

# Impact of Future Derivatives on Stock Market Volatility Essay

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## Impact of Future Derivatives on Stock Market Volatility

Derivatives has been the talk of the financial world after it was accused as the primary reason for such a deep financial crisis that affected the global economy in 2007. Thus, the modelling of asset returns and judging the volatility of stock market and whether the [derivatives](#) have a substantial effect on stock market volatility, is still the key task for every finance professional as it provides much needed on risk patterns involved in investment process. The Finance Gurus propose that stock market normally exhibit high levels of price volatility and cause concerns to the investor regarding unpredictable outcomes, however with launch of derivatives in the nineties in the major financial hubs, the volatility of stock market has become more complicated with derivatives offering new areas and scope of hedging and speculation. Thus, it is important to examine the impact of derivatives on stock market volatility. (O'Connor)

At time of introduction of derivatives, it was said that it is being launched with the twin objective of increasing liquidity and mitigation of risk. However, the finance world is still

figuring it out whether these objectives have been materialized or not as it carries both theoretical and practical importance with it. Thus, with the help of stress testing models like GARCH and other models we will be looking on the impact of future derivatives on stock market volatility.

Introduction:

The completeness feature of the market has generated the need for introducing innovative financial instruments with the objective of creating efficient portfolios along with security from price fluctuations. Thus, with futures and other derivative instruments offeri...

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...micians, this method was developed by Boolsersleva nd Taylor. GARCH modles have the ability to allow conditional variance to depend on its previosu lags. Thus, this method allows interpretation of the current variance fiited in the model as weighted function of previous period volatility and fitted variance of previous period. Concluded to beter than ARCH Model, although GARCH(1,1) can be further generalized with GARCH(p,q) model but since GARCH(1,1) captues sufficient volatility most of the practioners avoid GARCH(p,q) model.

GARCH(1,1) is expressed as:

Works Cited

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