NCDEX WELCOMES ALL

New Delhi 30 Oct 2010

Agenda

- Overview & Evolution of Commodity Markets
- NCDEX Overview
- Financial Vs Commodity Markets
- Myths in Commodity Markets
- Opportunities in Commodity
- Future Scope & Regulatory support

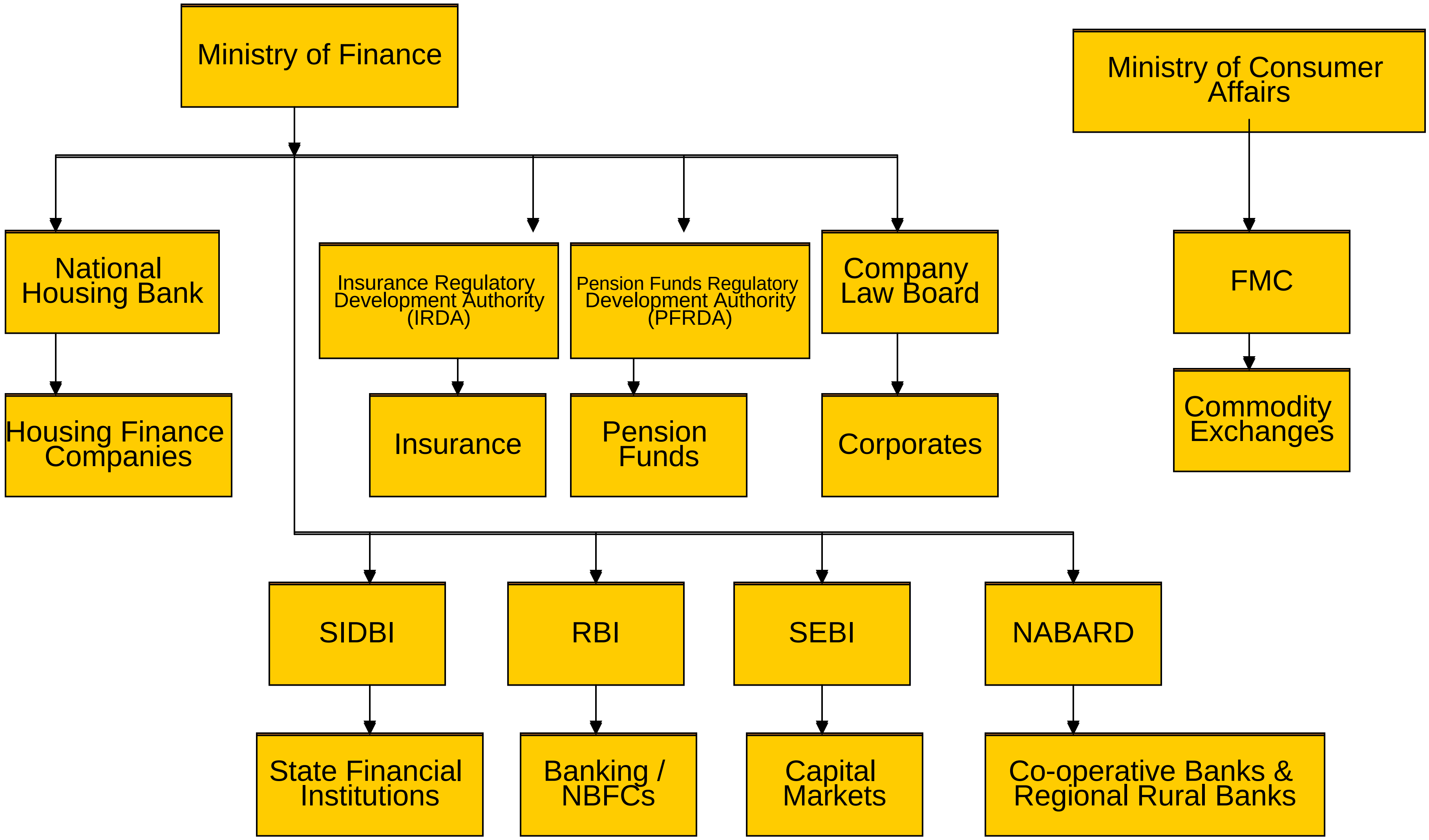
Evolution of Global Commodity Exchanges

- Development of modern futures trading began in US in early 1800s.
- The Chicago Board of Trade (CBOT) officially founded in 1848
- Earliest recorded forward contract on CBOT was on March 13, 1851
- By mid 19th century, futures markets had developed an effective mechanism for managing counter party and price risks
- New exchanges were formed in the late 19th and early 20th centuries as trading started in non-agricultural commodities

