

LITERATURE REVIEW:

Albert Ballinger, Gerald P. Dwyer Jr., and Ann B. Gillette (2004): This article gives considerable data and empirical evidence that the futures market for West Texas Intermediate crude oil increased the short-term volatility of the cash price of crude oil. The authors show that the variability of prices increased using both published posted prices and transaction prices for producers. This article supports the view that information not previously aggregated into the cash price for crude oil is at least part of the reason for the greater variability of the cash price after the opening of the futures market. It provides an example in which futures market increased the volatility of the cash market, and prices became more efficient.

Brajesh Kumar, Priyanka Singh and Ajay Pandey (2008): Hedge Ratio is a ratio of total futures position to the total present position that needs to be hedged. In this article the authors have examined the hedging effectiveness of futures contracts in Indian stock and Commodity Markets. The authors state that understanding optimal hedge ratio is essential for devising effective hedging strategies for risk management. They have estimated dynamic and constant hedge ratios for S&P CNX Nifty index futures, Gold futures and Soybean futures. For this purpose various statistical models have been used.

Christos Floros and Dimitrios V. Vougas, (2007): This paper examines the lead-lag relationship between futures and spot markets in Greece. Authors have used a Bivariate GARCH model in case of both available stock index futures contracts (FTSE/ASE-20 and FTSE/ASE Mid 40) of the Athens Derivatives Exchange (ADEX). The authors use the model to explain price discovery of futures market over the crisis period 1999 to 2001. Empirical analysis confirms that futures market plays a price discovery role, implying that futures prices contain useful information about spot prices (in line with similar findings in the literature). These findings would be helpful to financial managers and traders who are dealing or planning to deal with Greek stock index futures.
Delphine Lautier (2010): In this article, the author has defined convenience yield and its role in the connect between spot price and futures price. The author has dealt with various sources of imperfections that usually lead to arbitrage in commodity markets. Existence of convenience yield can be explained with empirical studies since direct evidence of convenience yield cannot be available.

Garbade, K.D., and Silber, W.L. (1983): In this article, authors have tried to establish the connect between live cattle cash and futures markets. Empirical data on cattle futures and spot prices obtained from CME has been analyzed to show the relationship between the two.

Gary Gorton, Fumio Hayashi and K. Geert Rouwenhorst (2005): In this article, the researchers have dealt with basic properties of an equally weighted index of U.S. commodities futures from the perspective of a Japanese investor. It was found that the returns on the U.S. equally-weighted commodity futures index maintain their basic properties documented in Gorton and Rousenhorst (2005), when translated into Yen. In particular, looking at returns on Japanese stocks and bonds, the commodity futures index, translated into Yen, continues to display equity-like returns, but with slightly less volatility. In addition, the Yen-based commodity futures returns show essentially zero correlation with Japanese equities and negative correlation with bonds.

Habib Ahmad, Syed Zulfiqar Ali Shah and Idrees Ali Sha, (2006): In this article, the authors have investigated the impact of futures on spot price volatility. Authors have analyzed three time series data on Futures Index, Spot Index and KSE-100 Index from July, 2001 to January, 2010. GARCH model was used to assess volatility in Spot, KSE-100 and futures returns. The model has confirmed volatility clustering. The outcome of Granger Causality analysis indicates that KSE-100 market assist in the forecast of both spot and futures markets but on the contrary spot and futures were not found to forecast each other and KSE-100 market. Empirical evidence also showed that KSE-100, spot and futures markets are highly volatile and every market contributed to increase the volatility of other market in Pakistan.
Harrison Hong and Motohiro Yogo (2009): The authors have presented in this article the findings of their study of relationship between yield spread and returns on commodities. Just as in case of stock market, in commodity markets also, high yield forecasts low commodity returns and vice versa. A low aggregate basis (defined as the ratio of futures to spot price averaged across commodities) forecasts high returns. Authors state that basis is a factor that counts in commodity markets and not so much in stock markets.

Hoffman G.H. (1931): This article deals with various factors which affect the domestic spot prices of commodities in organized markets. The author has made a mention of various factors such as demand, supply, area under acreage, futures prices, etc. and shown how they could affect the spot prices. The author has also tried to establish the connect between spot and futures prices stating that there is always a strong correlations between the two.

Jatinder Bir Singh, (2007): This article investigates the hessian cash price variability before and after the introduction of futures trading. The objective of the author was to find out whether the futures market helps in reducing the intra-seasonal and/or inter-seasonal price fluctuations. A multiplicative dummy-variable model was used to examine the price variation difference. The empirical analysis showed that futures market has reduced the price volatility in the Hessian cash market.

