months
Limits	\$0.05/lb, 500 pts, \$2000 Expandable price limits, see Rule 1202.D
Minimum Fluctuation	Regular 0.00025=\$10.00

"Futures with delivery of the contract is transferable standardized contract binding the buyer to pay the price on the maturity date of the contract, or binding the seller on that day to deliver the object of the contract. Futures without delivery of the object of the contract is transferable standardized contract binding the contracting parties undertake to the maturity date of the contract payment of the difference between the contract price and the price of the contract or on the maturity date."⁵

2.2. FUTURES MARKET CHARACTERISTICS

Basic characteristics of futures markets could be considered:

- Standard object of trade,
- Mainly stock exchange trade,
- The adjustment,
- Futures traders, and
- Margin.

Standardization of futures is caused to store them mainly takes place on the stock exchange, and less on the OTC market. The most active futures exchanges in Sydney, Hong Kong, Tokyo, Osaka, Paris, London, Singapore, etc. Operations in the futures market is well regulated, whereby the degree of regularity varies from country to country. Trade futures is largely regulated in the United States on three levels: through clearing houses and stock exchanges, via the National Futures Association and a commission to trade commodity futures.

Participants in the stock trade futures.

Futures traders can be classified in several ways. According to the general classification, all futures traders may be:

- traders on the floor, and
- merchants van parquet

The traders on the floor include: local brokers and traders.

Strategies are divided into: hedger, speculators and arbitrageurs speeders.

⁵ Hadžić, M., Bankarstvo, treće izmenjeno i dopunjeno izdanje, Univerzitet Singidunum, Beograd, 2009, str. 300.

Under traders futures van stock exchange parquet implied to thousands of individuals and institutions (eg, banks, financial intermediaries, investment banks, mutual funds, pension funds, etc.).

3. OPTIONS

Option is any contract that one of the contracting parties have the right to buy or sell. Options give the holder the legal power that consists to do something, but not the obligation to do the same. So the option is the right but not the obligation to buy or sell an asset at a predetermined price by a specific date in the future.

So, the options are securities that are essentially specific in relation to the forward and futures contracts or in relation to other financial instruments. Options still fall into derivative securities that are nevertheless related to financial instruments for the onset of the financial markets. Organized trade options began more than 40 years, namely in 1973 and the first in the US in Chicago when trading in these derivatives and reaches its peak. Sam root of the financial derivatives linked to the first half of the XVII century, in Japan and the Netherlands. And then, as a few centuries later option actually means the right but not the obligation to sell or to buy an asset according to predefined elements that relation on dates or prices. Accordingly, options are something more specific securities because they leave a choice to contract and do not realize, but what makes the main difference between options on one side and forwards and futures on the other hand is to be paid with the price which is optional title premium to this so-called glass. "Conditional right" or the right to withdraw from the purchase price and at a specified day.

It should make a difference between the price of an option contract that is contracted (as the price at which a buyer buys and the seller sells goods or assets on a certain day of the premium which

represents the cost of withdrawal from the contract. In this case the greater risk borne by the vendor options and from the base the fact that the obligation to perform under the contract what the customer requires it, regardless of possible unfavorable circumstance at a given moment on the financial market.

There are two types of options, such as:
1) purchasing options, and
2) put options.

In addition to the above types of options that differ according direction which contain up the buyer or seller, we distinguish between more and some other options, and depending on the selected criteria. In this sense, different options how to use them and there is talk of European, American, exotic tip options, etc. Yet the most common classification options according to the type of assets to which they relate, so that a real difference to financial, commodity and real options.

CONCLUSION

With the use of financial derivatives, which include forwards, futures and options is the main motive of investors to prevent any possible risk in trading securities. The main essence of these agreements consists in the fact that in the case of these financial contract both parties are obliged to carry out financial transactions in a pre-agreed time and according to the previously agreed price. Another important feature of financial derivatives is that the parties do not pay the premium even pay a commission which usually precedes the signing of the contract, significantly reducing transaction costs or business is based on respect for fair business practices, and more importantly, on respect for the law governing the operations in the financial markets.

In any case, one of the most important qualities of forward contracts is that this is a contract governing the future delivery of assets and agreed in advance, or fixed price, or whose collection falls on the end of the contractual period to which it relates forward. On the whole, futures arose after the forwards. For them characteristically that comes strictly contracts or such that are not standardized, and they are assembled in a form that is at the moment of the conclusion of adapting to the needs and requests of the parties.

Futures contract and futures contract, represents an agreement between two parties to buy or sell assets in a known time in the future for a known price. Forward contract or the futures contract is an agreement between the two entities, the buyer and the seller, on the sale of certain assets - goods, which achieves to take delivery of these assets - goods and its final payment made in future. Both types of contracts are very important for stock exchange market. One of the most famous stock exchanges on which they are used are:

- International Monetary Market (IMM)
- The Chicago Board of Trade (CBOT) and
- London International Financial Future Exchange (LIFFE).

It is important that remark forwards, futures and options as well as represent a very powerful instrumentation hedging and to the one on the basis of which the investors are trying to protect from very different types of risk. For example, just by using options such derivative securities can be reduced, if not completely eliminate the risk of price changes, fluctuations in market indicators, or from changes in interest rates, which in any case improve the position of investors in the market and so what reduces the risk.

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