Evolution of Indian Commodity Exchanges: The Big Picture

History of over 100 years of trading →	First exchange established Bombay Cotton Exchange in 1893
Ban on futures trading in sixties →	Driven by upheavals - market goes underground
Removal of ban by 2003 →	Corollary of Liberalization Programme and reforms
Creation of new exchanges →	National online demutualized multi-commodity exchanges

Regulatory Structure in India



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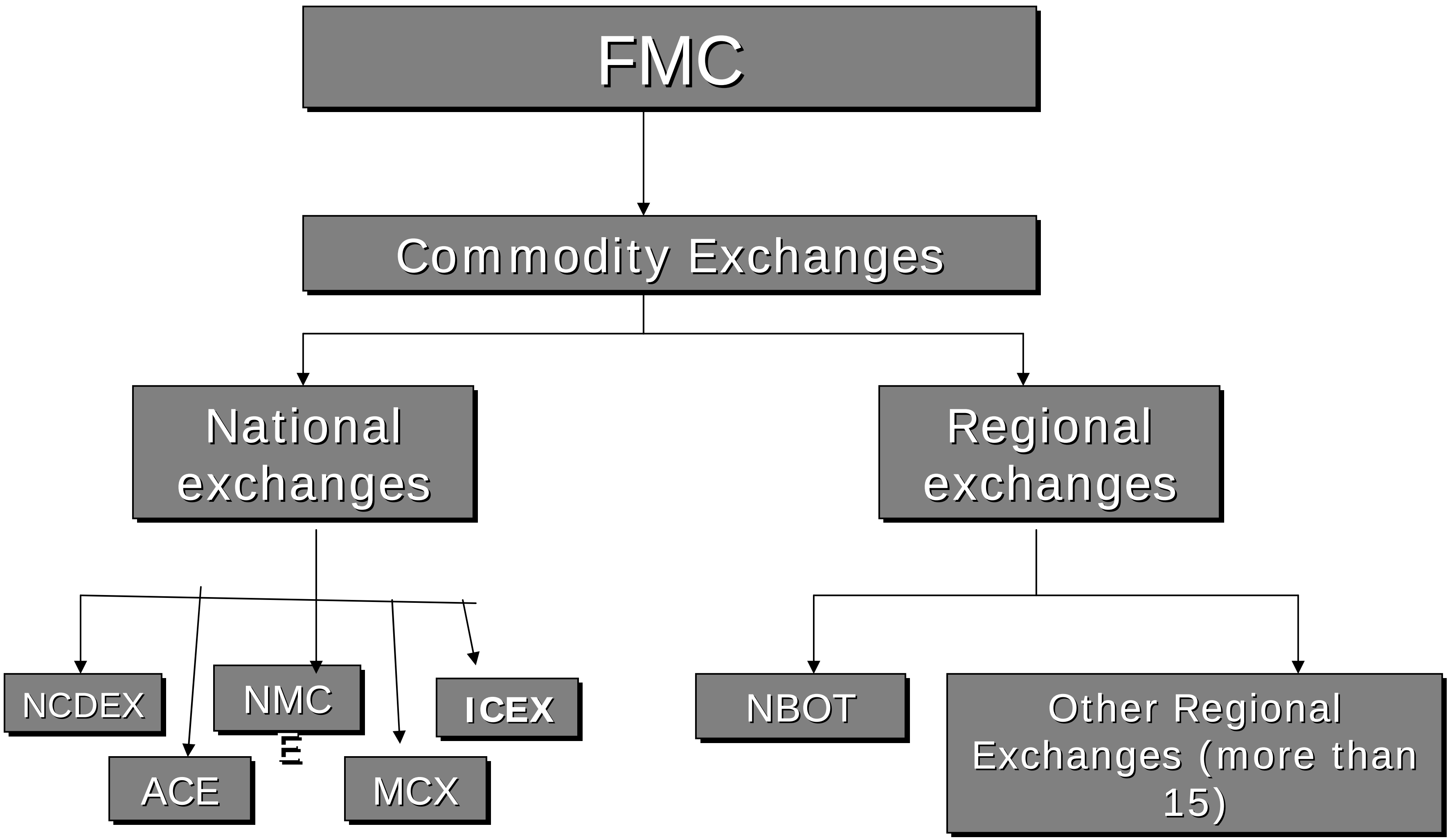
Structure of Indian Exchanges