Lokare S. M. (2007): The author has talked about the resurgence of commodity derivatives market in India as a result of the liberalization process and establishment of national level commodity exchanges in the country. The author feels that Indian commodity market has succeeded in achieving co-integration of spot and futures prices though the liquidity of futures contract have still not gathered critical mass. In case of some commodities, speculation activity is not much while in case of some others, speculation is reasonably high. Thus hedging is possible in some commodities while it is a difficult proposition in case of some others.
Lucia Baldi, Massimo Peri, and Daniela Vandon: (2010): This paper examines the long term relationship between spot and futures prices for corn and soybeans, for the period January 2004-September 2010. Cointegration method has been used in the presence of some breaks in the commodity prices. Causality relationships between spot and futures prices within each pre-identified sub-period to find out how spot and futures prices originate and then spread. First, empirical evidence shows that breaks in futures trading have significantly affected the demand and supply for corn and soybeans for food and energy applications. Second, sub-periods consequently identified express different dynamics in the causal relationship between spot and futures prices and support the idea that a number of factors contributed to the 2007-2008 food price increase.

Manuel Hernandez and Maximo Torero (2010): The article examines the dynamic relationship between the spot prices and futures prices of agricultural commodities. The article first discusses the “no arbitrage” theory and then asset pricing theory to define the relationship between spot and futures prices and then performs Granger Causality tests on spot and futures prices of selected agricultural commodities i.e. corn, wheat and soybeans. This is done mainly to find out the direction of flow from spot prices to futures prices and vice versa. Both linearity and non-linearity causality tests are conducted on returns and volatility of spot as well as futures. The article states that based on empirical data, changes in futures prices lead changes in spot prices more often than the reverse.

Pasupuleti Venkata Vijay Kumar & Piyush Kumar Singh (2011): In this article, the authors have given the results of their study on the return and liquidity of sectoral indices, market index return of Indian Financial Market. The data analyzed by the authors pertain to Bombay Stock Exchange (BSE). The authors have considered various sectoral indices such as those on Banking industry, Software industry, Real Estate industry, etc. and considered returns on their indices and compared them with returns on market index i.e. SENSEX (BSE).

Ruyin Long and Lei Wang (2008): This paper studies the dynamic relationship among futures price, spot price of Shanghai metal and futures price of London. Co-integration theory, Granger causality tests, residue analysis, etc.
are used in the analysis for this purpose. The study shows that the three prices have the long equilibrium relationship: the copper futures price of Shanghai has internalities to the futures of London; the aluminum futures price has externalities; the three have different price discovery functions.

Sakthivel P. (2005): The article deals with effect of the introduction of futures trading on the spot market volatility. The author has investigated the impact of introduction of index futures trading on volatility of Nifty. The GARCH (1, 1) model was used by the author to capture the time varying nature of the volatility and volatility clustering phenomena using daily closing price of the Nifty. The findings of the study show that after introduction of the futures trading, stock market volatility reduced, due to increase in market efficiency. The article has also examined futures trading changes structure of spot market volatility using GARCH model. The article observes that there were changes in spot market volatility after introduction of futures trading.

Sathya Swaroop Debasish (2009): In this article, the author has tried to investigate the effect of futures trading on the volatility and operating efficiency of the underlying Indian stock market. This is done by taking a sample of selected individual stocks. Specifically, the study examines whether the index futures trading in India has caused a significant change in spot price volatility of the underlying stocks and how the index futures trading has affected market/trading efficiency in the Indian futures and stock markets. The effect of the introduction of futures trading is examined using an extended period of June 1995 to May 2009.

Sayed H. Saghaian (2010):

Scott H. Irwin, Dwight R. Sanders and Robert P. Merrin, (2009): It is common believed that speculative buying by large investors like index funds in commodity futures and over–the–counter derivatives markets creates a “bubble” in commodity prices. The prices, more particularly of crude oil start picking up beyond their fundamental values. The authors have explained in this article that this is a myth and empirical evidence does not support this theory.
Suyash Bhatt (2012): In this article, the author has tried to explain the mechanism of price discovery in its proper perspective to assess the long term price trends in commodities. He has used different types of equations for different objectives depending on their suitability. One of the statistical techniques used is multiple regression analysis based on which the author shows that prices of domestic wheat were significantly affected by variations in demand, Minimum Support Price and CBOT prices.