NCDEX

NCDEX – Current shareholders

NABARD
15%

NSE
15%

LIC
15%

IFFCO
12%

Shree Renuka sugars
12%

PNB
8%

Canara Bank
8%

CRISIL
5%

Goldman Sachs
5%

Inter Continental Exchange
5%

-Only institutions are our shareholders
-NCDEX fully compliant with shareholding guidelines

Products offerings

Agriculture	Metals	Energy	Others
■ Grains ■ Pulses ■ Oil & Oilseeds ■ Spices ■ Fibres ■ Plantations ■ Softs ■ Others	■ Precious ■ Ferrous ■ Non-ferrous	■ Crude Oil ■ Natural Gas ■ Coal	■Polymers ■CER

NCDEX Profile

Exchange architecture is vast and dynamic

Products	**62 (43 agri, 7 bullion 3 polymers, 4 energy, 5 metals**
Members	1100
Terminals	**~20,000 in ~700 centres**
Accredited Warehouses	**760 with 5 Lakh MT capacity**
Clearing banks	13

Functions of an Exchange

- Major functions of an exchange are
  - Price discovery
  - Price dissemination
  - Risk management
  - Market surveillance
  - Clearing and settlement

Key risks in commodity trading

- Foreign exchange risk
- Interest rate risk
- Commodity price risk
- Credit risk
- Operational risk
- Investment risk

Commodity price risks include

- Increase in purchase cost vis-à-vis commitment on sales price
- Change in value of inventory
- Counterparty risk translating into commodity price risk
- Basis risk

Commodity futures

- Base inventory hedging
- Borrowings linked to commodity prices
- Removal of counterparty risk
- Locational premium/discount

Risk Management

- A commodity Exchange manages two types of risks
  - Price risk
  - Credit risk
- The commodity exchange provides a market for all participants to manage price risk by locking prices of commodities for fixed delivery dates in advance
- The exchange also has to organise trading in such a way that risk of default (counterparty credit risk) is almost eliminated
- Various measures to manage credit risk:
  - Capital adequacy requirements
  - Margins
  - Mark to Market
  - Price bands
  - Member Margin Fund

Role of an Exchange

- Anonymous auction for price discovery
- Neutrality - conflict of interest avoided
- Transparent real time price dissemination
  - Benchmark reference price
  - Liquidity to participants
- Risk Management in a volatile market
  - Robust Clearing & Settlement systems - counter party credit risk mitigated
  - Fair, safe, orderly market - rigorous financial standards and surveillance procedures

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FINANCIAL MARKETS	COMMODITY MARKETS
RESTRICTED TO INDIAN MARKETS	RELATED TO INTERNATIONAL MARKETS
BALANCE SHEET, UPCOMING PROJECTS, AUDITED RESULTS, RATIOS	PRODUCTION, CONSUMPTION, EXPORT, IMPORT, TAXATION, POLICY
FMCG, BANKING, OIL& GAS, POWER	AGRI, BULLION, FERROUS, ENERGY
OPTIONS AND INDEX TRADING IS ALLOWED	RESTRICTED
DELIVERY IN ELECTRONIC FORM	DEMAT & PHYSICAL FORM
PARTICIPANTS ARE LARGE – FII, BANKS, MUTUAL FUNDS, RETAIL	RETAIL , PHYSICAL INDUSTRY ONLY
SEBI	FMC
COMPANY INFORMATION IS ADV	CROP INFORMATION IS ADV

Correlation: 1997-05

Correlation Coefficients in Indian markets				
	Gold	**Silver**	**Stocks**	**Bonds**
Gold	1	0.55	-0.09	**-0.076**
Silver		1	-0.06	**-0.015**
Stocks			1	0.112
Bonds				1

Data: LBMA bullion prices, NSE Nifty, NSE G-Sec Index

Benefit of diversification can be seen from the
Risk Adjusted Returns

Volatility comparison – 1997-05

<u>Average annual volatility</u>

- Sensex or Nifty - 25-30%
- Govt Sec Index - 5-10%
- Gold - 12-18%
- Silver - 15-20%
- Cotton - 10-12%
- Oil seeds - 15-20%

- Commodities are less volatile compared to equity market, but more volatile as compared to G-Sec's

Risk-Adjusted Returns:1997-05

Portfolio structure	Abs Cumulative Returns	Risk of portfolio	Risk Adjusted Return
100% Stock Portfolio	73.70%	24.43%	3.017
Stocks (50%) & Gold (50%) Portfolio	47.80%	14.37%	3.326
Stocks (50%) & Silver (50%) Portfolio	48.30%	13.29%	3.634
100% Gold Portfolio	21.80%		2.001
100% Silver Portfolio	22.90%		1.742
100% Bonds Portfolio	25.20%	7.92%	3.182
Bonds (50%) & Gold (50%) Portfolio	23.50%	8.79%	2.673
Bonds (50%) & Silver (50%) Portfolio	24.00%	6.58%	**3.647**

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Myths about Commodity Exchanges

Myth	Fact	Enablers
Exchanges are speculative markets	Speculators infuse liquidity	Hedgers price risk gets transferred
No physical deliveries	Physical deliveries are incidental	Platform for better price discovery
How can trading volume be greater than actual production?	Trading volume is a multiple of physical production & value chain participation	High open Interest (Indicator of depth of the market)
Exchange responsible for price movements	Exchange reflects the price movements of spot market	Confluence of Demand and Supply

Myths about Commodity Exchanges

Myth	Fact	Enablers
Commodity market are complex	Natural products, Trackable	Sources of Information
Commodity Markets are risky	Seasonal in nature, has intrinsic value	Hedge risk (price + production plan)
Trading fuels inflation and price rise	Trading reflects the possible sentiments	Trading helps to understand the future price trends
Exchange must have cash settled contracts	Delivery based contracts helps erractic movements	Links physical market with futures for enhanced efficiency

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Factors affecting price of a commodity

- **Some of the important factors affecting price are**
  - Production
  - Consumption patterns
  - Carry over stock
  - Expected demand
  - Imports and exports
  - Government policies
  - Economic condition

    (Rate of Growth, Inflation, Interest Rate etc.)

Trading Strategies

- Hedging
- Arbitrage
  - Cash & Carry Arbitrage
  - Inter Exchange Arbitrage
  - Inter Commodity Arbitrage
- Calendar Spreads
  - Bull Spread
  - Bear Spread
- Speculation
- Jobbing

Portfolio diversification & value investing

- Low co-relation between stocks/bonds and the commodities market
  - Better diversification of portfolio
- Commodity markets are less risky compared with stock market.
  - Reduces risks in a diversified portfolio

Agenda

- Overview
- Arbitrage Opportunities
- Hedging Opportunities
- Investment Opportunities
- Institutional Participation
- Future Scope / Regulatory support

Regulatory Facilitation

Institutional Participation
Banks,MFs, PFs, FIIs
→ Pool the retail money to the market, boost liquidity & volume

Exchange Traded Options
→ Benefit of ‘upside’ for value-investing

Trading on Commodity Indices
→ Benchmarking the market

Banks - Present Scenario

- Not allowed to trade on commodity exchange
- Not allowed to do margin financing against commodities
- Bank lending to commodities remained very low
  - **Commodity a 'sensitive sector'**
  - **Not under priority sector lending**
  - **Credibility of Warehouse receipts**
  - **Reliability of the warehouse**

Involvement of Banks

- Banks as aggregators
  - Institutions with good rural presence and sufficient financial expertise and infrastructure
- Banks can hedge their agri and corporate loans
- Banks as market makers for price stabilization
  - Role similar to the role of RBI for stabilization of dollar prices
- Banks as dealers in commodity markets

FII presence

- Benefits
  - More liquidity
    - Broaden and deepen markets
  - Help in the utilization of capital
  - Global experiences
  - Research
  - Best practices

- Issues involved
  - Concentration and control over prices of crucial commodities
  - Physical delivery
  - Withdrawal from the country

Involvement of Mutual Funds

- Mutual Funds can bring liquidity and professional skill in the commodity market
- Mutual Funds can mobilize small savings and invest in commodities and commodity derivatives
- Easiest route for retail investment

Options and indices

- Options
  - Provides benefit of upside
  - Substitute MSP of government
  - Not allowed under FCRA
  - Need for changes in the Act
- Indices
  - Weather indices
  - Regulatory changes needed

Thanks

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